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WAR FINANCE

WAR FINANCE

and its consequences

by

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Introductory

*Non enim tarn auctoritatis in disputando quam
rationis momenta quaerenda sunt.*

It is the object of this book to show that the origin of the world's present afflictions is to be found in the aggravation of that maldistribution of wealth which has always to some extent existed, but which, in this country at all events, was gradually being mitigated until the war of 1914-18 caused the worst relapse in that respect it has ever experienced. The evil has been at work both nationally and internationally, and it has been strangely overlooked that many of the arguments which have been addressed by our Government to that of the United States in regard to our war debt to that country could be applied with still greater force to the far greater holdings of the national debt by our fellow subjects at home. That system of credit which, in addition to the acquisition of actual wealth, permits and encourages a limitless accumulation and posthumous transmission of deferred claims to wealth, was thereby given exceptional scope, and it was fully taken advantage of. The profiteering, wild speculation, over-production or under-consumption, ruined commerce and shipping, breakdown of currencies and exchange, unbalanced budgets, unemployment, internal revolution, external political malaise, rearmament and the host of other disorders with which we have become only too familiar during the past seventeen years, are all, in our opinion, either prodroma or sequelae of the main disease, the greatly increased concentration of *claims to wealth*. This was caused by the blind application

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of the methods of the modern industrial and credit system to the task of furnishing the supplies of all kinds that were needed for the prosecution of the war, when even such checks as prevail in time of peace were suppressed or withdrawn; and then by the appalling reparation, currency and credit policies that were afterwards pursued. The same kind of advisers were followed in each case, and when they were further consulted about the difficulties which were the natural outcome of their previous recommendations, it is hardly surprising that the remedies they prescribed proved no less noxious.

The reason why the attempts of our statesmen to bring about an improvement have so often ended in failure is because, never having correctly diagnosed the disease, they have merely tinkered with the local conditions. They have relied far too much on the bankers, who have shown quite an extraordinary incapacity to appreciate the significance of events which should have been full of instruction for them. When on the termination of the war the time was ripe and propitious for fundamental changes, they had nothing better to recommend than a slavish reversion to the system which, as we hope to prove, was the original source of most of our subsequent ills. Clinging to their outworn formulae and deaf to repeated warnings, they are still waiting expectantly for a return to what they call 'normal'⁵, an imaginary static condition in the dead past. Why should the Government continue to accept their assertion that the Gold Standard, which is little more than a century old and was never universally accepted, is the *normal* and therefore only sound one, any more than the methods which preceded it or those others which have supplanted it so successfully? Has our budget, our trade or our international reputation suffered so grievously during the past four years as to point to the desirability of a return to the previous state of affairs?

It seems to have been overlooked that it was the flourishing

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condition of her industries on a *paper* franc that provided France, in the course of a few years, with the means for the restoration of gold, and ever since that event she has had to face a succession of financial crises and make repeated appeals to her people for sacrifices to save—what? Not her trade, but the gold franc! If denying themselves the fruits of production for the mere form of the medium for its exchange is not sacrificing the substance for the shadow, what is it? The French are said to be a logical people, but surely if they were they would further feel the necessity of keeping an exactly equivalent number of gold francs against every credit entry in their ledgers. If that is what they are aiming at they will probably succeed since their trade seems to decline as their stock of bullion increases. In *The Functioning of the Gold Standard* by Dr. Feliks Mlynarski, which was written at the request and published on the authority of the Financial Committee of the Gold Delegation of the League of Nations, one may read: 'The history of money covers a period which is some thousands of years longer than that covered by the history of the Gold Standard. This fact alone seems to prove that the Gold Standard is not a necessity to economic civilization and that it is possible to do without it. As there have in the past been periods in which the Gold Standard was not known, it is not impossible that there may in the future be others. This does not mean, however, that, in case of a decline in the production of gold, mankind will be obliged to return to silver or to a bi-metallic system. ... It is the ideal of the science of money to stabilize a paper currency without the help of gold.' It was not until we left gold, or rather it left us, that the deterioration in our finances and trade was arrested and there appeared those signs of recovery for which the Government takes so much credit to itself, though it still retains its belief in the old system!

In a letter to *The Times* of the 8th October 1919, Mr. (after-

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wards Sir) E. M. Harvey,¹ referring to one from a fellow banker on 'Currency and Bad Times' which had appeared in the same journal in the previous month, observed: 'As Mr. F. C. Goodenough points out, an inconvertible currency is a forced loan which insidiously tempts a foolish Government because the people cannot see the risk of disaster. An inconvertible currency is a loan to the Government free of interest, but more expensive to the community than any usurer's charges. How can the value of the pound be raised? First of all by taking such steps as those suggested by Mr. F. C. Goodenough for establishing a better control over our note-issuing machinery—a control which will prevent notes being issued in excess and provide for automatic redemption. Beyond that there is only one line; thrift on the part of the Government and industry on the part of the community. The industry will provide the goods necessary to readjust the relative quantities of money and goods, and the thrift will provide subscription to Government loans, which, supplemented by the proceeds of taxation, must reduce the outstanding Treasury Bills, Ways and Means advances and Bradburys, and cure other sore spots in our debt.'

So, currency issued by a state without paying private individuals for the privilege is to be condemned, while we are to work hard and forgo the fruits of our labour in order that we may 'repay'⁵ to privileged individuals the 'debt'⁵ which it will be shown in the following pages we never really incurred! Goods are to be produced not so much for consumption, which is to be restrained by thrift with the object just mentioned, but in order to bring about a readjustment between them and the money issue. As the latter is reduced by automatic redemption the amount of goods produced will, of course, decline. In other words, money is not to subserve the production, distribution and exchange of goods for consump-

¹ Afterwards Deputy Governor of the Bank of England.

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tion, but production is to subserve the fancied requirements of the money machine, which is to be left in the control of the bankers! It will be observed that Sir E. M. Harvey here relates money not to gold but to goods, which is what the General Commodity Standard, not what the Gold Standard, requires. The former is much the sounder, but it is not what he elsewhere advocates. How thrift on the part of the Government is to provide subscription to Government loans he leaves us to guess. He has told us that the people could not see the risk of disaster attending the issue of an inconvertible currency, but if he and his fellow bankers had foreseen the disaster which actually resulted from the application of their own theories, into which a foolish Government were insidiously tempted, one might have imagined that they would have refrained from pressing them. Notwithstanding our own bad experience of the financial policy adopted in 1925, however, and of all the countries which have reshackled themselves to gold, most of our bankers, as well as a good many of our economists, still remain unshaken in their attachment to that discredited standard.

The foregoing is a fair specimen of the kind of advice the bankers had to offer and its adoption has reduced nations to poverty, caused international trade to vanish and brought us back to a system of exchange which the Italians of the Middle Ages might have regarded as barbarous. No serious person questions the honesty of our bankers or their competence for the management of money and the purely routine work of their business. But when it comes to large questions of credit and currency policy they had better keep aloof, unless they wish to increase the distrust with which their views are now deservedly regarded by wide sections of the instructed public. For the former their timid empiricism may be appropriate enough, but for the latter a breadth of vision and a boldness are required which they would shrink from with horror. The

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Macmillan Committee, reviewing the years 1924-30, say in their Report: 'At any rate the actual situation which was disclosed in the years following the return to gold marks that step as the beginning of a new series of difficulties for our trade and industry. Whatever the disequilibrium between costs and prices which still existed in 1924, it was seriously accentuated by the adjustment of sterling prices to gold prices.' There can be no doubt whatever about that, and one may wonder how much longer it will take our financial authorities to draw the obvious deductions from that and the convincing evidence that has since accumulated, namely that the system they then endeavoured to restore is obsolete, and not merely in abeyance but gone for good. While in the earlier stages of civilization when credit was non-existent gold may have served a useful purpose as an intermediate form of barter, we believe that since it was adopted in 1816 by Act of Parliament (56 Geo. III, c. 68) as the standard of value in this country, the prosperity with which it has been credited was achieved in spite of it, not through its beneficent agency.

We have been told, generation after generation, that all the wonderful discoveries and inventions that were being made were for the amelioration of human conditions and tended to give us a fuller and nobler life. It required, however, a war of unprecedented destructiveness, of both life and material wealth, to reveal to us how rapidly the machine that had been created could be extended, and how gigantic were its productive possibilities. During the course of the struggle we saw that there was hardly any limit to these, even under hampering conditions of the most formidable kinds, as long as the aim were sure and the impulse of determination were present. In laboratory and workshop, on farm and in factory, in arsenal and on battlefield, on land and on sea, never was seen so much industry! At the beginning nobody had any conception of the amount of war material that would be re-

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quired, yet the need was met. Everybody was called upon for sacrifice and all the best readily responded. As every man was needed, every man had to be properly fed and clad, and he was. It can be done well enough when the nation is in earnest, and many a humble individual was then better off in many respects than he or she had ever been before. One may occasionally meet men who look back with a certain wistfulness to those dark days because even the hardships and horror they then went through seem more endurable than the pangs of hunger, the humiliation and the vacancy of unemployment they have since known. In the Debate on the Address, on the 11th February 1919, the Prime Minister (Mr. Lloyd George) said: 'In some respects the economic conditions of the country during the war have been better than during our lifetime. Wages have been higher. There has been no unemployment. There has been no distress. There has been no poverty comparable to that which existed before the war. There has been no unemployment, which is always a fertile source of distress, hunger and privation—none during the war.' Though towards the end supplies were short they were sufficient if fairly distributed, and they were therefore strictly rationed. The profiteer had to produce his food cards with the rest, and as the claims which he was sedulously accumulating against the rest of the community could not become fully effective until after the conflict was over their evil was not then apparent.

It is marvellous what a nation united, a nation with a clear objective, a nation inspired with a strong will can achieve, even with divided and unsure leadership and numbers of its people misplaced. If war could be won over a human enemy, could it not be waged with equal success against an inhuman one, that of the degradation and distress of mind and body of our fellow countrymen? Whether or not it really needed so much slaughter and devastation for its discovery, war did at least discover to us what a quickening of the machine was

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Possible and it is only reasonable to suppose that it might be set to work for constructive just as effectively as for destructive purposes. In spite of the numbers of men who had been withdrawn from industry and in spite of the disorganization it first caused by the change over to production of an entirely different kind to that previously required, manufactures demanding the highest technical skill were turned out at a rate and on a scale that were simply astounding. As a result of the rapid development manufacturers and producers of all kinds simply could not help creating surpluses after the struggle was over. In the Declaration of the Supreme Council of the Peace Conference on the Economic Condition of the World, issued in 1920, the widespread destruction and disorganization caused by the war were reviewed and the necessity for economy in consumption and a resumption of the ordinary occupations of peace time were urged upon the nations as the only means by which the serious reduction of real wealth could be made good. Yet, so great is the recuperative power of the world that, within a few years, notwithstanding the continuance of grave disturbances in many countries, the Economic Section of the League of Nations collected data which showed that, as compared with 1913, world population had increased by 1925 at the rate of 5 per cent and general production 18 per cent, or no less than 25 per cent if cereals and other raw materials were excluded!

So, after all this tribulation, was the promise to be redeemed that all our labours and researches, inventions and discoveries were to redound to the benefit of all? By no means! We had simply created for ourselves a new problem, that of *over-production*, and the way to deal with it was to destroy the surpluses and plan to limit future production. Of course, there was nothing new in that. Have not fish been thrown back into the sea, has not the fishmonger destroyed his surpluses rather than spoil the market by reducing his

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prices? Has not fruit been allowed to rot on the ground, and been destroyed by the fruiterer, rather than let the poor have it cheaply? Such methods have been familiar to our state of society for generations past. Why, even under the recently established Milk Marketing Scheme, great quantities of rich milk are now being wasted. Whether or not that is due to a passing difficulty in the ascertainment of the right quotas to allocate, we venture to assert that no scheme can be right which leads to the destruction or the limitation of the supply of such a valuable form of nutriment while large numbers still go in need of it.

The great preponderance of purchases from, over sales to, the United States by the belligerent countries at high prices, which externally relieved the first from its previous indebtedness and led to an enormous accumulation of deferred claims in its hands, being similar in character, naturally produced similar results to the vast accumulation of deferred claims in the hands of the war profiteers within the belligerent countries. The United States deemed it hurtful to her own trade to accept foreign goods in satisfaction of such huge claims, and there was not sufficient gold available for that purpose, so payments to that country finally broke down. The subjects of the belligerent countries, on the other hand, could not possibly take payment from their fellow countrymen in goods, but they could go on accumulating credits against them and claiming interest thereon. As long as the creditors, national and international, granted loans or invested in industrial securities freely, as they did at first, and trade was thereby kept going, while wages remained fairly high, disaster was averted. But when, in preparation for the restoration of the Gold Standard, credit in this country was restricted, and wages began to be reduced, the trouble began. The effect of the return to gold was immediately to increase the commodity and service value of deferred claims which, with the enormous

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additions that had recently been made to them, were already weighing so heavily upon us. Some parties being thus gorged with wealth and over-supplied with credit while others were stripped of both, the former were naturally unable to find scope for profitable investment while the latter were prevented from satisfying their ordinary needs. Trade fell off, dividends declined and in many cases altogether ceased, bringing down the value of stocks and shares. Credit now became abundant and cheap, but such a situation lessens both the security and the demand for loans. Even those who were still in a position to provide sufficient security were not keen to borrow money for the production of commodities when the majority of those in want of them lacked the means to purchase them. The bankers, who had resisted demands for credit when it was wanted though dear, were much puzzled by this and in their annual addresses proclaimed it as a great new discovery that cheap credit was no cure for depression.

It was sought to remedy this state of affairs in the good old conservative way, by cautious attempts to stimulate production and at the same time by urging upon the whole people the duty of practising the strictest economy. The people who wanted the fruits of production and had the means of purchasing them therefore religiously did without them; the far greater number whose means were already quite insufficient were further limited by the reduction of wages that followed. When goods could not be sold, because of this self-denying ordinance on the part of the pious rich and the further deprivation of the hungry poor, it is hardly to be wondered at that commodity prices should have slumped. But those, at the head of affairs did wonder, and their next hope lay in the raising of prices, that is in the removal of the one alleviating circumstance! The great coal strike of 1926 and the financial embarrassment which broke the Labour Government in

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August 1931 were the direct result of Mr. Churchill's gold policy, and what recovery has since occurred is due to its reversal by the pressure of events. Our profiteers, no longer able to find opportunities at home, looked abroad and took full advantage of the facilities which the restored Gold Standard afforded to join in the mad gamble in American securities, with what results we all know. The succeeding catastrophe, undermining confidence, caused a severe intensification of the gold fever which has terribly wasted the nations afflicted with it, though certain cunning individuals may have been able to turn it to their own advantage.

Statistics prove beyond a doubt that the world is infinitely more fertile as well as far better equipped than it has ever been before, and whenever demand has outrun production, as it did for a time after the war, production has always again overtaken and outstripped demand with the greatest ease. What was it, then, that caused the latter to fall off as seriously as it did after 1928, plunging the wealthiest nations into despair, and why has recovery been so painfully slow during the period of widespread want that followed? It is common knowledge that at the very time when millions were suffering the cruellest privations traders were unable to find customers for their superabundant stocks, but as the true explanation for that deplorable conjuncture has not yet been found the true remedy has not been applied, and there is nothing to prevent a recurrence of the disaster. Indeed it is expected and explained as the trade cycle! A study of the matter will show that the merry progress of industry was never stopped by the •exhaustion of natural resources, the insufficiency of machinery or labour, nor by a satiation of human needs, but always by some derangement of the financial machine. It is surely high time this were traced and removed. If, as we believe, the cause of the restriction of demand is to be found in the undue concentration of purchasing power, it becomes desirable to

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go back a step further to discover the cause of that also. It was that pursuit which led us to make a critical examination of the methods whereby the Government obtained the enormous supplies of every description for the prosecution of the Great War, and to ascertain how it was possible to feed, clothe and fully employ the nation for the purpose of destroying wealth on a gigantic scale when it appeared that we could not afford the much smaller amount of labour and materials that were required to satisfy the more reasonable needs of peace. We hope that the following survey of our system of public finance may reveal the clue to, and afford useful material for the elucidation of, what is surely one of the most vital problems which the world has to solve.

II

The Genesis of our Internal War Debt

Towards the end of July 1914 it became evident to every thoughtful observer that war in Europe, the climax of many years of acute political tension, was rapidly becoming inevitable and that this country was bound to be involved in it. The bankers foresaw that one of its first results would be a rush by their customers for cash, and they prepared to meet this by calling in their short loans and increasing their deposits at the Bank of England as much as possible. The expected happened, and on the 31st July and the 1st August there were heavy withdrawals of gold, the effect of which was a great sudden contraction of credit. It happened, therefore, that just before the commencement of public borrowing on a greater scale than had ever been seen before the total amount of money available was greatly diminished. On the 6th August, two days after our declaration of war, the first vote of credit (for £100,000,000) was passed by Parliament. The Government began by borrowing on Ways and Means account and by putting huge amounts of Treasury bills on the market. In November they started the issue of a long series of war loans. By the first they were ultimately to raise on balance several hundreds of millions, by the second well over a thousand millions and by the third several thousands of millions sterling. At no period before the war was there anything like so much money in the country, and its outbreak, as we have seen, was immediately preceded by a

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great reduction in the amount previously available. Where, then, did it all come from? If it had no existence, how could the banks or the public respond to these gigantic and unprecedented demands? A very pertinent question, it can hardly be denied, to answer which we must review the following series of events.

On the 31st July the Stock Exchange was closed for an indefinite period; on the 1st August the Bank Charter Act was suspended, a partial moratorium which had already been established was made general under the Postponement of Payments Act, and the bank holiday which fell on Monday the 3rd August was extended over the succeeding Tuesday, Wednesday and Thursday. On the last of these days the Currency and Bank Notes Act was passed authorizing the Treasury to issue £1 and 10s. notes without limit and these were declared to be legal tender to any amount. The Government then gradually got control of most of the gold in the country, taking steps to limit its use and supervise its export. In view of the extraordinary powers conferred upon it by Parliament in this emergency, was it not strange that it should have conceived it to be necessary to *borrow* the money which it was clearly able to, and did in fact, create in virtue thereof? Instead of paying for its use, ought it not, through its agents the Bank of England, rather to have charged for and controlled it? Curiously enough the Government did begin in the right way, as appears by a Treasury Minute dated the 6th August 1914 whereby the Chancellor of the Exchequer recommended to the Board 'That the issue of Currency Notes to Bankers shall be made by their Lordships through the Bank of England as and when required to an amount not exceeding in the case of each bank 20 per cent of the total liabilities of that bank on deposit and current accounts, as shown in its monthly statement last issued before the date of this Minute, subject to the following conditions:

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'(a) That Currency Notes shall be issued only upon application from the bank requiring the issue, such application to be made in the case of banks having accounts with the Bank of England direct to the Bank of England and in the case of banks not having accounts with the Bank of England through the London agents of such banks.

'(b) That the amount of Notes issued to each bank shall be treated as an advance by the Treasury to that bank, bearing interest from day to day at the current Bank Rate: provided that the bank may at any time repay the whole or any part of such advance either in Currency Notes or otherwise.'

By a Minute of the 20th August it was agreed that such issues should be made to banks whether they had an account with the Bank of England or not. On these terms the banks altogether applied for and received about £13,000,000 worth of the notes, but they soon discovered that the Government's borrowing policy, by swelling their deposits, made it quite unnecessary for them to pay for the loan of the former and they accordingly soon returned those they had acquired in that way. Seeing that the banks make their profits by the use of their customers' money, for which they pay no interest on current account and usually no more than $1\frac{1}{2}$ per cent below bank rate on deposit account, relending it at something above bank rate, this was altogether a strange mode of proceeding, though not to the disadvantage of the public. The proper method no doubt was to substitute this new form of currency for that previously circulating as occasion arose; but that was no reason why similar loans should not have been granted by the Treasury through the Bank of England, on approved security and under proper controls, when needed. This indeed would have enabled them to put some check upon the diversion to superfluous and luxurious objects of money urgently required for national purposes. By departing from their original course and resorting to borrowing, the Government

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sowed an endless crop of evils, in the futile endeavour to eradicate which a great part of the past sixteen years has been spent. Let us now examine the nature of the various modes of borrowing which were resorted to.

(1) Ways and Means Advances. These are overdrafts of the Government account at the Bank of England yearly authorized by the Consolidated Fund Act and the Appropriation Act in anticipation of the gathering in of the revenue. The Chancellor of the Exchequer writes a courteous letter to the Governor and Deputy Governor of the Bank of England requesting them to move their Court to make such advances as may be required for the public service during the quarter ending on such a date, at such rates of interest as may be from time to time agreed,¹ and in due course receives a reply from these officials to the effect that the request has been laid before the Court of Directors and assented to. It would be very interesting to see what would happen if the Court ever expressed itself as unable to comply with the Chancellor's request. It has never taken so great a risk as that, but on one occasion at least the Governor and Deputy Governor were desired by the Court of Directors to draw the Chancellor's attention to the amount which had already been advanced on the credit of Ways and Means and 'to convey the expression of their hope that you will realize the inadvisability of an increase in these advances, and their earnest desire that measures should be taken for their repayment'. Whether or not this admonition was taken as an affront to the Chancellor's dignity, as it well might have been, it was in any case ignored. As all such advances have to be paid off in the following quarter, during the war it was the usual thing to borrow ever larger sums and pay off the previous advances out of them, so that the effect was just the same as if it had been a continuous loan account.

¹ But never more than five per cent, the statutory limit.

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(2) Treasury Bills. These are issued per Acts 40 Vict, c.2 and 52 Vict, c.6 in the form of a simple declaration that the holder is entitled to payment out of the Consolidated Fund of the United Kingdom at the Bank of England of a specified sum at a specified date. They are issued in denominations of £1000, £5000 and £10,000 for 3, 6, 9 or 12 months, numbered serially, beginning afresh with each new financial year, and bear the impressed signature of the Secretary to the Treasury. By the Treasury Bills Act, 1877, sec. 8, it is laid down that these bills are only to be issued by the Bank of England under the authority of a warrant from the Treasury countersigned by the Comptroller and Auditor General in his own name. The Treasury may invite tenders for such bills and reserve to itself the right to reject applications. Not less than three (formerly five) clear days' notice has to be given in the *London Gazette* of the date on which tenders will be received at the office of the Chief Cashier of the Bank of England, subject to stated terms and conditions. There was, besides, a scries bearing a fixed rate of interest formerly reserved for the Commissioners for the Reduction of the National Debt and other public or semi-public departments. By a Treasury Minute of the 13th April 1915 it was decided to extend the offer of these also to the public, the rate being declared subject to variation from time to time without previous notice.

As Dr. Leaf tells us, 'it is largely by the issue or withdrawal of Treasury bills that the Government [*at the time he wrote, under the restored Gold Standard*] controls the market and carries out its policy of inflation or deflation. In the earlier stages of the process the banks used to wonder whether the market was not being flooded with Treasury bills beyond its power of absorption. *But it soon became evident that the money thus borrowed was only a creation of credit; the sums borrowed were at once dispersed to the public and came back to the banks in the form of*

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additions to their customers' deposits and so the circle went on continually expanding.' Strange that this obvious effect, which we have italicized, was not immediately anticipated by those whose lives were spent in bank parlours!

(3) War Loans, Exchequer Bonds, etc. It was by the issue of these that the largest sums were 'borrowed' and it is for our present purpose unnecessary to distinguish between them, as they were in principle the same, chiefly differing as to amounts purchasable in units and date of redemption; the former being in the form of stock and long-dated, the latter being for specific amounts and short-dated. Some were issued at a discount, others were made redeemable at a premium; the rates of interest offered tended to increase as the loans were multiplied, and holders of the earlier issues were given the privilege of exchanging them for the more profitable later ones, generally in proportion to the 'new money' they invested in the latter.

On the 30th June 1915 the Chancellor of the Exchequer (Mr. McKenna) introduced a bill into the House of Commons to empower trustees to purchase a sufficient quantity of the new war loan to enable them to exercise the option (which other investors were to enjoy) of converting into the stock the consols, annuities and old war loan that they held. The Chancellor anticipated that a prudent trustee would sell other securities for which he could obtain a ready market and good price for reinvestment in the new war loan. These arrangements were of distinct advantage to the investor; but, by adding to the weight of interest and, by subsequent conversions, to capital also, only an additional burden to the country.

When an ordinary individual obtains a loan from his bankers they create the money by crediting him therewith, both their advances and deposits showing corresponding increases. The Bank of England does precisely the same when

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it makes advances to the State. The credit of the joint-stock bankers being founded not merely on their capital, but far more on their deposits and reputation for strength, what they in fact do in transactions of that kind is to lend their credit, just as they might do by backing a bill. But this does not apply to the Bank of England's dealings with the State whose credit is naturally far greater than that of any of its subject institutions. While the ordinary bankers have always to keep an eye on their cash resources, maintaining a rough ratio between them and their advances, the Bank of England is itself the source of cash and as such controlled by the State. By making advances to the latter, moreover, it is not lending its credit, for they are made on the credit of Ways and Means, that is the national revenue, and the Bank's resources are in this case replenished by the very client they are supposed to be accommodating. There is therefore never the least danger of the Bank of England overstraining its credit in this way, however large its advances to the Government may be. Does not the process described really amount to the State itself creating the money it needs through its agent the Bank of England, it may be asked, and the reply is an unqualified affirmative. Why, then, should it pretend to borrow and pay interest on fictitious loans? We think this is all wrong, and it ought not to pay more than the administrative expenses, plus perhaps a small commission as long as the Bank of England remains a private concern. If we have thus far succeeded in making ourselves clear, it may still be said that all we have done is to show that Ways and Means advances are the fruit of the Government's own creation, but there remain the very much larger sums of money obtained by public loans, the funds for which we opine did not previously exist. We have now to show how these likewise were created by the Government, and the process was a very singular one.

Suppose an Englishman had £100,000 invested in various

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English and £50,000 in foreign industrial securities, as well as a balance at his bank of £20,000, when a war loan was issued. Foreigners would naturally be reluctant to purchase the industrial securities of a country at war, and in the last one, even if willing, they would have been hindered by almost insuperable difficulties. If therefore our Englishman had sold any of the first mentioned of his holdings it would almost certainly have been to his fellow subjects, and by merely changing the internal ownership of a bank credit he would have added nothing to the money generally available for war loan since the transferee's balance would have been reduced to the same extent as the transferor's was augmented. As to his foreign investments, he would have been unable to deal with any enemy issues, and if he had managed to sell his neutrals to foreigners the foreign exchange thereby obtained would *pro tanto* have increased the country's purchasing power abroad, for which a domestic loan would have been useless except to enable the Government to acquire it from such individuals or corporations. If, on the other hand, he had retained this part of his investments all or part of them would in all probability have been subsequently borrowed or compulsorily purchased by the Government, through the American Dollar Securities Committee, with the same result. It follows that all he could have lent the Government for internal purposes would have been the £20,000 which lay to his credit at his bank.

Ordinarily it would only be speculators, not staid investors, who would borrow in order to lend, but circumstances alter cases and the financing of one's country when at war is no ordinary case. It was represented to the public as a patriotic duty to use every means in their power to increase their subscriptions to war loan and the Government arranged for the banks to afford their customers special facilities for the raising of money with this object. In his War Budget statement of the

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17th November 1914, the Chancellor of the Exchequer (Mr. Lloyd George) said: 'I am in a position to state that the Bank of England has patriotically agreed to give me important credit facilities in connection with the new Loan (3½ per cent 1925-8) which will have the effect not only of bringing enormous relief to the pressure¹ of the money market which the raising of so large a sum would otherwise create, but of making the security itself a most valuable investment to the whole financial and mercantile community. For a period of rather more than three years, that is from the date of the issue of the loan until 1st March 1918, the Bank of England will be prepared to make advances against the deposit of War Stocks or Bonds, without collateral security, of amounts equal to the issue price of the stock or bonds deposited, without margin, at a rate of interest 1 per cent below the current Bank Rate.' Dr. Leaf asserts that banks can only lend more to their customers by lending less to the Government. That is only true under such a system as the Gold Standard which limits the issue of money by reference not to actual needs but to the stock of gold it has been possible to accumulate. Otherwise Government borrowing itself creates credit, as is proved by what actually happened during the war. The banks can expand credit to lend to the Government, either directly or indirectly through their clients, with the assurance that the basis for such expansion will be immediately supplied by the Government's issues and by the use it makes of the amounts borrowed. Herein lies one of the objections to the system of providing for national requirements in this way at all.

'We will suppose, then, that our Englishman borrows £20,000 from his bankers and invests his balance, thus

¹ This was a delusion. By no amount of pressure could non-existent money have been obtained either from the money market or any other private source. The true nature of the so-called 'relief' was the provision by the Government itself, through its agent the Bank of England, of the money for the 'loan' of which it afterwards paid interest.

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swollen to £40,000, in war loan. His bankers are well secured because their client's already substantial holdings of British and foreign securities are reinforced by the addition of this new investment of £40,000 in gilt-edged paper, and the liquidity of their position will only be temporarily affected by it. Let us see the effect of this last transaction. The £40,000 has passed to the credit of the Government, who soon spend it on various public services and it finds its way into the banking accounts of the various recipients. The latter are thus enabled to relend it to the Government, while their bankers also are thereby enabled to make still larger advances either to their customers, the Government or the money market. Considerable portions of the war loans were in fact taken up by the bankers themselves *through the use of the additional credit which the Government's own operations were making it possible for them to create*. Lloyds Bank alone took up some £60,000,000 worth, and it is not to be supposed that it was so employing funds which had till then been lying idle. Thus we see what a roundabout way the Government had to go for the privilege of paying for the use of the money which it was itself creating for the public need!

Now, just as a much larger superstructure of credit can be safely erected on every enlargement of the currency base, when there is a legitimate demand for it, so, on a smaller scale, does the need for currency grow with the expansion of credit, and this was being met very easily at that time by the issue of £1 and 10s. currency notes by the Treasury. These, which, with bank notes, may fitly be described as credit coupons or vouchers, were the one kind of money for which the State did not pay, and as that fact, instead of pleasing, caused a strange uneasiness among many good people, we must next endeavour to show how groundless it was. Referring to the notes formerly issued by the private bankers of last century, Dr. Leaf describes how 'the farmer who had to pay

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his workmen for their labour and keep during the harvest would go to the man of means in his neighbourhood—we may at once call him the banker—and borrow from him promises to pay coin on demand,¹ which would be accepted by his men because they could use them with the shopkeepers. They in their turn would pass them on in exchange for goods, and so they would go from hand to hand. In the course of time the farmer would have sent his wheat to market, where it would be sold, and after some months he would receive payment for it in "notes" of the banker from whom he had borrowed or some other banker. These he would pay back to his lending banker; the credit given him would be duly cancelled and the notes, if issued by the lender himself, retired, or if issued by another banker passed on to be cancelled by him in exchange for cash. . . . If the notes were accepted as currency and passed from hand to hand in the market, then, so long as they were out, the issuer was receiving interest, at what would now be considered a very high rate, on his original loan and paying none himself. He was employing no capital of his own and receiving a handsome income merely on the credit of his name.' One might well wonder in what respect the 'man of means' in this apt illustration could be better situated than the State itself, and if he could charge for his promises to pay, which were acceptable in his own locality because he was there reputed to be wealthy and honourable, why the State should be unable to charge for the use of its notes, which, instead of being merely acceptable with limitations like the private banker's, are legal tender for the payment of any amount throughout the whole country! Of course, credits raised for such an unproductive enterprise as a war are not self-liquidating as in the case illustrated, but whether for the purposes of war or peace the State is certainly no less able to create the means than is the banker.

¹ That is exactly what the Treasury' notes were.

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Dr. Leaf goes on to say: 'But this system of a credit currency, though admirably simple and economical in its working in normal times, had a great drawback. In all progressive and commercially enterprising communities there come from time to time periods of speculation when everyone is convinced that he can make a fortune in a little time if he can only get command of a little capital to start with. At such times it is fatally easy for the banker to supply more credit; for no one troubles much about the interest he has to pay when sudden wealth is in view. Thus bank-notes are multiplied beyond all the bounds of legitimate trade. Everyone seems well off, prices rise, etc.' Although used for a very different purpose, this passage gives a very exact picture of what happened during the war. In those days the conviction of a business man that he could make a fortune in a little time was only too well founded. It was easy for him to borrow when a greatly increased demand for, coupled with a shortage of, almost everything, practically no foreign competition to cope with and the Government itself as principal buyer, made it plain beyond a doubt that he could sell his whole output on the most profitable terms. It was easier than ever for the banker to create more credit when public borrowing was proceeding apace and the issue of legal tender was unhampered by any of the ordinary checks, and most tempting to him to do so when he could charge a good interest for it while it cost him little or nothing. That is what enabled certain people to enrich themselves at the expense of the rest. Now, if the Government had kept the lending of the additional money it created to itself, we repeat, it could have charged for its use and at the same time have so controlled it as to keep prices from rising and scandalous fortunes from being made. That was its plain duty, but, having no plan already devised, it was caught unawares and the rest of the public has been ever since heavily penalized for its want of foresight, being made to pay for the

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use of its own money and also to facilitate the financing of those whose chief preoccupation was to make as much as they could out of their country's dilemma. As Mr. R. G. Hawtrey has pointed out, the easy credit, which was the outcome of our methods of financing the war, enabled the profiteer to increase its cost by forcing up prices, and the 'lavish expenditure by the public on consumable goods was competing with the Government not only for the investment of the available savings but for the employment of the available labour and productive power.'⁵

Replying to a question addressed to him by Sir Samuel Roberts on the 26th March 1919, Mr. Austen Chamberlain said 'In pursuance of negotiations conducted by my predecessor and announced by the Governor at the meeting of the Bank Court on Thursday last, the Bank of England has agreed to pay over to the Exchequer the entire excess profits for the five years ending 28th February 1919, thereby contributing towards the cost of the war the whole of the excess profits which have resulted from the war conditions, not only in respect of the services performed for the Government but in respect of the business of the Bank generally. The House will recognize this action as being in accordance with the Bank's high traditions. I am still in communication with the Bank in regard to arrangements as to the future.' These were embodied in Section 6 of the Currency and Bank Notes Act 1928 which provides as follows:

'(1) The Bank shall, at such times and in such manner as may be agreed between the Treasury and the Bank, pay to the Treasury an amount equal to the profits, arising in respect .of each year in the issue department, including the amount of any bank-notes written off under section six of the Bank Act 1892 as amended by this Act, but less the amount of any bank-notes so written off which have been presented for payment during the year and the amount of any currency

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notes called in but not cancelled before the appointed day which have been so presented.

(2) For the purposes of this section the amount of the profits arising in any year in the issue department shall, subject as aforesaid, be ascertained in such manner as may be agreed between the Bank and the Treasury.

(3) For the purposes of the Income-Tax Acts any income of, or attributable to, the issue department shall be deemed to be income of the Exchequer, and any expenses of, or attributable to, the issue department, shall be deemed not to be expenses of the Bank.

(4) The Bank shall cease to be liable to make any payment in consideration of their exemption from stamp duty on bank notes.⁵

Thus the public nature of the operations of the Issue Department of the Bank and the inappropriateness of their being the subject of private profit is at last statutorily recognized, but the public creation of credit by Ways and Means advances is still treated as if it were money lent by the Bank which accordingly continues to charge interest on it. Sir E. M. Harvey told the Macmillan Committee that 'there is more than one way in which the Bank can temper the wind to the shorn lamb, if we may call the Government the shorn lamb [*indeed we may*] but I think you may take that as a fair indication of the attitude of the Bank in this matter'. That is all very well, but one might fairly ask whether it is quite proper for the State to be the object of such benevolent condescension. The creation and regulation of the currency, which is one of the essential bases of internal credit, being among the sovereign rights of the nation, it is here contended that the Government ought never to pay for the use of either for national purposes. The failure to recognize the special position of the State in these matters is so astonishingly common as to be found even in an observation of so distinguished a banker and scholar as

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the late Dr. Walter Leaf, who, referring to the issue of currency notes, said: 'This was essentially a war loan free of interest for an unlimited period and as such a highly profitable expedient from the point of view of the Government.'⁵ Why the expansion of the currency to meet the nation's greatly intensified need for production of a very specialized kind should be regarded as a war loan is not apparent. Who was the lender? As to its being highly profitable to the Government, in other words to the public, it would seem far nearer the mark to say that the borrowing whereby credit was obtained for the same purpose was highly unprofitable. At all events, the Government rightly issued the additional currency that was needed without paying anybody for the privilege, and, by substituting its Treasury notes for the gold which formerly circulated, quite rightly released the latter for foreign payments. That measure, though fondly regarded by many as temporary, caused much alarm and ill-informed albeit well-meant criticism at the time, but needs must when the devil drives, a beneficent devil on that occasion!

The currency issue, however, was only a small part of the financial problem and ought now to be considered as settled. But the discounting of the very large numbers of Treasury bills which were taken up by the joint-stock banks, discount houses and others, and still more the enormous internal long-dated debt together constitute a colossal charge which, in our opinion, ought never to have been incurred. This is not meant as a criticism of the particular governments which did the borrowing, as they merely acted in accordance with long-established practice, and it does not appear that a single member of Parliament or anybody else has ever called it in question. The fact that changes of procedure of such a fundamental kind are never likely to be made, are indeed hardly possible while the country is at war, makes it all the more desirable to consider them in time of peace. By far the larger

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part of business in modern times is carried on by book-keeping which requires a backing of credit, and it is the method of creating this for public needs which cries aloud for reform. It ought always to be transferred from subjects to the Exchequer by taxation as soon as possible after the need has arisen. As far as it is necessary to anticipate the receipt of revenue, resort should be had to Ways and Means advances alone, which should cost nothing by way of interest. Loans should never be raised on national account except, in case of necessity, abroad. Dealings between state and state offer the only true analogy to those between the individual subjects of a state. The longer a debt is postponed, with the piling of interest on interest, the more unbearable it becomes, as many a harassed moneylender's client has found to his cost. Excepting external transactions, what a nation cannot afford to pay for immediately it obviously cannot afford at all.

This was well expressed in the Colwyn Report, para. 74: 'The war, except so far as the money for it was raised abroad, had clearly to be paid for immediately and the burden on the community as a whole could not be thrown on to future generations.' Apprehending that aspect of the case so clearly, it is surprising that the committee should have remarked, as they did in para. 75 of their report, that 'the loss to the nation was of course due to the expenditure, and *not to the particular method of financing it*. The burden of expenditure was incurred once and for all by the nation as a whole; so far as it was met by taxation it was immediately shared out between individual citizens; so far as it was met by internal War Loans the tax burden on the individual was postponed, the subscriber receiving a claim to future goods and services in exchange for his money—a claim which could only be met by future taxation on himself and his fellow citizens. *The loans entailed a subsequent annual transfer of wealth within the community for payment of interest and repayment of capital. This transfer, which is the burden to*

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be attributed to the internal debt itself—as distinct from the war expenditure behind it—does not destroy wealth; it merely redistributes wealth (with undoubtedly important effects)¹ within the community.' The loss to the nation was surely to a very considerable extent due to the particular method of financing it, and it is much to be regretted that the commissioners should have considered that, as they expressed themselves: 'We are concerned not so much with the consideration of the merits or demerits of operations now past as with the position which they have brought about and the questions of future policy to which they give rise' (para. 62). They would have performed a much greater public service if they had carefully considered the method or policy of *borrowing* and their recommendations in regard to future policy might have been with great advantage affected thereby. The terms of reference 'to consider and report on the National Debt and on the incidence of existing taxation, with special reference to their effect on trade, industry, employment and national credit' were quite ample enough and clearly entitled them to do this, but this vital aspect of the matter was never considered by them or any other body.

In the Final Report of the Cunliffe Committee on Currency and Foreign Exchanges after the War, occurs the following paragraph:

'5. Government Borrowings on Ways and Means Advances from the Bank of England—We desire to draw attention to the extensive use made during the war of the system of Ways and Means Advances from the Bank of England. We inferred to this matter in paragraph 16 of our Interim Report and explained its effect in causing credit and currency expansion. The powers given to the Government by Parliament to borrow from the Bank of England in the form of an overdraft on the credit of Ways and Means were, as the name

¹ In the wrong direction, i.e. by concentrating it in fewer hands.

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implies, intended to enable the Government to anticipate receipts from Revenue or permanent borrowings for a brief period only. Indeed Parliament by expressly providing that all such advances should be repaid in the quarter following that in which they were obtained showed that it had no intention of bestowing upon the Government the power of securing an overdraft of indefinite duration and amount. Under the exigences of war finance the Government found it necessary to re-borrow in each quarter on the credit of Ways and Means the amount needed to enable them to comply with the statutory requirement that the previous quarter's Ways and Means Advances should be repaid, with the result that the total outstanding advances remained for a long time at a high figure. We are glad to see that efforts are now being made to reduce this overdraft to more moderate dimensions.

'We therefore hope, now that conditions are less abnormal, that the Government will confine its use of Ways and Means and Advances from the Bank of England to providing for purely temporary necessities. Such advances afford a legitimate method of tiding over a few weeks' shortage, but are entirely unsuitable for borrowings over a longer period.'

As long as Ways and Means advances retain their present character of a temporary loan in anticipation of revenue receipts they are doubtless unsuitable for 'borrowings over a longer period', but there is no valid reason why the system should not be changed. Our suggestion is that they should not be regarded as borrowing, but frankly as a creation of credit, for which no interest should be paid, and that they should also take the place of the issue of Treasury bills. If thought desirable, statutory provision could be made for the extinction of such credits within specified periods as is now the case with the present advances and Treasury bill issues, and they might with the sanction of Parliament similarly be renewed in case of necessity. In our view there is everything

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to be said in favour of their being used to finance a war. At the end of the last war the directors of the Bank of England themselves recognized the impropriety of such a semi-public institution making a profit out of the issue department and voluntarily surrendered the whole of it to the State. That was a tacit admission of the wrongness of the previous practice. The Bank still, however, charges interest on Ways and Means advances and it is time that that also ceased. In addition to the fuller control which the method we advocate would give the Government and the elimination of all interest charges, which are of course inflationary, it would reduce the work of accounting to the minimum. That this is of no small importance we may see by reference to the evidence which Sir E. M. Harvey (Deputy Governor of the Bank of England) gave before the Macmillan Committee, whom he told that, apart from its large printing factory, the staff of the Bank of England which before the war was approximately 1000 was then (November 1929) about 3700 to 3800; and to give an idea of the magnitude of their work in connection with the National Debt, he added that they had upwards of 3,000,000 separate stock accounts apart from the very large holdings of bearer securities. In the course of the year they probably had to record between 900,000 and 1,000,000 transfers and pay 4,500,000 to 5,000,000 dividend warrants and upwards of 5,000,000 coupons.

If, instead of raising loans, the Government had provided for its internal expenditure entirely by credits opened at the Bank of England, as we suggest, there would have been a notable economy of labour on the administrative side at a time when it was so much needed for other tasks, appreciably smaller costs, and no interest to pay for financing the war. Instead of having some £7,000,000,000 of internal war debt, on which a high rate of interest had to be paid and distributed to millions of subscribers, involving the services for heaven

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knows how many years to come of an elaborate organization for its administration, an unnecessary burden on the Post-Office, the loss of no end of official time on conversion schemes and the dislocation of spending power which follows from them; at the end of the war there might have been a technical debt to the Bank of England, of probably not more than a quarter of the amount, free of interest. If this had not been prevented by adequate taxation at the time, it would at least have been a far less formidable problem to leave over. If, indeed, the expanded production of the war period had been continued thereafter, but converted to the supply of peace requirements, the larger volume of credit would still have been needed, and, provided that the lower salaries and wages had been maintained at or raised to more comfortable levels, the general standard of living would have been raised and we should have had a prosperous and contented nation. Which of the two methods is the more inflationary? Professor Cassel in his definition of inflation, says: 'During the war some governments simply caused the central bank to print more notes and put them at their disposal in the form of advances. Other governments preferred to issue big loans and even resorted to the means of imposing high taxes, but in so far as the buyers of government bonds or the tax-payers had to use bank credits for their payments, and bank credits were arbitrarily extended in order to facilitate such payments, the effect was the same.' Was it indeed? Surely the first of these methods whereby governments rightly created the money needed for carrying on a national struggle without paying interest, was far less inflationary than the second, whereby they issued loans on which they had to pay interest, and these loans, were purchased by means of arbitrary bank credits for which interest had also to be paid by the subscribers.

III

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While thus providing themselves with the money for the struggle in the most expensive way, the Government later sought with excessive reluctance and timidity to get some of it back from its beneficiaries through the costly and troublesome machinery of taxation. The vicious system of financing a war by loan and postponing taxation as much as possible, however, was never before practised in this country to anything like the degree it was on this occasion. In the statement with which he introduced his special War Budget on the 17th November 1914, the Chancellor of the Exchequer (Mr. Lloyd George) told the House of Commons that the Revolutionary and Napoleonic Wars cost this country £831,000,000 of which £440,000,000 was raised by loan and £391,000,000 by taxation; the Crimean War cost us £67,500,000 whereof £32,000,000 was raised by loan and £35,500,000 by taxation, while the South African War cost of £211,000,000 was spread over four financial years. 'If we do not tax, and tax heavily,' he said, 'it will be a serious departure for the first time from the honoured traditions set and hitherto maintained by this country in every single war in which it has ever been engaged.' Nobody would accuse that statesman of a lack of financial courage, yet even he, anticipating that the first full year of the war would cost us £450,000,000, said: 'It is obviously out of the question to raise the whole of this money by taxation,' and practically

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everybody at that time thought the same, little dreaming that within five years four-fifths of that amount would be required, and would in fact be raised, for annual interest alone! But the object of this last, be it noted, was to *make payment to* the bondholder whereas the other was *to extract it from him*, a very different thing! Now, it may be quite truly objected that, although the money may have been available five years later, it was not so then. It is indeed most important to dwell upon the difference between the material things we need and the mere money symbols for them. As one of the principal aims of this book is to bring this home to the reader as clearly and strongly as possible we will pause here to consider the matter a little further.

Unless conscription were to be generally applied and goods were to be requisitioned, what was really required was a transfer of purchasing and service-rewarding power, in whatever form, from individual citizens to the community as a whole for a common purpose, and it was a very good thing that such transfer should restrict the individual's command over goods and services at a time when they were so urgently needed for that common purpose. The methods actually adopted by the Government had the opposite effect of increasing individual purchasing power, to combat the abuse of which much valuable time and energy had to be devoted and with only partial success. The supplies for which the money was needed were certainly not then in existence, though the materials and the labour were, and even if the money had been it would in itself alone have been quite useless. By far the most important and difficult problem was to produce the trained fighting men, the guns, ammunition and other supplies for the war, and, while the withholding of labour on a large scale would inevitably have led to defeat, the withholding of money would only have had the good effect of showing us how unnecessary and wasteful it was to

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borrow it. The money could be created easily enough, as we have seen, by the Government itself, and it is another principal aim of this book to show how badly this was done and with what terribly evil results. The extra goods were produced and used up; the extra money, using the term in its widest sense, was created and continued to grow in amount long after its purpose had come to an end. Our orthodox financiers and economists strongly object to the creation of money at a rate and on a scale greater than the real wealth it symbolizes, and, *except that by them real wealth is too often understood to be synonymous with gold alone*, they are right. But they seem not to appreciate the equal importance of reducing the symbols of wealth *pari passu* with shrinkages in the quantity of the real thing, except when the said symbols take the form of currency. They apparently fail to realize how much worse they are in the form of war loan with its claims to interest!

In the budget speech referred to, Mr. Lloyd George said: 'If we rose to the heroic level of our ancestors we should be raising to-day a revenue of between £450,000,000 and £700,000,000 and no borrowings would be necessary.' He quoted the following from Mr. Gladstone: 'These, then, were the convictions which Mr. Pitt and the successors of Mr. Pitt entertained of their duty to their country. This was the idea that they had of their obligations to posterity. Do you suppose that in those days, when the Duke of Wellington was crowning the British arms with fresh laurels from year to year, your fathers did not think they were fighting for the advantage of posterity? Did they not think they were fighting for our advantage—for we were posterity to them—when they made such efforts to meet those tremendous charges by sacrifices of their own? Why cannot you do that in 1854 which your fathers did in 1798? What were their means as compared with ours?' Mr. Lloyd George rightly applied these exhortations to his own auditors, reminding them that they were equally true

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then, and he reinforced them with eloquent arguments of his own. Nevertheless he only proposed fresh taxation estimated to yield £15,500,000 for eight months of war and left himself with a deficiency of £230,321,000. 'There is only one way, I regret to say, of meeting that, that is by means of a War Loan,' which he thereupon announced, £350,000,000 3½ per cent (1925-8) to be issued at 95, the first of what was to be a long series of public borrowings, and at the same time he made the announcement as to bank facilities which we quoted in the last chapter. What a feeble peroration after so stirring an exordium! It was a strange proceeding for the Government to borrow the money of its own creation at all, but here was its chief financial spokesman going further and announcing an arrangement whereby its agent, the Bank of England, was to afford extraordinary facilities to individuals by lending them money on exceptionally easy terms to enable them to lend it back for liberal interest to the Government! As the bank-rate was afterwards advanced and this first issue of war loan declined in value owing to the more favourable terms offered in respect of those which succeeded it, subscribers who took full advantage of these facilities found themselves in the curious position of paying for the service of a loan from the Bank of England (through their own banks), on security of less than its value, at less than the Bank's minimum discount rate! In March 1915 an issue of £50,000,000 of five-year 3 per cent Exchequer bonds realized £47,700,000 net and in April the Treasury announced that applications would be received through the Bank of England for an unlimited number of Treasury bills at variable rates which were to be notified daily. They were at first 2¾ per cent for three months', 3⅝ per cent for six months' and 3! per cent for nine months' bills.

Despite the emphasis which he repeatedly laid on the gigantic additions that were being made to our requirements, present and future, in his next regular (i.e. the second war)

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budget, introduced on the 4th May 1915, Mr. Lloyd George imposed no new taxes at all! Sharing with many other public men the strange notion that the war might not last even another year, he estimated that if it did we should have to expend £1,132,000,000, of which £270,000,000 would be raised by existing taxes. In the extremely unlikely event of one of the groups of belligerents giving in after so short a trial of strength, and it was never contemplated that we should do so, there was surely no reason why we should make no adequate provision for our known commitments! From a Return issued by the Treasury on the 14th September 1915, we learn that the war charges incurred up to the 31st March 1915 were estimated to amount to £359,786,000 (the figures given representing Exchequer issues, not audited expenditure), and they were met as follows. As to £3,003,000 by suspension of part of the New Sinking Fund of 1914-5; as to £23,003,000 by revenue in excess of peace-time charges; and as to £333,780,000 by borrowing, £296,000,000 being the proceeds of the 3½ per cent War loan 1925-8, £47,700,000 of 3 per cent Exchequer bonds 1920, and £64,150,000 net of Treasury bills, which together left £74,070,000 to be added to the Exchequer balance.

The Chancellor very fairly reviewed the obligations of Great Britain in the common enterprise and the way in which we could best assist our allies, but when he came to discuss finance, he failed, as so many others have done, to make a clear distinction between the internal and external problems. He said: 'We have to raise in this country £1,100,000,000 for financing the operations of the war here and abroad. We have to find between £300,000,000 and £400,000,000 for purchases abroad. What are the possible means of bridging this great deficiency? There is first of all the paper bridge—what is known as the dilution of the currency. Diagnose it, disguise it as they will, there are many

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girders in the German financial bridge which are made of paper, and no amount of paint and varnish will disguise that fact. It is a very easy method, a very tempting method. You appear to get over your difficulties in the simplest way, and it is very difficult for anyone to point out where you are going wrong for the moment, or for some time. But, looking at it most carefully, it is simply an indirect method of levying taxes upon the income of the people. You water the currency and prices go up. A country which has no foreign trade, which is the case in Germany now, can do it. A country which has still a great international trade cannot do it.¹ Gold would vanish and there would be an advance in prices which would be of a most serious character. Therefore that is a course which I should say would be a fatal one for a Chancellor of the Exchequer to pursue in order to get over his difficulties in meeting a great deficiency.⁵ Under this same Chancellorship we had nevertheless ourselves adopted the said paper bridge by the Currency and Bank Notes Act, which to this day serves us extremely well, expanding and contracting with changes in the economic atmosphere, distributing the stresses and absorbing the shocks much better than any gold one can do. Prices in this country had already seriously risen, and, as the world has since seen, they may go up or down whether your bridge be made of paper or gold; and if the latter does vanish it is at least open to question whether the world is any the worse for it provided the proper adjustments are made. A paper currency is unsuitable for the settlement of any but quite small and temporary international balances, but its internal use is of great assistance by releasing gold for external purposes, as we have ourselves found.

'What is the second method?' continued Mr. Lloyd George. 'The second method is a method which is already pursued by Germany, and I am not at all sure that she is not pursuing it

¹ Strange that that should place us at a disadvantage!

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now in the United States of America, and that is the sale of her existing securities, or the creation of new securities by borrowing abroad, both of them perfectly legitimate, but only helpful within limits, and the difficulty is to ascertain those limits. The market is a very limited one and if more securities were placed on a foreign market than it could readily digest the losses would be enormous. What would happen? It would leave us much poorer at the end of the war. It would have the effect of putting up the rate of interest against us and therefore adding to our permanent burdens. *[This was afterwards to be adopted by the Government as a deliberate policy !]* It would also in the end put up the prices of food and raw material. *[This the Government were already doing in the most reckless way.]* Therefore that is a course which we should only pursue carefully and guardedly, and within limits which we must carefully find out and which the markets must carefully find out for themselves.' There is really not very much in this verbose statement of the case. Again, we ourselves soon had recourse to both of these methods, the effects of which are by no means the same. By selling selected foreign securities we maintained our credit, thereby keeping the rate of interest down; by borrowing abroad we somewhat weakened our credit and thereby caused the rate of interest to rise against us. Such dealings, however, were necessary and perfectly justifiable in the circumstances. In dealing with foreigners a nation has to make the best bargain it can, but the evils here enumerated were also quite unjustifiably brought upon us at home by the bad methods of the Government where its authority was supreme. 'What is the third, and in my judgment the only straightforward and reliable course which would help us through the war, and, what is still as important, see that we were not damaged after the war. There is always a great temptation in times of stress for men to take a course which will enable them to get through that

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particular stress without thinking of what the results will be. What is that third course? Depend more largely upon the income of the country.' Very true, but it was the very one that he avoided!

Here let us try to clarify in a few words the real situation of this country in regard to imperial and international finance as contrasted with our internal finance. Before the war we imported commodities of substantially greater value than those we exported, but the debit balance thus arising was converted into a credit one by our so-called invisible exports, that is the shipping, banking and other services which we rendered to our fellow subjects oversea and to foreigners. This surplus, augmented by the dividends and interest we received on previous surpluses of the same kind which we had invested abroad, was likewise invested abroad, so that the amount of capital we had engaged in our Dominions, our colonics, our dependencies and in foreign countries was continually growing. The war, however, made such demands on our productive apparatus, shipping and man-power that, while it increased our needs for imports, it obliged us to curtail our exports, with the result that our former credit balance, after rapidly declining, finally disappeared altogether; and to pay for our growing debit balance we had only three resources left: (i) the export of gold, (2) the pledging or sale of British-owned foreign securities, and (3) the floating of loans abroad which a return to peace conditions would enable us to discharge in the future. Whether expressed in terms of money or not, goods and services in the last resort can only be paid for by other goods and services. When, therefore, we paid for our surplus of imports by the transfer of British-owned foreign securities we handed over rights which we had acquired by goods previously delivered or services previously rendered on our part. When we paid for them by the proceeds of foreign loans we paid with the promise of goods to be delivered or

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services to be rendered on our part in the future. By the last method it is accordingly possible to leave posterity to pay our foreign debts with the fruits of their energies, unless they should choose to repudiate them, as some of the United States of America have done in the past and Russia has done more recently; or the creditor countries should be unwilling to accept payment in the only form possible, as America has been since the last war. The position in regard to our internal obligations on the other hand is entirely different. The cause of the falling-off of our export trade during the war was, apart from the risks of war, an intensified need on our part for the products of our own industry, the character of much of which had of course changed, and the only way it could be met was by increasing the output and diminishing our sales of them abroad. We could not presently produce them by a subsequent expenditure of energy as the promise of which implied in money bonds did enable us to acquire foreign goods which we could not immediately pay for. Money or no money, the only way to supply our real needs was by making the fullest and most effective use of the nation's human and material resources. As long as we did that, which was the only thing that really mattered, no financial device could possibly get more out of the country at home; and to secure as much as possible of the products that we required of other countries we had to make the best possible use of the three resources mentioned above. What the nation could afford was thus alone determined. The vast increase of production and the great rise in prices were reflected in the money figures which staggered us until we got used to them. We could not grasp their significance and to a large extent they were deprived of it by the rise in prices, which also took from them all comparative value.

Expenditure soon began to outrun all estimates and to cause grave concern. On the 21st June 1915 the Government

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sought the sanction of the House of Commons for the issue of an unspecified amount of a new War Loan at 4½ per cent, to be issued at par and redeemable 1925-45, to enable them to liquidate the outstanding liability to the Bank of England in respect of the advances made to acceptance houses and others under the Government's guarantee for the maintenance of British credit, to deal with the maturities of Ways and Means advances, Treasury bills and Exchequer bonds, as well as make some further provision for the continually recurring deficits. The amount thus raised was nearly £600,000,000, but more than a third of it was subscribed by the banks, by the methods already described. On the 29th of the same month Mr. Asquith and Mr. Bonar Law opened a campaign in support both of what was described as the first great democratic loan in British history and a national movement in favour of economy by addressing a great gathering at the Guildhall. The Prime Minister then stated that the war was already costing us £3,000,900 a day, while taxation was producing no more than a quarter of that amount. All the same, the Government continued to show a strange reluctance to take the appropriate steps. Although certain members of Parliament kept urging the Chancellor of the Exchequer to make more substantial provision for the rapidly growing burden by increasing existing and imposing additional taxation, and he was petitioned in the same sense by several anxious patriots outside, there was never any grasping of the nettle.

While the scale of our public borrowing was frequently criticized it is strange that nobody ever seemed to question the principle. Perhaps the nearest approach was made in a speech of Mr. Snowden's in Committee of Ways and Means on the 12th May 1915, in the course of which he expressed himself thus: 'I now come to the question of raising the money by means of a loan. It seems to me that there are only three favourable conditions under which a large national loan

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could be raised without inflicting considerable injury upon the trade of the country, and particularly upon the working classes. If we were able to borrow in the foreign market, a loan would have no very serious consequence upon the industry of our country, or if it were possible to raise a loan out of savings which were not needed for ordinary commercial purposes, or if there was capital lying idle, and if a loan could be raised from that, no very serious consequences would ensue. Of course, there would still remain the very serious objection to a large loan, that the interest upon the loan would be a permanent burden upon the prosperity of the country. But not one of these favourable conditions exists at present. We cannot borrow in the foreign market; all the foreign markets are closed, there is no surplus capital in the country waiting for investment, and although the Chancellor of the Exchequer last week seemed to think that he might be able to appropriate, if not all, at any rate a considerable part of the current savings, he could not do that without its having a disastrous effect upon the industry of the country generally. There is an index by which we can test whether we could borrow without serious financial and commercial consequences. I believe it was Dr. Chalmers, some seventy years ago, who first raised this point that a loan under such conditions as I have stated was a tax upon the working classes—a tax falling wholly upon the working classes—and that the total amount was raised out of the year's income. That condition has, I believe, been accepted as orthodox by every recognized economist since that time. Mill accepted it practically without any doubt or equivocation. What Mill says upon this point is so very important that I will read two or three sentences. This answers the interjection made by the Secretary to the Treasury a moment ago when he said that the burden would fall upon the working people.'

Mr. Acland: 'I said the national income quoted by the hon.

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Member was included in the income of the working classes, so that when he was advocating that our expenditure should be raised by a tax on two-sevenths of that, he would have to include the working classes so as to get the money.

Mr. Snowden: 'I do not limit myself to two-sevenths because I had been pointing out how much better able we were to bear a large impost than we were at the time of the Napoleonic Wars. This is what Mill says upon this point of a loan falling wholly upon the working classes.' If the capital taken in loans is abstracted from funds either employed in production or destined to be employed in production their diversion is equivalent to taking the amount from the wages of the working classes. Borrowing in this case is not a substitute for raising the supplies within the year. A Government which borrows does actually take the amount within the year, and that too by a tax exclusively on the labouring classes, than which it could have done nothing worse if it had supplied its wants by avowed taxation, and in that case the transaction and its attendant evil would have ended with the emergency; while, by the circuitous mode adopted, the value extracted from the labourers is gained not by the State, but by the employers of labour, the State remaining charged with the debt besides and the interest in perpetuity. The systems of public loans in such circumstances may be pronounced the very worst which in the present state of civilization is included in the catalogue of financial expedients."

'I say we can test whether the conditions which are stated to exist at the present time actually are existent. If the Government borrowed under other conditions than those I have stated it would have no appreciable effect on the rate of interest; but, when the rate of interest rises as the result of borrowing, it is proof positive that the amount that the Government borrows is being withdrawn from capital employed in industry, and therefore all that Mill says, supported

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as it is by every other recognized economist, applies to the circumstances of the present time. One word more about this burden in perpetuity of interest. Roughly speaking, the National Debt ever since about 1820, has stood at between £700,000,000 and £800,000,000. Since 1820 the country has paid £3,000,000,000 interest on the National Debt. Every generation of taxpayers pays in interest the total amount of the Debt, and this will go on from generation unto generation, or until the patient taxpayer develops sufficient intelligence to kick against it.'

It was Mr. Snowden's opinion that there were only three conditions favourable to the floating of a public loan, and we will now consider them. The first that he mentioned, a foreign loan, being of use only for foreign payments, would not serve the purposes in view, as they were at least mainly internal. The second was savings not needed for ordinary commercial purposes. These are claims to goods and services the realization of which has been postponed, which it is certainly desirable to transfer to the State when its vital interests require the utmost private economy. We do not share Mr. Snowden's opinion that the amount borrowed by the Government was necessarily withdrawn from industry. In fact only a small fraction of it was, *from that which was superfluous to go into that which was urgently important*, and we think more might well have been so diverted at a time when it was necessary to restrict private spending as much as possible. The most effective way of doing this, however, would have been by increasing taxation, which was to be preferred on so many other grounds as well. War is undeniably a disaster of the first magnitude and it would be very extravagant to expect industry to remain entirely uninjured by it. The causes of the rise in interest rates we shall discuss hereafter. It was a deliberate but mistaken policy of the Government to raise them which was later advantageously abandoned. Mr. Snowden's

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objection to a loan that it imposes a burden on the prosperity of the country is among our own. We will next examine his interesting quotation from Mill. Agreeing as we do with the Victorian economist in holding that the *immediate* effect of State borrowing is to take money from its subjects just as much as taxation does, we do not think the transfer necessarily injures the working classes. It may even benefit them, as their labour may be needed for the purposes of the public borrowing as much as or possibly more than it was before. It is purely a question of the extent to which their labour would be required and rewarded by the public or private bodies respectively. The public might not spend the money on employment directly at all but on the goods produced by private bodies; and that would not necessarily diminish the demand for labour. Individuals whose money is taken may be injured by being deprived of purchasing power so far as it is not surplus to their immediate needs. If it is taken by way of taxation it is a permanent deprivation, unfelt if surplus, while if borrowed the temporary surrender is rewarded by the payment of interest and possibly by a premium on repayment of the capital in addition. This might be more or less than they might gain by investing the amount in commercial ventures, it would certainly be less risky. We hold that public needs should always be provided for by immediate taxation and that nothing can ever be gained for the public at large by postponing it. The *ultimate* effect of meeting them by loans is clearly prejudicial to the working classes by reason both of the increase of burdens and the greater concentration of wealth which the method causes, but that also applies to all other classes excepting only the principal holders of the loans. The advantage of the latter is not always gained by the direct employer of labour, but, what is worse, by the *rentier* pure and simple. Graduated taxation is definitely beneficial to the working classes and all the poorer part

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of the population, as it tends to lessen the inequalities of wealth.

Mr. Snowden next proceeded to discuss taxation, saying that he considered income-tax and death duties were the two most ideal forms. In his reply, Mr. Lloyd George said: 'The hon. Member for Blackburn (Mr. Snowden) is not present, but he has delivered his usual contribution and his rather usual alternative budget, and as you listen to him it all seems so easy. I want £1,000,000,000 this year—a stroke of the pen! All you have to do is to put 15s. in the £ on the income-tax. The working classes will be no worse off, and the people with incomes of £150 and £250—and they are only a small group—if you take three-fourths of their income, they would not suffer; on the contrary they would be all the better for it. That is not the sort of criticism which has been directed at me from the majority of the people of this country. May I just put this point to the hon. Member for Blackburn? Quite apart from the wisdom of taking away three-fourths of a man's income, you would not get the money I require. The whole of the income of those who have got £3000 a year—I do not know whether he regards a man with £3000 a year as a rich man—comes to £220,000,000. I will take three-fourths of that, and then the £3000 a year man would have £750 a year. Suppose I took three-quarters of the whole of the income of those earning £3000 a year that would bring me in £165,000,000, and that is only about one-fifth of what I need. May I point out that I have already got from this source probably £30,000,000 or £40,000,000 at the least. Consequently all I would really get by this method would be about £120,000,000, but I am short of £850,000,000, so that by the proposal of the hon. Member for Blackburn I get about one-seventh of what I am in need of. These magical ways sound all right, but they are not business. The hon. Gentleman said, "You must not go to the working classes, and you must not

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go to the people earning £200 or £300 a year, but you must go to the people at the top" and he spoke of a man with £50,000 a year. May I point out that if I took the whole of their income I should not be so much better off for financing a great war. If I take the whole of the income of the men getting £3000 a year, I should only get about one-fourth of what I am short. I am glad the hon. Member for Blackburn has made this statement in the House of Commons, where it can be answered, because when such statements are made outside they are really mischievous. My hon. Friend says: "Here you are, one-third of the income of the country wipes out the whole of your deficit." My hon. Friend the Financial Secretary to the Treasury pointed out that the income of the country is £2,400,000,000, but what is that? That is the whole of the income, but the amount that passes for review under the income-tax is only £1,150,000,000 and the total upon which income-tax is actually paid is only £970,000,000. There is a balance of £1,400,000,000 and that balance represents the income of the people who receive less than £160 a year. That means the working classes, the clerks or men who are engaged in businesses of that kind. The hon. Member for Blackburn says he would not charge a penny piece more in taxation upon that £1,400,000,000.

'Supposing I took the people earning between £160 and £700 a year. If I took one-third of these incomes, they would only produce £300,000,000 and I am still £500,000,000 short. Where is the hon. Member going to get that amount? It is no use making sums of this kind and the hon. Member should figure it out. No hon. Member should come here with statements of this kind without figuring out the whole thing. You cannot come here in a light and airy fashion and say, "I will get the money by taxing people with £50,000 a year."⁵⁵ You cannot do it. How are you going to raise £800,000,000 in this country in the course of a single year? The hon. Member says

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you must not borrow, because that is wrong and it hits the working classes. He says you must tax but you must only tax those people who have got thousands a year. If you take the whole of the money belonging to those people you would still be short. I hope the next time the hon. Member delivers a Budget speech to this House he will just make up the account, because it is a matter of arithmetic.' In the latter the right hon. Gentleman himself evidently did not excel.

This was altogether a wretched travesty of what Mr. Snowden said to make in that gentleman's absence, and it might well cause surprise that a serious assembly could listen with patience to such a tissue of inaccuracies. The debates, however, show clearly enough that the majority of members lacked the knowledge effectively to contest them and to the few who might possibly have been able it might have seemed contrary to the interests they defended to do so. As Mr. Lloyd George said that £1,400,000,000 represented those who received less than £160 a year,¹ leaving only £1,000,000,000 for all the other incomes, it would appear that he would be obliged to take more than three-quarters of these to supply the deficit. But did it not occur to him that his argument was quite as conclusive against the possibility of *borrowing* the money as of raising it by taxation? Public borrowing no less than taxation involves the transfer of spending power from the subject to the State, and if it does not exist it cannot be transferred by either method. No reliance was to be placed on any of the figures on which the Chancellor based his argument and his indisputable cleverness precludes belief in its ingenuousness. The £2,400,000,000 which Mr. Snowden quoted and Mr. Lloyd George himself had previously adopted for the total national income was, it should be remembered, based on calculations made some time before the war, since when there had been a consider-

¹ It would be no fewer than 10,000,000 at £140 a year.

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able rise in prices and that would have brought it up to at least £3,000,000,000. A rise in prices does not of course raise all incomes or increase real wealth, but it does raise some incomes, thereby aggravating contractual obligations and the previous inequalities. That is precisely the evil of it. Broadly speaking there will be a rise in the *total* incomes of the nation corresponding to the rise in prices. Now, the Chancellor had a deficit of £800,000,000 to make up, and he said: 'But I again wish to emphasize that, even if you have the whole of the ordinary savings of the country, you would not be able to meet the finances of the war.' That may already have been perfectly true, and it is an unquestionable fact that at no subsequent period of the war was there a sum available of sufficient magnitude to provide for any of the successive deficits. Yet they were all met, and mainly by 'borrowing'!

Although, according to the financial big-wigs, the money could not be obtained by taxation, it could, even with the addition of growing interest, be raised by borrowing! It is indeed one of the curiosities of our war finance that the longer the destructive struggle continued and the more our wealth was thereby depleted the larger were the sums that we were, able to find. Instead of tending to exhaustion, previous drains seemed miraculously to have increased the flow. It is only draughts for constructive social purposes, it appears, that so soon dry up the fountain of our wealth; for the waste of war it will play unceasingly! How is that? Here is a pretty conundrum that we have set ourselves to solve! The Chancellor of the Exchequer has assured us, and tried to demonstrate, that the money simply did not exist, and we ourselves have admitted as much in regard at least to the remaining period of the war, that is by far the greater part of its duration. Where, then, did it come from? Why, the Government *created* it by their 'borrowing' method as we have explained elsewhere. Such a disproportionate amount of attention has been

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focused on the expansion of the currency, a mere necessary incident in a vastly greater expansion of credit in the form of loans, that we must next enquire what was the nature of the money 'borrowed'. It was *money of account*, in other words book-keeping, just a crediting and a debiting. Now, nothing is easier than to create money of that kind, to enter £800,000,000, or whatever the sum may be, on the credit side of an account, whether it represents existing wealth or not. It is easier even than the printing of currency notes, and doing it by Ways and Means advances is no more, indeed it is less, inflationary than 'borrowing' it, as we have already sought to prove. It may be objected that it is very bad to create all this money when there is no real wealth at the back of it, but exactly the same objection applies to all our war loans *and indeed to all the so-called savings in the country*. The latter are no more than claims on future production and service, and what else was this £800,000,000 to be? But why add to the large accumulation of such claims already existing? Certainly it would have been better on many accounts to have transferred a sufficiency of these to the Government instead. That is what would have resulted from financing the war by taxation, which is what we think ought to have been done. Warships, artillery, munitions and war materials of all sorts, whether considered as wealth or not in time of peace, are urgent necessities in time of war, and production of that as of any other kind has to be financed. The raising of the money for such purposes by the Government is just as necessary and defensible as the raising of capital by a firm or company that proposes to enter into industry. The difference between the two cases is this. If a firm or company is successful it has its offices, warehouses, machinery and all its apparatus for production to set against its subscribed capital, and out of its trading profits it is able to maintain its assets and meet its current expenses, whereas a state engaged in war

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makes no profits to apply to either object. But neither does a private enterprise that fails, and what happens in that case? The realizable assets will probably be insufficient to satisfy the claims of creditors, there will have to be a composition, winding-up or bankruptcy as the case may be, and the shareholders are only too likely to lose all the money they have invested in the concern. Just think how shareholders have been 'taxed' in that way since the end of the last war!

War nowadays is practically always a losing enterprise, even to the victors, and there is only one way to meet the losses, namely by taxation. So-called borrowing does not avoid this, but only puts it off and aggravates the burden by the addition of premiums, interest payments, and it maybe by a subsequent increase in the purchasing power of the money 'borrowed'. In former times the losses of war fell most heavily upon those whose own fields were ravaged and whose other property was destroyed. The armies lived on the land at the expense of the local inhabitants whom they often forced into their service as well. All kinds of things were requisitioned and seldom paid for. A civilized state now aims, or is supposed to aim, at spreading the burden equitably over the whole afflicted population by taxing them according to their individual capacity to pay, and to compensate those who have specially suffered in the general interest. But all this is defeated by the modern system of financing wars by loan. The so-called postponement of payment is a delusion and a fraud, merely causing a grossly unfair distribution of the burden. Of this, indeed, it relieves some altogether, even increasing their capital and providing them with an additional income, notwithstanding that *it may appear* that they are bearing their due share of the taxation. What it all amounts to is this. In the dark ages your acknowledged enemy levied present tribute on you at his peril, for you were at liberty to strike

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him down if you could. Nowadays it is a certain number of your fellow countrymen who levy a continuous tribute on you and they are protected in their depredations by your own Government.

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Considering that they are supposed to be the guardians and promoters of the *national* welfare, our Government have always manifested far too particular a concern for those of His Majesty's subjects who are engaged in selling commodities at a profit and an extreme reluctance to restrain their unfair exploitation of all the rest. Our parliamentary debates, with too few exceptions, also give the impression of the special pleadings of groups of men representing such narrow interests rather than those of the whole commonwealth impartially. This is the less defensible since the former can easily organize themselves for their own particular purposes, whereas the Government itself offers virtually the only means of protection open to the latter. Moreover, at an altogether exceptionally grave crisis in the fate of the country the body officially representing and acting for it assumed in many negotiations the position of an ordinary corporation, and proceeded as if it were merely one of the multifarious units of which the nation was composed, obliged to compete with the rest on practically equal terms. This not only had a delaying and weakening effect but also started, firstly, a rise in prices, salaries and wages, and, secondly, a progressive improvement in the economic position of the more self-seeking at the expense of the more public-spirited elements of the population. Instead of suffering disadvantages through their disqualification for or avoidance of military service, the for-

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mer found that their involuntary or voluntary defects not only saved them from its discomforts and dangers but actually gave them a privileged position in the economic sphere. What more could the stay-at-home profiteer desire? An insatiable demand in a contracted market ensures sales at almost any prices the seller chooses to fix, and there is no need for anxiety when the British Government is the customer. Here, therefore, was the opportunity to trade with the greatest possible profit with hardly any risk at all! The rapacity of those who were in a great hurry to get rich in the end compelled the spending authorities to adopt some measures of self-protection which were gradually to be extended, but not until immense evil had been wrought by previous neglect.

By the spring of 1915 the rising tide of indignation against the profiteering that was going on began to find loud expression and there was a growing demand that some at least of the excessive profits that were being made out of the war should be taken for its service. In the debate on the first war budget, Mr. Watson Rutherford had broached the subject of a levy on capital, which, as he pointed out, at the rate of only 5 per cent of his very moderate estimate of £12,000,000,000 would have produced £600,000,000. The subject was brought up again in Committee of Ways and Means on the 12th May 1915 by Sir Thomas Whittaker, who contemplated the raising of a sum by that means of only £250,000,000. 'It is an attractive proposal,'⁵ he said, 'but, like many of these attractive things it is very difficult because so few people in this country have any considerable amount of their capital in available cash; *it is the cash we want?* Mr. Lloyd George referred to this with approval, adding: 'I am not sure that the country sufficiently realizes the point he put, that you cannot pay for a war with railway companies, houses and land. You must have liquid assets for that purpose and the difficulty of the Government is not that this country is not rich enough to

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wage a war for twenty years with the wealth it has accumulated [*sic*], but the difficulty is to liquidize your assets to pay debts as you go along. You cannot say to a man to whom you owe a debt, "Well, here is a house", and transfer it to him. You have to pay it in cash, or the equivalent.' What the right honourable gentleman meant by 'the equivalent' is not clear, but if by cash he meant paper money the Government were the body to create it. If gold was meant, then the country might as well have surrendered at once, as it certainly could never be obtained in sufficient quantity. The truth of the matter, of course, was that it was goods and services that we wanted and somehow or other we did produce them.

On the 21 st September 1915 Mr. McKenna, the new Chancellor of the Exchequer, brought in the third war budget and his revised estimate of the expenditure for the current financial year was £1,590,000,000. Like his predecessor, he said: 'It is obvious that by taxation alone a small part only of the deficit could be met. . . . We may estimate the dead-weight debt at the close of this year at £2,200,000,000. Our accumulated wealth is great and a national debt even of this magnitude will by no means cripple our resources.' Was not the accumulated wealth he had in mind just such a mass of deferred claims as the war loans themselves constituted? Making the extremely doubtful assertion that 'there is no record of a nation having voluntarily accepted liabilities bearing so high a proportion to the total national income for which provision has to be made within a single year', he proposed new taxes which he estimated to bring the revenue up from £272,000,000 to £387,000,000. Taxation had so far fallen impartially on those who were suffering most and those who were profiting most by the war. Now at last the special fiscal obligations of the last-mentioned class were to be recognized by the imposition of an Excess Profits Duty of 50 per cent. In the debate on the Finance (No. 3) Bill, Mr. Snowden

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strongly condemned the very inadequate provision that was being made for the expense of the war by taxation and he revived the suggestion of a levy on capital. The Financial Secretary to the Treasury (Mr. E. S. Montagu) said in reference to this: 'There seems to be an opinion abroad that the huge deficit can be found out of the enormous accumulated wealth of the country, which is sometimes put at £15,000,000,000, and which my honourable Friend the Member for Blackburn put at £10,000,000,000.¹ He thinks that it would be quite simple to impose a tax on that which would raise a revenue of £500,000,000. But you cannot tax capital that you cannot realize.'

This was surely an astonishing proposition for a junior finance minister to put forward, one, too, who made so many sound observations in regard to the necessity of private economy during the war and in other connections. He went on: 'The accumulated wealth is in the form of houses, factories, railways, canals, landed estates, furniture and, to some extent, securities, none of which can be converted into the goods and services that are required for active warfare except in so far as you can sell them or pledge them to foreign purchasers or lenders. It is no use lending them or selling them to one another.' This must be described as astonishing proposition number two! One might fairly ask, what is the use of wealth at all if you can do nothing with it, be it real or notional in character? The same minister proceeded: 'So what is wanted in this war is not artificially created money, but actually produced goods and services which the Government must have for the war, and for which there can be no substitute.' Here is a pretty tangle of inconsistencies! Well, the Government were actually getting the goods and services, and Mr. Montagu made out an excellent case for their not being paid for

¹ It certainly cannot be said that the Socialist member overstated his case.

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at all, since he said that none of the things which come within our category of real wealth, nor the securities, nor the artificially created money, which come within our category of notional wealth, were of any use for this purpose. The fact remains that the goods and services *were* paid for by money which was artificially created, and in such an extravagant way that it called into being a great mass of interest-bearing securities as well.

We must apologize to our readers for a certain reiteration, for what may seem an undue emphasis on certain points, but when we hear these distinguished gentlemen confounding wealth with the mere tokens of wealth, lumping together houses, railways, securities and money, we feel the necessity of stressing the falsity of arguments so ill based. If, as was the case, more than two-thirds of the sum mentioned by the honourable Member for Blackburn could be raised for interest alone on the said new securities after the country had dissipated many thousands of millions of pounds worth of additional goods and services in this conflict, why could it not have been raised then? It could be if a certain method were applied, and we are now to learn from what should have been a well-informed source what that method was. In the same debate, Mr. Samuel Samuel, who had dispensed hospitality to successive Chancellors of the Exchequer, made this remarkable contribution: *'It will be for the Government to produce the means to make these securities (i.e. the old, not the new, ones) realizable to a certain extent to enable holders of those securities to provide money to carry on the war!'* This and the other passages above, which we have italicized, show how little the financing of such operations was understood by our public men. That at least is the kindest construction we can put upon their pronouncements.

Imagine the Government providing the means, i.e. the paper cash, to enable investors to sell their paper securities in order that they might be in a position to return the said cash

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to the Government in the form of loans!¹ Money that could not be raised directly so as to avoid interest, let us again observe, could be raised easily enough indirectly for loaning to the public at interest! That this odd procedure, with still odder variations, for the financing of the material needs of a nation at war, should have been actually followed may be better understood in the light of these illuminating quotations; and if our Chancellors of the Exchequer had been subjected to that wholesome discipline of impeachment which has unhappily been allowed to fall into desuetude, they might justly have quoted them in extenuation of their delinquencies, for they are not themselves required to be experts. If the purest distillation of financial wisdom is not to be extracted from the brains severally of a son of the head of a well-known firm of bankers and bullion merchants in the City of London and of one of its oil and banking magnates, where, it might fairly be asked, is a poor Chancellor to seek it? All we can say is that that kind of finance may be orthodox, it may be secular, but it is none the less shocking.

'In July 1915 the Treasury took the first step with the view of helping the Exchange by instructing the Bank of England to purchase American Dollar Securities in London and transmit them to New York for sale, and these operations continued until the close of the year, by which time securities of the nominal amount of \$233,000,000 had been purchased.' This is quoted from the final report of the American Dollar Securities Committee who began their labours in January 1916. In September 1915 a Commission was despatched to the United States to negotiate an Anglo-French loan of \$500,000,000 for five years at 5 per cent, the issue price being 98. This was to be a joint and several obligation of the borrowing powers, between whom the proceeds were equally

¹ In the main they managed to keep their securities and 'advance money' to the Government as well!

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divided. These two measures comprised the 'second method' which Mr. Lloyd George in his last budget speech had condemned on the part of the Germans, but only mildly since he must already have known that we ourselves should soon find its application both useful and necessary. In the debate on the Address on the 15th February 1916 Mr. Asquith said that the forecast he had made in the previous November that the cost of the war would probably amount to £5,000,000 a day had been very nearly, if not quite, realized. After dwelling on the stupendous nature of the charge, he asked: 'How is this burden going to be met? There are two ways, and two ways only, in which it can be met. The first is by large additions to taxation, and those I believe the House will find before they are many weeks older my right honourable Friend the Chancellor of the Exchequer will have the courage to propose. But no additions you could possibly make to the taxation of the country, unless it were of a suicidal and Utopian kind could possibly fill this large and ever-widening chasm. The only other way in which the gap can be bridged is by the maintenance of our credit, which is the most valuable asset not only of this country, but of our allies.' The last was about as helpful an assertion as if he had said that we must keep solvent without telling us how. He spoke more to the point when he went on to say that we must keep up our productive activities and our export trade *[as far as was then possible]*, cut down our unnecessary imports and our consumption of luxuries. This maintenance of credit was helpful, especially abroad, but it would not have carried us very far without intensive production at home. For all the might and reputation of the British Empire, it was astonishing how little real credit the foreign nations whose goods we were purchasing were prepared to extend to us. It is seen how we were obliged to supplement our gold and other exports with the sale of part of our great holdings of valuable foreign securities almost as

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soon as the balance went against us. Until our principal creditor, the United States, entered the war and thereby became equally interested in its successful prosecution on our side, our external debt was indeed quite negligible.

A more vigorous pursuit of the campaign in favour of economy had now become necessary by reason of the flaunting of new and ill-gotten wealth on an enormous scale by profiteers, as well as by the unaccustomed surpluses of working class people whose joyful indulgence in spending may be understood and find condonation in their previous limitation to the barest necessities of life. The former inflamed the indignation of serious patriots, and caused dangerous industrial unrest, just as the latter, with the unfortunate increase in drunkenness and its concomitant slackening of effort caused growing anxiety. It was daily becoming plainer that, if the war was to be effectively pressed to a victorious conclusion, the planning and control by the authorities which had been already initiated must at least be further extended, if not made entirely to supersede private enterprise with its duplication and waste of effort, its many other shortcomings and above all its extravagant cost to the nation. Before the year was out the people were to witness some startling changes in this and other spheres, such as compulsory military service and a change of government. As far as financial arrangements went, on the 16th December five-year 5 per cent Exchequer bonds were issued for an unlimited amount, while the Treasury bill issue of the previous April was continued till the end of 1915 and throughout the whole of 1916. During the first quarter of 1916 the rate was 5 per cent for all maturities, but on the 24th March it was fixed at 4½ per cent for 3, 6 and 9 months' and 5 per cent for 12 months' bills. On the 16th June a flat rate of 5 per cent for all maturities was restored.

The fourth war budget was opened by Mr. McKenna on the 4th April 1916. 'In ordinary circumstances', he said, 'it

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would not be expected of the Chancellor of the Exchequer that he should explain his reasons for not inviting the Committee to assent to higher taxation than the burdens which he is about to propose, but such is the willingness of our people to make sacrifices, and such is the determination of the country to spare nothing which is necessary to bring the war to a successful issue, that I have thought it incumbent upon me to say these few words in introducing proposals which will bring our total revenue up (from £337,000,006) to £509,000,000.' What was the explanation for this extraordinary hesitation to take proper advantage of this serious spirit on the part of the taxpayer? An imminent surrender of the enemy? Some great new source of revenue? Nothing of the kind. The Chancellor assumed with good reason that the war would continue throughout the whole of the financial year he was budgeting for. He anticipated a shortage of tonnage (6,000,000 tons odd were sunk this very year), which would naturally have a considerable effect of an adverse kind upon both revenue and expenditure, the partial or entire prohibition of particular classes of imports being then projected. Yet the deficit of £1,323,000,000 was again to be *made good* by borrowing! It is only fair to record an observation on this by Mr. Wardle, the Acting Chairman of the Labour Party, who, like his colleague Mr. W. C. Anderson, made many excellent contributions to the debates, showing a serious patriotism as well as a watchful, but not a touchy, attitude in regard to the welfare of the working classes. 'If the State', he said, 'can do without borrowing it ought to do without it, and if we lived on our income and paid for this war as much as possible I believe that after the war the recovery would be infinitely greater than it can possibly be by borrowing large sums of money, as represented by the present proposals of the budget.'

During the Second Reading of the Finance Bill, on the 18th May 1916, Mr. McKenna contended that there had

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been an enormous reduction in personal expenditure and that it was absolutely impossible for the nation to make so great a financial effort if that were untrue. 'You cannot raise in taxation £500,000,000 in a single year and £1,300,000,000 in loans except from the economy of the people,' he said, as if the sum last mentioned were the fruit of saving! Why, the same minister, on the 10th August following, said the nation's income (i.e. the aggregate of net private incomes) 'may probably be put at about £2,500,000,000 or perhaps £2,600,000,000, and he would have his hearers believe that two-thirds of this was being saved! The industries of the country at that time were mainly occupied in furnishing the fighting forces with their ships, aeroplanes, ordnance, equipment, stores, ammunition, etc. and it would have been pretty scandalous if the profits on these and on the considerably reduced output of peace-time goods and services had been great enough to permit the more favoured members of the community to accumulate a surplus of £1,300,000,000 in a single year, after paying £500,000,000 in taxes and all their ordinary expenses, besides indulging in the extravagances which formed the grounds of the complaints which Mr. McKenna was trying to refute. The idea, of course, was fantastic, and if it had been merely the product of a tired brain in the heat of discussion we would willingly have left it in oblivion; but, since it expresses the mistaken conception whose baleful effects it is our business to trace to their source, we are obliged to criticize it. Bad as the profiteering was, it could not go to quite such lengths as that. The money for the loans whereby the war was principally financed, as we have now repeatedly pointed out, was 'made' in quite a different way. Later in the same debate Mr. McKenna asserted that 'our total indebtedness on the 31st March next (1917) would just about equal one year's national income, which, of course, is not a burden intolerable to contemplate.'

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Now, if the total national indebtedness after two years and eight months of war amounted to a single year's income, two-thirds of which was being saved, what possible excuse could there be for the plea that we could not pay for it during its progress? To regard this, the power to raise this gigantic revenue, primarily not as a fiscal, but as a moral triumph. It is only by the willingness of the people to pay that it is possible to raise these great sums.' As far as this applies to the rich, we may learn from a statement issued by the Treasury in April 1916 that the weight of income-tax and super-tax combined was for 1915-6 at the rate of 3/1.7 in the £ on an income of £3000 a year, 3/9.8 on £6000 and 4/6.7 on £10,000; for 1916-7, under Sees. 20 and 23, Finance (No. 2) Act 1915, at the rate of 3/7.7 on £3000, 4/3.8 on £6000 and 5/0.7 on £10,000; for 1916-7, as now proposed, at the rate of 5/1.7 on £3000, 5/9.8 on £6000 and 6/6.7 on £10,000- There does not seem to be anything strikingly heroic about these contributions, especially when those who made them had exceptional opportunities for increasing both capital and income. Supposing they had not been willing to pay, what was the alternative? It was presumably *their* war quite as much as anybody else's. Then, as to the death duties, about which there has always been such an outcry. *The Times* of the 15th July 1916 records that the inventory of the personal estate of a deceased linoleum manufacturer which was lodged the day before with the Sheriff Clerk of Cupar amounted to £1,077,303 and the estate duty paid was £203,027, leaving more than four-fifths to the beneficiaries, the not inconsiderable sum of £874,276. So much for taxation!

As for the war loans, they were called upon not to pay but to receive. 'If other nations were as willing as this nation to pay, they, too, could raise great sums for the cost of the war. It depends upon the moral power of the people. Whatever else may be said of this nation, in our power to submit to bear

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taxation, I think, we have shown a moral strength of that [*sic*] which none of the other belligerents have yet proved themselves capable.⁵ In the light of all this rhapsodizing about the fortitude and moral grandeur of the taxpayer, which Chancellors of the Exchequer signally failed to turn to account, what is the poor fellow who did his bit in the trenches to think of himself if his income was too small to make much, if any, *pecuniary* contribution? As to the foreign belligerents who are animadverted upon, how *did* they pay for the war? If Mr. McKenna thinks their financial courage was inferior to ours, he cannot surely reproach them for any lack of the other, perhaps not less noble, kind. The tribulations of most of them, whether physical, moral or financial, were certainly not less than ours. He was expressing himself thus at the very time when men were suffering the unspeakable agonies of Verdun. He went on to say, 'I am entitled, I think, to speak with some feeling on this subject, because the raising of this revenue causes great hardship to very large classes of people.'⁵ Yes, particularly to the poor and the less well-to-do, and it was only increased by the borrowing method, but the Chancellor was apparently not thinking of them. What caused him distress at the moment was the necessity for increasing the Excess Profits Duty from 50 to 60 per cent! He was most apologetic about this, but we shall bring out some of the actual facts of the case in another chapter.

In the month of July 1916, when, instead of an expected net addition of £1,027,000 to their gold stock the directors of the Bank of England were met with a decline of £924,000, even though it still left them with substantially more than a year before, they decided to put up the bank-rate. The Treasury scheme for using acceptable securities as collateral for loans obtained abroad, and even parting with them in case of necessity; the free export of Empire-produced gold together with what other commodities we could still turn out,

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or, by economy, spare for foreign markets; and the restriction of imports to absolute necessities, were, as we have said, practically the only ways of paying for the latter. It was not likely that in war conditions an extra one per cent would greatly influence Americans to make long-term investments on this side of the Atlantic, or to leave their gold on deposit here, but this was the traditional remedy and it was therefore now applied. In *The Times* of the 14th July 1916 we may read: 'After a somewhat protracted meeting of the Bank Court, the bank-rate was advanced yesterday from 5 per cent—at which it had stood since August 8, 1914—to 6 per cent. To-day we shall presumably have the Treasury bill rate revised upwards in order to adjust them to the higher money values. The Bank of England's action had been fully anticipated in the comments we have made during the last few days on the rise in money rates in New York, though up to the last moment there remained a disposition in the City to believe that it might be found unnecessary. The feeling of immediate relief which would doubtlessly have been prevalent in the discount market if "no change" had been announced will, however, be quickly replaced, we believe, now that the deed is done, by no less relief that there is no prolongation of the "waiting and seeing" of the last three days.' The same journal of the 19th of the same month observed: 'Among other effects of the higher Bank Rate it is clear that the likelihood of the Government issuing a new long-dated War Loan in the near future is still further diminished. With dearer money, any such loan would have to be at a correspondingly high rate, and therefore monetary conditions point to the continuance of the policy of short-term borrowing. It is easy enough to criticize both the policy itself, especially in regard to the piling up of the amount represented by Treasury bills, and also the raising of the bank-rate, which is undoubtedly disliked in **the** City. But criticism is not very profitable. What is wanted

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is a much more practical recognition by financiers generally, and by the whole community in every section, of the necessity for making our "continuous short-term loan policy" a success.'

When criticized for paying so high a rate of interest on public borrowing and for not substituting a new war loan for the very large amount of floating debt, particularly in Treasury bills, which was worrying some members of Parliament, Mr. McKenna said: 'The main point that we have to take into view, in my judgment, in issuing a loan is whether or not the state of the Money Market at any given moment discloses a condition of inflation, and if credits are being heaped up which do not really represent real money. If we got a condition of inflation, and if these yearly Treasury bills were in truth not invested money, but were going to be discounted and made the basis of new credit, we should have to issue a loan, it would not matter what the price. It would not be the price that would determine our judgment; it would be the whole condition of trade and the state of the country.' By a condition of inflation and the heaping up of credits 'which do not represent real money' was presumably meant the expansion of private credit beyond what was required for current commercial operations. There were no grounds for inferring this from the increase in bank deposits since that was fully accounted for by the Government's own operations. This is borne out by an article on 'Banking in Time of War—Results of the Half-Year', which appeared in *The Times* of the 20th July 1916 and contained the following: 'Since the war began the deposits of the banks have increased by about 200 millions. This expansion has not been the result of granting more credit to traders; on the contrary bills discounted and loans have in the same period declined by nearly 50 millions. The whole and more of this increase in their resources has been invested in Government securities.' That, of course, was

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necessarily the case, since every penny the Government spent beyond the proceeds of taxation had been obtained by the issue of those securities.

The conditions which Mr. McKenna alleged as justifying the continuous issue of Treasury bills on a large scale, for which he was criticized, in preference to the floating of a loan, were in fact created by the course he was pursuing and he was thereby increasing the cost of public borrowing. This may be illustrated by the following discussion which occurred during the sitting of the Macmillan Committee on Finance and Industry, when Mr. R. H. Foa was giving evidence, on the 6th February 1930.

1776. Mr. Brand: Supposing the Bank of England wanted the market rate put up and the Big Five agreed with the Bank that they would charge a somewhat higher rate; do you think they could do it?—I think they could do it if they chose a propitious moment when money is scarce, but when money is plethoric, no.

1777. Mr. Keynes: In those circumstances could they not achieve the same object by releasing more Treasury bills?—What they do is this. If in the opinion of the Bank of England the market is too easy, and is affecting the foreign exchanges, and making it likely that they will lose gold, they sell us Treasury bills in large sums. The Treasury bill is, in the inner circle, the most readily negotiable thing that there is, because, although the bankers will never part with the commercial bills that come into their hands, it is not an uncommon thing for them to say "Will you take a line of Treasury bills?" "Yes." So the Treasury bill is employed very often in regulating the value of money.

1778. By a joint-stock bank?—Yes, I have had millions.' Mr. McKenna's argument is indeed unintelligible until it is realized that, whatever his present views may be, he was then possessed by the Gold Standard theory that the one infallible cure for both inflation at home and an adverse balance of payments abroad was the raising of the

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bank rate. This came out when, although the criticisms had been directed against the Government's *internal* financial policy, he suddenly turned to the financing of our external purchases which were causing him the most anxious pre-occupation. He said: 'I am talking of the foreign payments we have to make, whether on our own account or our advances to our allies, because we have to make good our own deficiency in production in relation to our consumption and we have to pay for that somewhere abroad. Some other nation has to be induced to supply us with goods. We have to pay for those goods. If it is a difficult task day by day to raise credits in this country, how much more difficult is it likely to be in raising credits day by day in a foreign country? I do not want to go into detail in that, but I would ask my hon. Friend and hon. Members opposite, when they criticize the rise in the bank-rate to 6 per cent to remember that we must not look at it as an internal problem of finance, but as a question of what is necessary to ensure our foreign credits. No one can tell—for nobody knows the figures except myself and those who are immediately associated with me—what we have to pay in dollars day by day and we alone are able to judge what is the effect of putting up the bank-rate. Of course I cannot take any responsibility for putting up the bank-rate, because that is a matter exclusively in the control of the Bank of England. I would like to say at once that the Governor of the Bank of England spoke to me about an advance and I entirely agreed with his action. I felt it was necessary to secure ourselves partly against inflation, but much more against the drain upon our dollar funds abroad.'

The plain man may not easily understand why the Government and the business community at home should have to pay more to their investing compatriots because of the country's difficulty in meeting external demands in time of war, especially when he learns that the investor's money was

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provided by the country itself and reflects that the winning of the war was a concern of the investor's no less than of the others. It was apparently not then, there is indeed much evidence to show that it is not even yet, fully realized that the financing of internal and external operations are not necessarily completely interdependent except under the Gold Standard, which at that time was inoperative. The raising of the bank-rate, useless as it was for the object in view, had the immediate effect of increasing the cost of credit at home, which naturally reacted to our prejudice on interest rates abroad; but our money market was ultimately to break away from its thralldom and thereby learn a valuable lesson. That is the historical way in which important reforms silently take place amongst us without our appreciating their significance or even being conscious of their occurrence.

As regards external payments it seems more than doubtful whether the Government were making the most of the enormously valuable security behind British issues. Mr. Annan Bryce said that while they were paying 6 per cent for credit abroad, the value of day to day money in America was 2½ per cent, in Paris 3 per cent and in Rome 4 per cent. He also complained that our allies were hoarding gold. 'Two of these countries whom we are financing, Russia and France, have got enormous stocks of gold. France has £200,000,000 and Russia has £200,000,000. What in the name of wonder is the use of these hundreds of millions of gold to these two countries? They say it is to maintain their credit after the war. Their credit now is not being maintained by themselves, but it is being maintained by us. We are paying. Why in the world do not they give us some of that gold at a pinch? What is the use of gold except at a pinch? What is the use of bank reserves except at a pinch? Suppose we locked up in a fortress like Spandau one hundred millions of gold. Should we keep it there like the talent in the napkin mentioned in the Scrip-

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tures and make no use of it? No! We should certainly put it out. When you want your reserve is when the pinch comes.' That is a truth which very few have learned even yet. The *cacoethes cumulandi* to this day infects many a great nation as badly as ever. It transpired in the course of a subsequent debate (that on the Consolidated Bill of 19th October following) that £300,000,000 of our Treasury bills were held abroad, which the high rate of interest would account for, and Mr. McKenna expressed satisfaction at this and the hope that £400,000,000 might be so held. 'It is one of our many objects in offering these securities to the public as a State security that they will be held abroad,⁵ but it was rightly objected that there was a danger in large numbers of our short-dated securities being held by foreigners, as they might fall due at a most inconvenient time and not be renewed.

The great strain of obtaining the money required internally might have been to a very considerable extent lessened by a bold policy of taxation, which is the best of all antidotes for inflation, but none of the war Chancellors seemed to be equal to it. The whole cost of the war had to be met as it was incurred, there can be no question whatever about that, and the borrowing method was not only extremely harmful and unjust to the greater part of our people, but it compelled the Government to raise a constantly increasing sum for the accumulating interest alone. Replying to a question by Mr. Faber, Mr. McKenna asked: 'Does he really press me as a man of business to announce now the date of issue of a new loan to be made which would start gigantic speculation in War Loan Stock on the Stock Exchange? Some would make fortunes, others would lose them; and clearly it is not in the public interest for me to make any statement which could be made a basis for Stock Exchange speculations.⁵ All such evils might have been avoided by more careful spending and by paying our way *in the financial* as we were doing *in the economic*

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tense. Mr. McKenna had said that if there were a condition of inflation a new war loan would be floated regardless of cost, and inasmuch as he did not issue one he must be taken to have held the opinion that there was no inflation, yet he approved of the raising of the bank-rate which was the traditional remedy for such a condition. At this time, too, the Bank of England increased the rate of interest, to 5 per cent, but it was allowing on the surplus funds of the joint-stock banks. These it was presumably using for Ways and Means advances or taking up Treasury bills. Whether this was done at the suggestion of the Chancellor of the Exchequer or whether it was the action of the Bank in its anomalous private capacity is not clear. In either case it was again paying for the use of the money which had originally issued from it as the agent for the Government, and presumably debiting the latter for the imaginary accommodation a second time. The effect of this also was deflationary at the very time when the government was continuously borrowing, and it must have increased the cost of the latter, as did the advance in the bank-rate, although Mr. McKenna went out of his way to say that the latter was no business of his! Following this measure, in July, there was an advance in Treasury bill rates; those for three months being raised to 5½ per cent, those for six months to 6 per cent and yearlings 6 per cent, the nine months⁵ bill being dropped. On the 27th September the rate was fixed at 6½ per cent for all maturities and it was maintained at that figure until the end of the year. At the same time 6 per cent three-year Exchequer bonds displaced those previously issued at 5 per cent, and so our financial policy kept adding to what may well be called our redundant war charges. Were it not for their essentially recondite nature, some of the proceedings of the Chancellors and of the 'Old Lady of Threadneedle Street'⁵ might almost have led us to wonder, saving their reverences, whether the one were not in his nonage in regard

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to such matters and the other in her dotage. But we ought perhaps to assume that

*Plutus himself,
That knows the tinct and multiplying medicine,
Hath not in Nature's mystery more science.*

Has it not been truly said that 'Mystery constitutes the essence of worship'?

After nearly two and a half years of groping, muddling and waste at enormous cost in blood and treasure, the nation was at last to begin in earnest to organize all its resources for the mortal struggle in which it was engaged. Under more energetic leadership, less trammelled by respect for precedents derived from wholly different times and conditions, many important changes that were long overdue were to be brought about. A policy of 'Get and Do' was to displace that of 'Wait and See'. In December 1916 Mr. Lloyd George succeeded Mr. Asquith as Prime Minister, and in the reconstruction of the administration the Exchequer was assigned to Mr. Bonar Law, together with a seat in the newly created War Cabinet of five and the appointment of Leader of the House of Commons, an innovation designed to free the First Minister of the Crown from attendance at its debates so that he might devote himself more fully to the direction of affairs of the most urgent importance outside. Whether or not it had by then become impracticable to introduce any fundamental change in the methods of financing the war, none was in fact made, nor was there anything in the utterances or actions of the new Chancellor to indicate any feeling on his part that they were in principle wrong. After a meeting with the bankers in the City on the 5th January 1917, he announced the impending issue of a new war loan which, as explained at another great meeting held at the Guildhall six days later, was to be in two forms—a 5 per cent redeemable 1929-47 at par, to be issued at 95, and a 4 per cent, tax-compounded, 1929-42, to be issued and

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redeemed at par. The continuous offer of Treasury bills and Exchequer bonds was suspended and holders of these and of the 4¹/₂ per cent war loan were given the option to convert them into the new 5 per cents at the rate of £105 5s. 3d. for every £100 of their holdings. The new loan was also to be accepted at its issue price in payment of death duties provided the deceased had held it for six months before his death. In his address at the Guildhall Mr. Bonar Law said: '. . . and if my appeal is made to one class more than any other it is to those who have money in the banks to take it from the banks and lend it direct to the State. . . . We wish not merely for money available in balances now. We wish everyone in this country to look ahead and see to what extent he hopes in the near future to be able to get money to give to the country. For that reason I have been in communication with the banks and I am authorized by them to say, with the Bank of England supporting them, that every facility will be given to every customer to take loans from the banks in order to subscribe to this Loan.'⁵ Here we see the strange process which we have before criticized again at work. It might have seemed very good of the banks to offer their assistance in that way, but it was extremely profitable to them to do so.

Another illustration of the imperfect appreciation of the nature of money and financial transactions is afforded by an article on the new war loan in *The Times* of the same date, which contained these words: 'It was believed in some quarters in the City yesterday that the Bank-rate might after all be reduced from its present level of 6 per cent. If this should prove to be the case it would undoubtedly facilitate the issue of the new Loan. It would tend to raise investment values generally and thus increase the resources available for subscription to the new Loan. A reduction in the Bank-rate would also facilitate the arrangements by which the banks will lend money to customers for subscriptions to the Loan.'⁵

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By reducing the bank-rate, then, one raises investment values and makes it easier for the banks to make advances to their customers for the purpose of taking up war loan and so increases the resources of the Chancellor of the Exchequer.¹ But by what magic does this effect the really important increase, that of supplies for the army, navy, air-force and the civilian population? If these are to be got by such pretty book-keeping alone, why could not our enemies do likewise? One thing it certainly will do is to increase the future claims of the fortunate few on the rest of the community. *The Times* of the 18th January contained the following: 'As regards the precise terms on which facilities for borrowing from the banks are being provided, we can now state them more explicitly. A number of enquiries addressed to us as to whether any "margin" must be put up by the borrowers and whether any "collateral" is required, may be thus answered. The banks generally, we understand, will lend to "approved customers" at i per cent below bank-rate (varying) on the sole security of the stock, up to a 5 per cent margin. That is to say, if a customer wishes to take up £1000 of the Five Per Cent War Loan costing £950 the banks will now lend him £900 at 5 per cent interest on the security of the stock and he must find the balance of £50. If he has not the £50 in cash for the purpose, they will, however, lend him that too if he can give further collateral security for this additional borrowing.'

In his statement on the war loan results which Mr. Bonar Law made in the House of Commons, on the 26th February 1917, he referred to the fact that of the loan issued in 1915 £200,000,000 was subscribed directly by the banks and said it was undesirable to have these large contributions from the banks 'so that the business of the country may be successfully carried on in other directions.' By this it is apparent that he held the mistaken opinion that the banks were thereby deprived

¹ Such profits have no substance. They are mere credit inflation.

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of money which might otherwise be used to assist trade and commerce. 'I am quite sure,' he continued, 'in the circumstances of 1915 it was right that the banks should make such a contribution. Their deposits had largely increased, and I may say, if the necessity had arisen, that I intended myself to make a similar appeal to the banks, and the Committee of the Banks had indeed in advance promised me that they would give that support if it were required.'¹ What would this great country do if the banks had not been willing in such a quandary to support it? Of course their deposits had increased and would go on increasing as long as the Government went on borrowing to spend. The money was created by the Government just the same whether subscriptions to its loans were made by individuals or the banks, but the former were preferred to the latter for another reason than that stated above, namely because it was supposed that they would enforce necessary economy by restricting individual spending power. Inasmuch, however, as the new money came into circulation, and only part of the greater profits made was taken, the desired result was much limited. Resolute taxation, imposed strictly according to capacity to pay, would have been far more effective and would have acted as a stern reminder that the war had really to be paid for by self-denial at once. The loans, on the other hand, provided a good present income together with an assurance that the 'capital invested' would be 'repaid' at a more favourable juncture in the future.

Do we not here see the fortunate little band of investors playing the part of Dr. Walter Leaf's country banker, quoted in a previous chapter, without the necessity for a reputation or the expenses of an establishment, having the Government

¹ Was it not remarkable that the banks never seemed to be at a loss to supply the funds whose provision caused so much difficulty and anxiety to the Chancellor of the Exchequer? If he had done a little prospecting he might have discovered the wells himself!

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to finance them, the whole population for their clients and the whole national wealth for their security? Did not a great deal of the new money that was constantly put into circulation stick to the fingers of the profiteers and did they not 'patriotically'⁵ and very safely turn a good part of it into these convenient war loans? How else are we to account for the swelling bank deposits and our mounting war indebtedness? In announcing that the war loan had brought in a gross sum of £1,000,321,950, of which only £22,000,000 had been put into the 4 per cent tax-compounded form, Mr. Bonar Law made a comparison between these results and those obtained in Germany where, he said, the amounts raised by loan had become successively smaller. He had also informed us that they had neglected to raise money by taxation. Yet there can be no doubt whatever that at least as full a use of the material resources at their disposal was being made by the Germans as those at our disposal was being made by us. That being so, it is evident that their financial weakness offered no greater impediment to the prosecution of the war than did our boasted strength. That our own system, if somewhat better, was certainly no paragon profitable to imitate, it is one of the purposes of this book to show. The evil in each case was not to be fully revealed until after the Peace.

Mr. McKenna, speaking on the Supplementary Vote of Credit in Committee of Supply on the 5th March, said: 'If this nation can spend on the service of the war over two thousand millions in a year, the very far greater proportion of which is spent inside this country, and *at the same time* can conduct all the necessary production to maintain the civil life of the people and feed and clothe them, does it not show that there must have been a gigantic organization of civil labour under the natural influence of economic forces?' One would gather from this that the war charges alone had amounted to over two thousand millions, but that in reality was the total

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national expenditure. Here, too, we see the usual misleading dichotomy between finance and labour instead of a recognition that finance is merely the book-keeping of human effort, the importance of which consists in *a. just* debiting and crediting, and it was precisely in this last respect that our system went woefully wrong. We venture to suggest that Mr. McKenna might have expressed himself more accurately by saying that goods had been produced and services had been rendered in the course of a single year, almost wholly in this country, of the price-value of over two thousand millions of pounds. As it undeniably suggests a far more effective organization of labour (depleted by the enormous drafts for navy, army and air service) than we are accustomed to see in peacetime, we can only infer that the 'natural influence of economic forces' is then in some way hindered, and it is our conviction that the hindrance is occasioned by bad finance. We may test this by what Mr. Baldwin had to say on the 27th of the same month: 'We are suffering—all the world is suffering—from a most dangerous inflation of prices. You have in the shortage of commodities common to all the world and in the inflated credits [a necessary consequence of the rise in prices] common to nearly all countries, two confluent streams which join forces in a mighty column which will sweep everything before it. The danger point will come after the war.' This was quite prophetic, but the danger came not from the shortage of commodities, which was made good in an astoundingly short space of time, but by the very thing which he goes on to suggest as a remedy: 'Economy in this country, if we are to avoid disaster, will be an absolute necessity, and the only thing we shall have—the one thing which is always the only corrector of extravagances—is high taxation, and we shall have that for many years to help us.' Now, if by economy Mr. Baldwin had understood wise spending, well and good; but he meant a *suspension* of spending which naturally led to a

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curtailment of production, and that spells poverty. If by taxation he had meant to effect a juster distribution it would indeed have been most beneficial, but the taxation which he had in mind was mainly for the payment of interest on the war loans, those monstrous by-products of the national agony whose capital value was later even to be artificially increased! Taxation with such an object was an extremely dubious form of help.

V

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The bank-rate had been reduced on the 8th January from 6 to 5[^] per cent, and on the 26th February the rate of interest allowed by the Bank of England on three-day deposits by the joint-stock banks was reduced from 5 to 4½ per cent. On the 30th March tenders were again invited for Treasury bills, and in the following month there was a fresh issue at par of 5 per cent Exchequer bonds redeemable in 1922, or at the option of the purchaser in 1919, with a right to convert them into any new war loan. On the 5th April the bank-rate was further reduced to 5 per cent. When Mr. Bonar Law opened his budget on the 2nd May, he began his speech with these words: 'In each succeeding year of the War the British Chancellor of the Exchequer has had imposed on him the duty of presenting a financial statement on a scale that has never before been heard of or dreamed of in any country in the previous period.'⁵ His predecessors and their colleagues had similarly dwelt upon the colossal and unprecedented sums required on almost every occasion that money was to be voted or accounted for since the war began. Almost all the superlatives had served their turn many times over, being rather wasted in the early days in view of the figures which were afterwards reached! Well had it been if those who used them had discovered a truer understanding of what those figures stood for, a fuller grasp of the task they had undertaken and some realization of the badness of the methods hitherto

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employed, instead of tamely following in the track of their forerunners, uttering the while platitudes whose constant repetition made the weary listener forget what significance they may have had. Mr. Bonar Law's next sentence reveals the shallowness of the traditional view that he held. 'These gigantic figures are not the subject of rejoicing, though there is ground for thankfulness that we are able to bear the financial strain that is laid upon us.' The financial strain! The real strain at home lay in the provision of trained men and materials for the war, in addition to the ordinary requirements of civil life which it was necessary to reduce to the minimum. When one reflects that if all the costs were doubled, as we may say they had been since July 1914, the amount to be raised would also have to be doubled in relation to the material effort they referred to, one sees that the figures of the budget do not even furnish us with a trustworthy index of that effort. Mr. Leif Jones truly remarked, during the Second Reading of the Finance Bill, 'The right hon. Gentleman, in his Budget speech, attributed the great increase in the estimate of expenditure for the year to the continued upward trend of prices, and he spoke as if in that upward trend of prices he was the victim of misfortune. But he and the Government are in some degree the authors of their own misfortune [*and, alas, of their country's!*] because by their method of raising money, as by their methods of expenditure they are continually raising the prices against themselves. The rise in prices, which is going on steadily, is due in my judgment in no small degree to the extravagant spending by the Government of this country.... And the fact that, instead of paying for all these commodities and services out of taxation, they pay for them very largely out of borrowed money, is another reason for the rise in prices.'

Mr. Bonar Law announced that the actual expenditure for the past financial year amounted to £2,198,113,000 while the

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receipts were £573,428,000, 'leaving to be raised by loan a sum of £1,624,685,000'. What a monotonous sameness there was about those war budgets and the manner in which their problems were handled! He thought it was satisfactory that we were raising by taxation as much as 26 per cent, but as Mr. Leif Jones pointed out, of the war expenditure alone only about 19 per cent came out of taxation, which made a very poor showing when compared with the 47 per cent of the Napoleonic and Crimean Wars. 'The right hon. Gentleman', he very truly said, 'does not escape having to raise this money because he borrows it instead of raising it by taxation. He has still in the course of this financial year to get from somewhere £2,290,000,000, and probably more.' One might have taken these shrewd observations as an indication that he who made them was a thoroughgoing reformer who realized that internal public borrowing was *in principle* wrong. Unfortunately it was again only the *scale* that was attacked, and the same speaker actually thought that too much was being taken by the Excess Profits Duty, to the future prejudice of industry, and had much to say in defence of the outrageous shipping profits which were among the chief causes of the increase in prices generally. His speech nevertheless contained some excellent passages.

In the course of his budget exposition, Mr. Bonar Law said: 'There is an amount of £72,750,000, which comes from War Savings Certificates and in my judgment there is nothing in connection with the financing of the War which is so satisfactory as the way in which men of small means have contributed to the expense of the War through this medium.' He said that from the time they were first offered, on the 22nd February 1916, to the 31st December these certificates had yielded a sum of £54,664,000, while the total thus subscribed in the four months from the 1st January to the end of April 1917 was nearly £46,000,000. These no doubt were very valuable

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as representing genuine self-denial whereas a great part of the larger subscriptions to war loan did not. ' There is another aspect of this question in which I am sure the House will take the deepest interest, and that is the National Debt. The debt was increased last year by £1,714,000,000 (net). It stood at 31st March at the sum of £3,854,000,000; but from that, in estimating what our position on a peace basis will be when the War is over, we are entitled to deduct the advances to our Allies and the Dominions. My right hon. Friend last year gave in my judgment quite correctly this standard of our financial position, that at the end of each financial year we should be able to show a surplus of revenue, not including the duties which will come to an end when the War closes, which will provide us with the amount necessary to carry on the service of the country, including a reasonable provision for the paying off of the debt which has been incurred. I have had the balance sheet examined from that point of view, and this is the result. Our total income is £573,428,000. If you deduct Excess Profits Duty and other non-recurring revenue, and interest from the Dominions and Allies, the amount of which is roughly £157,000,000, there is left a total revenue of £416,108,000. The pre-war expenditure, without debt charges, was approximately £173,000,000. If you add—and it will not be less for pensions and education—the amount of £30,000,000, and if you take the debt charge at the rate of 5i per cent, which would pay it off in from forty-two to forty-three years, at the amount of £153,700,000, on this basis, at the end of last year there was a balance in our favour of upwards of £59,000,000.' Truly this is inspiring finance! It not only rashly assumes a reversion to the pre-war price level, but envisages no increase in pensions, education or other public services; the one thing of importance apparently being the honouring of our so-called debt obligations! Nothing was allowed for the scaling down of the debts of our

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allies to us, which, as we now know, was to be very considerable.

When the whole nation was putting all its energies into the common task, what particular section thereof, are we to suppose, was rendering services of such transcendent value and was making such disproportionate sacrifices as compared with the rest that the country should feel bound to acknowledge a special obligation to it so colossal and continuously growing as this National Debt? Why, of course, it must be our sailors, soldiers and airmen, one would say, but such a guess, however natural, would be very wide of the mark. What meagre provision was made for them was mixed up with education in the first-mentioned amount of £30,000,000. The other, more than five times larger, was for some *corps d'elite* who *served* at home! Imagine what a blessing such a fund as the war debt was to the war profiteers. But for that, how would they have been able to store up their wealth securely and at the same time gain a good interest on it? One of the effects of the Government's borrowing policy was to increase the rates of interest all round and that was most convenient for these newly made fortunes, which it was not proposed to expose to the ordinary risks of trade when the golden period of the war had come to an end. In the same speech from which we have been quoting, Mr. Bonar Law said: 'There is a school of thought which desires money to be at the lowest possible level; there is another which thinks a low level is bad. There are two grounds for the latter view. One is the economic ground that low money means unreal expansion. [*Of course, we must not regard the huge mass of war "indebtedness" in that light!*] There is no doubt a great deal of force in that view, but under present conditions I am somewhat of a sceptic in regard to it. I quite recognize its force, but there is a check against this inflation in the restrictions which are imposed by the war, and you have got to put

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one advantage or disadvantage against another.⁵ Angels and ministers of grace defend us! Is it not evident that investors will prefer a high level and industrialists a low one? The objection that the latter means unreal expansion is presumably based on the notion that if money is cheap much will be borrowed for purely speculative as opposed to constructive purposes; but surely it is the inflationary effect of a high rate which tempts the lender to venture on that slippery path, while a low one makes him more cautious!

Mr. Bonar Law goes on: 'We realize that if the rate of money had been as low as home conditions would have made it if left to themselves, we should have had an immense saving per year in the rate of interest that we have to pay both now and in the future, and that has to be set against the economic argument [*whatever value that may have*]. But there is another aspect which does not permit of being dealt with in that easy fashion. It has been absolutely necessary that our exchange position should be kept right, and to do that it is also necessary that the rate of money here should be distinctly higher than in any other market in the world. That is essential, for though if we had been compelled to go off a gold standard¹ some other method would have been found of doing financial transactions, yet I do not think there is anyone who has given any thought to the matter who does not realize that such a result would have been serious, and possibly fatal, to the whole credit of the Empire.⁵ There are people no doubt, especially among the experts, who still entertain the opinions expressed in this quotation; but, although progress in financial theory is excessively slow, even in face of the remarkable accumulation of experience that we have had since the war, their numbers must by now be sensibly declining. In spite of the views expressed in the pass-

¹ We were in fact off it already and many of the Chancellor's mistakes were clearly due to his failure to realize the fact.

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age just quoted, Mr. Bonar Law began his Chancellorship by reducing the rate of interest, as we have seen, and Mr. Annan Bryce acknowledged this, on the 3rd May, in these terms: 'I do not think the Chancellor of the Exchequer has had sufficient credit from the public for the powerful success which attended the issue of the 5 per cent Loan. It was an immense success, but there were great difficulties in his way which had been created by the issue of 6 per cent Exchequer bonds and by the raising of the bank-rate of interest to 6 per cent in the autumn of last year. I believe the opinion of financial authorities was that neither of these steps was necessary, and certainly the 6 per cent Exchequer bonds was a very unfortunate experiment. *The right hon. Gentleman was pressed by eminent banking authorities in the City to issue his loan at 6 per cent.* He refused, and his patriotic boldness was justified by the immense success of the Loan. It would have been a terrible misfortune for this country if its credit had settled down on a 6 per cent basis.'

'The Committee, I think, will be surprised, and many hon. Members, I am sure, will be disappointed,'⁵ said Mr. Bonar Law, 'when I tell them that I do not propose to add any new taxation whatever, and that I only propose to make additions in the case of three existing Taxes,'⁵ which were the Entertainments Tax, the Tobacco Duty and, most important of all, the Excess Profits Duty, which he valiantly raised to 80 per cent. In the debate on the Second Reading of the Finance Bill on the 24th May, Mr. Snowden said: 'When the Government wanted to borrow a few months ago they had to spend thousands of pounds in newspaper advertisements and in appeals from the hoardings to the patriotism of the people to come to the assistance of the country and lend their money. They had to offer what *The Times* newspaper described as the most attractive combination of patriotism and pocket which had ever been offered to the investing people of this country.'

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When the Government want money they raise the rate of interest from 3 to 4½ per cent and then to 5¼ per cent. When they want life they take it. Now we demand that wealth shall not be treated less [*? more*] considerately than human life, and that when the country wants wealth it shall take that wealth, so long as it pursues the policy of taking human life by compulsion and without compensation.⁵ In his reply, Mr. Bonar Law said: 'I do ask the House to remember this, that no other country could possibly have raised the amount of revenue that we have done. As I said, it is all a question of what is the right proportion. I think I said at the time the loan was being raised that no Government in this country would allow us to be defeated in the war, or to be prevented from prosecuting the war from want of money, if the money was here and could be taken; and if we could not get it in any other way we would conscript it at once if we could get it. I said that then and I say it now, and if the necessity arose I would not hesitate to do it, not for a moment; but when I said it I began to ask myself how I would set about doing it, and I confess that I have not answered that question, and I am not going to answer it in these debates. It must be quite obvious to anybody that if you take away almost the whole of a person's income you cannot expect to borrow money. You cannot do both. I think it was rather hinted to-day that I was just a shadow of my right hon. Friend the late Chancellor of the Exchequer in following his budget. I am not a bit ashamed of it, I really think in this respect he had taken the right course and I am trying to do the same. It is my belief if an attempt were made to raise a much larger sum by a great increase in the Income Tax rates, which has been so much recommended, I am perfectly convinced in my own mind, if we made that attempt and if the war lasts for a considerable time yet, as it well may, we would find it far more difficult than now, and perhaps impossible, to raise the money which we shall re-

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quire for carrying on the war. That is my view.' The simplicity which Mr. Bonar Law displays in this argument would be incredible if his earnestness and integrity were not beyond question.

Whether the people who had command of wealth were ready to yield their proper share of it for the war or not, and Mr. McKenna assured us that they were, neither Mr. Bonar Law nor either of his predecessors made any serious attempt to get it from them by the only just way, namely by taxation. Mr. Bonar Law here expresses his conviction that it could not be so obtained; but, even were there no other grounds for scepticism, how many things that the Government had declared to be impossible were afterwards done with extraordinarily little difficulty! Their hesitancy can only be ascribed to a want of understanding or a want of moral courage, if not of both. Mr. Bonar Law says: 'It must be quite obvious to anybody that if you take away almost the whole of a person's income, you cannot expect to borrow money. You cannot do both.' But you do not need to do either. The real necessity was to deprive those who had private command over goods and services surplus to their absolute requirements of such part of it as was required by the State for the purposes of the war while it lasted. That would not have been a redistribution, however desirable such a thing might be from another standpoint, but merely a partial suspension of the power to exercise those claims upon the community which inhere in accumulated credits. War is not a carnival, it is a life-destroying and a wealth-destroying scourge. In giving their labour and their lives the poor give all they possess; and since the rich without such sacrifice on the part of their less fortunate brethren would be unable to retain their claims to wealth, they should at least be prepared to forgo the exercise of these for a time when property, liberty and life itself are all in jeopardy. Mr. Bonar Law said that no Government of this

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country would allow it to be defeated or prevented from prosecuting the war from want of money if they could find it, and that they would conscript it if necessary. That, of course, would be no more than their plain duty. The men and materials for the war had been obtained at unnecessarily high cost and used very wastefully in the past owing to lack of organization and haphazard methods which were now being progressively improved with great advantage to the country. The financial part of the business, however, was still being mismanaged as badly as ever. The answer to Mr. Bonar Law's observation that 'If you take away almost the whole of a person's income you cannot expect to borrow money' is that borrowing in that case would not be necessary, for the State would thereby obtain the means to pay its way, nor would it be necessary to take the whole of any person's income for that purpose if the burden were equitably distributed. The war was costing the country far more than it ought owing to the gross profiteering that the Government allowed and to its payment for the use of credit. Why should it ever pay for the latter unless it is absurdly contended that the credit of the individual subject is better than that of the State itself? That can never be where adequate taxes are justly and effectively levied. Nay, have we not seen the Government making special arrangements to provide individuals with credit to lend to the State? Could absurdity be carried further than this? In view of such proceedings is there any ground for wonder that our public burdens, present and future, were so heavy? The very extravagance of the Government was providing ample means for heavy taxation, yet they were afraid to impose it!

What precisely did the Chancellor of the Exchequer mean when he talked of money? Mr. McKenna said in the debate on the Supplementary Vote of Credit on the 30th October 1917: 'But the point for the moment on which I wish to lay

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emphasis is that in this consideration I think we attach too much importance to money terms and we do not sufficiently look behind at what the money means. We never make that mistake when we go into the country and address war savings meetings and advise the people to economize. We explain to the people quite simply that money only represents the value of goods and services which the people purchase; and, as there is a limit to the goods and services which the nation can produce, if the private individual uses up those goods and services himself, there being only a limited amount, there will be so much less for the service of the war. Our argument is absolutely complete and unanswerable. We always direct the attention of the audience to the goods and services as the real matter about which we have got to be anxious, and not really about the money.⁵ That is very true and is exactly what we have been insisting upon. The Government might raise an indefinite amount of money, but, even if every penny of it were backed with gold, it would be futile if the things we really needed were unobtainable. The piling up of war loans did not produce these but were only to bring forth a crop of new difficulties. Any private individual who can deposit the right kind of security can always obtain a temporary advance for a sound purpose from his banker providing the latter has what he deems to be a sufficiency of liquid cash in proportion to his liabilities and a Government loan satisfies all these requirements at once, since it provides the best kind of security, which is also easily turned into cash, the best kind of investment, and, through the spending of the money, liquid resources for the banks as well. The Government itself is the fountain-head of credit, to which, as we have seen, the Bank of England must always in cases of emergency appeal for authority to turn on the stream. Its loans no less than its issues of currency increase the amount available. Mr. Frederick Hyde, Managing Director of the Midland Bank, made the following statement

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in his evidence before the Macmillan Committee: 'At certain seasons of the year money comes out of the Bank of England by reason of the Government's borrowings, or possibly by the Bank of England entering into certain transactions, which put more money into the market. That money when it comes into the market increases our cash.' Exactly the same happened when the Government issued its own notes or obtained a credit entry in the books of the Bank of England on Ways and Means account, and it is our opinion that the latter ought always to be obtainable without cost beyond administrative expenses.

It is our contention that, except for the comparatively small and temporary indebtedness which must often be incurred during the execution of works for the public, the only justifiable national debt is that incurred externally. The latter during the war presented a more genuine difficulty to the Chancellor of the Exchequer and the most sensible measure taken to deal with it was the mobilization of dollar securities, already touched upon, and the preposterous opposition that it met with on the part of certain individuals was rightly brushed aside or ignored. Although of great value, however, this was not an illimitable resource. The enforced reduction in our export trade and the approaching exhaustion of the acceptable collateral security which we had ready to offer for foreign loans was making the financing of our inflated foreign purchases more and more difficult, though by no means sufficient advantage was taken of the colossal latent wealth which we controlled in all parts of the world, and the fact that it was almost as much the interest of those whose products we required to supply them as it was ours to purchase them. We offered overwhelmingly the most important and the most accessible market for them when the next most important was closed, and of our ultimate ability to pay there could be no reasonable doubt. On the 6th April 1917 the

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President of the United States (Woodrow Wilson) had signed a proclamation formally declaring the existence of a state of war between his country and Germany, though the inevitable step to include Austria was rather pedantically deferred till the 7th December following.

Although preparations were immediately started and energetically pursued to organize the nation for that object, it was a long time before the Americans were in a condition to participate in the actual fighting, but their inclusion among the belligerents brought immediate relief to our Treasury which had hitherto financed the external purchases not only of the British Empire but to a very considerable extent of her Allies also. This had been done on the customary lines of purely commercial transactions, that is by the export of goods, the rendering of services, the shipment of bullion, the sale of bonds and shares and by loans raised abroad on first-class security. *Moody's Investment Survey*, Vol. 24, No. 100, issued from New York on the 15th December 1932, which was devoted to an admirable examination of the entire international war debt problem, equally distinguished by comprehensiveness, conciseness, lucidity and fairness, states the position thus: 'War debts owing to this country [*the U.S.A.*] did not exist prior to our entry into the war on April 6th, 1917. During the thirty-two months of war prior to that date the Allies attempted to confine their war purchases to their own countries or dependencies. Such outside purchases as were necessary, for instance from this country, were financed partly by shipments of gold (of which only about one billion was available), partly through borrowing from private investors in neutral markets and partly through resale to us of American securities owned by British, French and other foreign investors. It is estimated that such resales of securities prior to April 6th, 1917 amounted to about two billion (i.e. \$2,000,000,000) and that eventually they reached the sum of

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about four billion dollars.¹ In the same period the Allies borrowed from *private* interests in the United States (partly on British security collateral) about two billion dollars and an additional billion from other neutrals.

'After our entry into the war, the Allies could probably have raised substantial sums, needed for purchases here, from American banks and private investors, much in the same way as the U.S. Treasury obtained its own funds through the sale of Liberty bonds. It was, however, mutually decided that it would be more practical to centralize all borrowing in the hands of the U.S. Treasury. In this way the factor of competition for funds would be eliminated and larger sums could be raised at more reasonable rates of interest.

'Under the Act of Congress of April 24th, 1917, and subsequent similar acts, the Secretary of the Treasury was authorized to establish credits in favour of foreign governments engaged in war with enemies of the United States, and to the extent of these credits to make advances to such governments through the purchase at par of their obligations. The total of such advances, extended largely at the rate of interest of 5 per cent per annum, had amounted to \$7,296,000,000 up to November 30th, 1918, and to an additional \$2,170,000,000, thereafter, to November 1st, 1920, a total of \$9,466,000,000. The maximum finally authorized by Congress was ten billion.⁵

In his budget speech Mr. Bonar Law stated that we had already made advances to our allies amounting to £828,000,000 and to our Dominions £142,000,000 and, in anticipation of American assistance, he had put in the estimate a sum of £400,000,000 for this purpose, which was £150,000,000 less than the previous year. By the end of the following October the total actually advanced had reached £1,192,500,000.

¹ The British Government sold in New York American securities of the value of \$888,070,000 (£177,614,000).

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On the 19th June the interest allowed by the Bank of England on deposits by the joint-stock banks was reduced to 4 per cent, and from the same date three and six months' Treasury bills were again offered at the fixed rate of $\frac{1}{2}$ per cent discount, which was increased to 4! per cent on the 3rd July. On the 22nd September the issue of the 5 per cent Exchequer bonds redeemable in 1922, or at the option of the purchaser in 1919, was stopped, and on the 2nd October a new issue described as National War bonds was offered at par, redeemable in five, seven and ten years at premiums of 2, 3 and 5 per cent respectively. There was also an issue of 4 per cent 'Income-Tax compounded'⁵ bonds at par. In an article on 'Banks and War Finance' which appeared in *The Times* of the 19th July 1917 it was said: 'The reason which prompted bankers to maintain deposit rates was that the issue of the War Loan made such heavy inroads on deposits that they decided to refrain from taking any action which might tend to limit the rate of the return of deposits. This attitude of the bankers was facilitated by the special deposit arrangement with the Bank of England. The rate allowed by the Bank to the clearing banks was $\frac{1}{2}$ per cent down to June 19, when it was lowered to 4 per cent. Thus for the greater part of the period the banks were always in the position of obtaining $\frac{1}{2}$ per cent more than they allowed on deposits on those balances which could not be employed on better terms elsewhere. This special deposit arrangement had the effect of stereotyping money market conditions, for the $4\frac{1}{2}$ per cent rate fixed a level below which the banks naturally declined to lend. In fact, in consequence of this arrangement the balances of the clearing banks employed in the market have considerably diminished within the past year. In spite of the fact that the special deposit rate was lowered on June 19 to 4 per cent the banks continued to maintain their deposit rate at that figure.'

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'The wisdom of maintaining deposit rates in spite of the lower rates at which money could be employed in the market is proved by the astonishingly rapid recovery which has occurred in deposits. Over a thousand millions of new money was subscribed to the Victory Loan and yet the deposits of the London City and Midland Bank were actually £5,496,525 larger on June 30 than on December 31; the London and South-Western deposits are also about £300,000 larger. Barclay's show a decrease of only about 2¼ millions and the London Joint Stock's a decrease of little more than one million. As compared with the figures at June 30, 1916 the deposits in nearly every case are substantially higher.' These figures were surely not surprising. The lending of money by the joint-stock banks to the Bank of England was, as we have already observed, *deflationary*, and not only a corresponding reduction in the active balances but a yet greater falling off in the advances, and consequently in the deposits, of the former was a natural consequence. Public borrowing, being on the contrary *inflationary*, as naturally had the opposite effect. It would surely have been very extraordinary if the thousand million or more subscribed to the Victory Loan had not caused great increases in the bank deposits as it came to be spent. These would probably have resulted even if it were money previously existing, since such issues lead to demands for more currency, and so tend to increase the liquid basis of bank credit, but this was all *new* money, the 5 per cent War Loan having realized a *gross* total (i.e. including conversions) of £2,069,845,000 and the 4 per cent, tax-compounded, £52,418,250. The article from which we have quoted opened thus: 'Since the war began the history of banking has been the history of war finance. With unlimited opportunities for the remunerative employment of money, the banker's chief problem has not been the making of profits, for they could be earned almost automatically, but the manufacture of credit

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rapidly enough to meet the needs of the Government.' That is very true, and the surprising thing is that the Government should have failed to do this for itself. The bankers took credit for having responded to the Government's request for their support, but such a request was really in the nature of a favour as it enabled them to lend more and more at interest beyond their customary ratio, and, as in such circumstances this involved no risk whatever and was soon corrected, it was quite absurd to speak of the strain to which it put the banks. The article in *The Times* went on to say: 'And the past half-year has not differed from its predecessors in this respect, except that the rise in war expenditure has accentuated the already enormous task of providing the sinews of war. As the result of the inflation which the exigencies of war finance has rendered inevitable, gross profits in the first six months of the year were probably on a larger scale than they have ever been, but the increase in most cases was largely, but not entirely, offset by increased working expenses, and to a less extent by provision for investment depreciation.' The very large additions which were undoubtedly made to the hidden reserves of the banks were to be badly needed in many cases to meet the heavy losses which mistakes of policy brought them after the war was over.

The Times gave a table setting forth the deposits, cash in hand, advances and investments of fifteen of the leading banks as at the 30th June 1916 and 1917 respectively for comparison, and said: 'These tables show considerable changes. In nearly all cases the deposits are appreciably larger than they were a year ago. But the principal feature is the marked expansion in the advances made by the banks, which indicates the extent to which the "borrowing to lend" policy was resorted to by patriotic people in order to increase their subscriptions to the Victory Loan. These advances, though on an enormous scale in the aggregate, have, we are informed, been

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already redeemed to a surprisingly large extent. This is borne out in the figures given in the report of the Bank of Liverpool, which shows that £9,000,000 of War Loan applications were financed by it, and that by June 30 these advances had been paid off to the extent of nearly one-third, the balance outstanding at that date being £6,346,267. At June 30 the London City and Midland had advances on War Loan outstanding amounting to £22,978,581, but unfortunately very few of the other banks show as a separate item in their accounts the advances outstanding against War Stock. The increase in deposits is reflected in the advances and not in investments, which in the majority of cases are less than they were a year ago.' The increase in deposits was, of course, caused by the new money being spent by the Government, which was likewise reflected in the Clearing House record turnover of £19,121,196,000 that is £3,846,150,000 more than the year before. The rapid paying off of the advances by the banks for investment in war loan was made possible by the large profits that were being made in business, the war loan being in effect a profiteers' accumulation fund. The fact that there was no increase in investments by the banks further indicates that the currency circulating was not in excess of actual needs.

On the Third Reading of the Finance Bill on the 17th July, Mr. Bonar Law said: 'Do not let the House imagine for a moment that the country can go on spending at the rate we are doing without serious disadvantage to the country. What is more, the disadvantage, I fear, will be realized more completely when the war comes to an end than it is realized now. As long as we are raising money by loan and the money is being spent and industry is going on, we are living in a false atmosphere. It is only when that comes to an end that we shall realize what the true position is, and I do not hesitate for a moment to say that it will be a position which will re-

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quire all the skill and wisdom of which this House and the Government, whatever it is which is then in power, can exercise to prevent a very serious situation arising even after we have won victory in the terrible struggle in which we are engaged. But in the meantime what we have to do is to try to finance the war in the way which will do least harm both then and now.' And he unfortunately still held the view which he again expressed thus: 'You cannot try to get a large part of the expenditure necessary for the war out of loans and at the same time tax industry to such an extent that it can hardly go on, and there is no surplus that can be lent. You cannot get both. In my belief nothing would be worse for the country than to lay your taxation upon such an overwhelming basis that every means of carrying on would be taken away altogether.' Again, in moving the Supplementary Vote of Credit, on the 12th December, he said: 'I know there are many people who think that we ought to have got far more of the expenses of the war out of taxation and far less from borrowing. I have not taken that view. I really am convinced that a great majority of Members of this House and a great majority of the people who have given any thought to this matter at all will realize that if you are to raise the immense sums which are required for this war, and if as part of the method by which you raise them a system of loans has got to go on [*That is begging the question. Has it?*]> there must be some limit to the amount of taxation which you attempt to raise. I do not attempt to say—it would be very rash to make such an assumption—that I have hitherto hit the exact mean. But I am convinced that any attempt to pay the whole of it out of taxation or capital levy, or anything else, would break down our financial system, and we should not be able to get the money which is necessary to carry on the war.'

In criticizing the financing of the war we may seem to be continually repeating the same kind of explanations and the

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same kind of illustrations, but when those in authority go on expressing what seem to us to be fallacious doctrines we feel the necessity of stressing what seem to us to be the objections to them, especially when they reappear in a somewhat different form, as they often do. This, however, is hardly necessary when the same views are so often repeated by the same individuals in almost identical terms. It appears that Mr. Bonar Law did at least come to see the error of the view which he had stated with such conviction in his budget speech in these words: ¹It has been absolutely necessary that our exchange position should be kept right, and to do that it is also necessary that the rate of money here should be distinctly higher than in any other market in the world.⁵ That was one of the penalties of the Gold Standard which he seems rather tardily to have discovered that we needed no longer be subject to when that standard had ceased to be effective. The market was quite taken by surprise when on the 27th December the fixed rate of discount for Treasury bills was suddenly reduced by no less than f per cent, that is from 4¾ to 4 per cent. *The Times* of the 29th December 1917 commented on this as follows: 'Although the discount houses yesterday simply followed the example of the banks and decided not to reduce their deposit rates for the present, we take it that next week, and presumably on Wednesday, the matter will be reconsidered and a reduction in both cases adopted in consequence of the lowering of the Treasury bill rates to 4 per cent. The fact that no reduction in deposit rates is made for the present is obviously due merely to a desire to make a fresh start after the New Year. Meanwhile it is accepted on all sides that an important change is involved in our financial policy under the direct lead of the Treasury, which by the lowering of Treasury bill rates to a more marked degree than anyone had recently anticipated, has shown that in the deliberate judgment of the authorities a period of cheaper money is in

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prospect [*the matter indeed lay in their hands*]. A change of policy it undoubtedly is and one which, for our own part, we are glad to see. For, hitherto, though to a far less degree during the past financial year than during 1916, it has been "the authorities" that have been responsible for making money dearer in the London money market than it need have been if the market had been left to itself. And the reason has been perfectly well understood—even if everybody did not agree with its cogency—namely the official view that money rates had to be kept up in order that foreign balances might be retained here. The conclusion may be drawn—and we believe it will be correct to draw it—that this view is no longer operative. Nor is there anything specially obscure in the justification for this change of attitude. In the first place, the expedient recently tried and still to be maintained by the Bank of England of giving a special rate for foreign money to the clearing banks has shown that this is sufficient by itself, without our domestic money rates having to be kept up to the same level [*surely not a very difficult discovery*], particularly now that a special embargo has been put on the sending of money abroad except under licence.⁵

A Select Committee had been appointed by the House of Commons on the 25th July 1917 to enquire into Public Expenditure and make recommendations to secure more effective control over it by Parliament. Their report, issued in the middle of December, contained the following: 'The gradual growth of expenditure on the war is due not only to new services and increased demands but also, in no small degree, to the increase in prices. It may be calculated very roughly that an all-round increase of 10 per cent in wages and in the cost of commodities purchased at home now involves an increase in the national expenditure of about £130,000,000 a year. The chief causes of the increase in prices are:

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'(i) The expansion of credits during the war;

'(2) The demand for commodities exceeding the supply and the inadequacy of Government action to control prices;

'(3) Increase of wages and consequent increases in the cost of production;

'(4) Increase in the rates of profit;

'(5) Unfavourable rates of exchange in some countries from which supplies are imported;

'(6) Some of these are at once effects of the increase of prices and causes of further increases.

'Among the most important of these factors is the expansion of credits. If it had been possible to finance the war from day to day by means entirely of the proceeds of taxation and of loans of money drawn from the savings of the people there can be no doubt that the general increase of prices would have been considerably less than it has been; the result would have been to transfer purchasing power from the hands of individuals to the hands of the Government. But the Government, through the Bank of England and the joint-stock banks, has created large new credits to enable its contractors to expand their production. It has also borrowed from the Bank of England large sums on Ways and Means advances, and in so far as these advances have not been offset by equivalent borrowings from the market on the part of the Bank, which has not always been the case, this operation has been a pure creation of credit.

'The Government has received from time to time considerable sums from the reserves of the joint-stock banks in subscriptions to the newly-created Government securities and these sums have been liberated in the course of Government expenditure. These measures may not in any way affect the stability of our financial institutions, but they have had the result of creating new purchasing power on a large scale. This new purchasing power, distributed over the greater part

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of the nation, in so far as it spends itself in investments in Government loans, does not take the form of additional demands for goods and does not send up prices.⁵

The Times of the 20th December 1917 commented on these observations as follows: 'We must confess that we are inclined to doubt whether most people will understand what the Committee really means when they refer to this "expansion of credits"—strictly it should mean the opposite of paying cash derived from taxes or loans raised from the public—or even whether the Committee themselves have quite sufficiently thought the matter out. We should certainly have liked to have had their recommendations on this subject made clearer by more precise examples of Treasury use of "credits" in financing the war (if they have any clearly before them) than the very general allusions made in the Report to Government creation of "credits to enable its contractors to expand their production" or to the borrowing from the Bank of England "on Ways and Means advances" or to subscriptions to the War Loans "from the reserves of the joint-stock banks". For our own part we have all along been unable to see that these financial transactions have exceeded *mutatis mutandis* the limits which would have been justified in the case of a sound private capitalist or commercial firm in conducting their own financial affairs as prudent business men, and we believe that it would be very difficult to show that the use of such "credits" by the State has directly raised prices.' It seems to us that the Committee's conclusions and these criticisms of them are both only partially correct, and it will be well to pause here to examine the matter with some care. The 'expansion of credits' which the Committee referred to and *The Times* questioned, was the borrowing by Government by Ways and Means advances, Treasury bills, War Expenditure certificates, War Savings certificates, Exchequer bonds, Victory bonds, War Loan, etc., which were all equally

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a fresh creation, or in other words an expansion, of credit except in so far as the amount realized was reduced by the surrender of previous issues in payment of new ones.

The suggestion of *The Times* in regard to the 'expansion of credits' that 'strictly it should mean the opposite of paying cash delved from taxes or loans raised from the public' is not wholly tenable. The 'expansion of credit' certainly could have been kept down by adequate taxation, which in our view is the only sound method, but not by loans raised from the public, as these were themselves in the main inflationary. Whether in all respects the best or not, modern business methods certainly require some expansion of credit for every considerable increase in the volume of production, whatever the nature of the latter may be, and the fresh cash resulting from Government borrowings enabled the joint-stock banks to increase their advances. That is what the Committee must have meant by 'credits to enable its contractors to expand their production'. So far we find no difficulty in following and agreeing with them. But what they meant by Ways and Means advances not being offset by equivalent borrowings from the market on the part of the Bank is not at all clear to us. Unless they were thinking of three-day deposits by the joint-stock banks on which interest was being allowed, when did the Bank of England ever borrow from the market? Ways and Means advances were, of course, far larger in amount and tended on balance to increase, which gave them the effect of permanence, whereas these deposits were not only smaller but of short and uncertain duration.

It was altogether an odd, as well as an expensive proceeding, this very partial attempt to correct inflation, if that was the object in view. When the Committee said 'the Government has received from time to time considerable sums from the reserves of the joint-stock banks in subscriptions to the newly-created Government securities, and these sums have

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been liberated in the course of Government expenditure* they were surely mistaken both as to the source from which these subscriptions came and the effect of the loans to which they contributed. Where was the necessity for the joint-stock banks to raid their reserves to acquire a fresh block of the very same kind of securities that those reserves were mainly invested in? Of what utility could it be either to themselves or to the Government, except to the former when the latter offered a new security bearing a higher rate of interest in direct exchange for an old one bearing a lower rate in part payment of a large new purchase? For themselves to invest in War Loan or to assist their clients to do so, all that was necessary was temporarily to increase the ratio of their advances to their cash, which in the circumstances they could do without running any risk whatever, and the ultimate result was more likely to be the very opposite of that imagined by the Committee, an increase rather than a reduction in the reserves of the banks.

The Committee, we venture to think, were also mistaken in supposing that such Government borrowings were all liberated in the course of the Government's expenditure, resulting in new purchasing power on a large scale distributed over the greater part of the nation. If that had really happened, in addition to the growing mass of national indebtedness we should have had a far greater expansion of the currency issue, but when profits were so high a not inconsiderable part was always saved and reinvested in fresh Government issues, forming the cumulative fund of our 'war indebtedness'. The Committee would have done well to emphasize the inflationary effect of this. Paragraph 20 of their Report reads as follows: 'In the expansion of credit, the issue of paper money, as hitherto practised in this country during the war plays a very subordinate part. If in any degree contractors' accounts had been met, or if the soldiers and sailors had been paid simply

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by using the printing press and issuing fresh supplies of currency for such purposes, the effect would, of course, have been serious. But this has not been done, and is not in contemplation. Notes are not issued in order to make Government payments. They are issued to meet requests from the banks for the currency needs of their customers; their quantity is regulated by these requests, and neither exceeds, nor falls short of them; they have to be paid for by the banks by transfer of securities or in other ways. The amount of currency has largely increased.' Since they accepted the irrefutable Treasury view that it was 'necessary in order to keep pace with the growth of transactions as measured in terms of money⁵ and was 'a consequence not a cause of the increased purchasing power of the community⁵ there is no reason whatever to support the hare which was being continually started in regard to this matter. They said, ' At the outbreak of the war it is estimated to have been, in circulation or in bank reserves, about 222 millions; it is now calculated at about 338 millions, not including such small quantities of gold as may remain in the hands of the public,⁵ and it is to be remembered that there was not only a great increase in the number and size of transactions, but that prices had been practically doubled.

We are unable altogether to accept the Gommittee's view that 'This new purchasing power, distributed over the greater part of the nation, in so far as it spends itself in Government loans does not take the form of additional demands for goods and does not send up prices.⁵ If it had been so widely distributed the harm done would have been much mitigated, because, however high prices had risen, incomes generally would in that case have risen more proportionally. But the new money got concentrated in the hands of a comparatively small section, the section which was greatly profiting by the war; and, instead of being conspicuous as huge additions to the currency would have been, it got hidden away in war

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loan and the enormous sums which were already being paid out in interest must also have tended to increase the demand for goods. It was, generally speaking, only the smaller subscriptions to war loan, particularly in the form of War Savings certificates, which had a restrictive effect on spending. The evil of the rise in prices, which was concealed by the full employment of the population at high wages and by war bonuses on a sliding scale as a temporary corrective, was not to be experienced in its full intensity until after the war, when wages were to be reduced, commercial assets were to suffer heavy depreciation or even become valueless, debts were to be collected and serious unemployment was to reappear.

VI

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As we have before remarked, an increase in the number and volume of sales, either separately or combined, increases the need for currency and credit, which the Government had accordingly provided in the manner shown, at the same time borrowing the money of its own creation at increasing rates of interest. The Chancellor of the Exchequer had declared it to be in his opinion desirable that the latter should be higher in this country than anywhere else, and that it was his considered policy to maintain them accordingly. Thus went on at an accelerated pace the accumulation of fresh claims, mainly in the hands of the war profiteers, which were to bear, whether directly or indirectly, with undue severity upon those who produced the real sinews of war, took the risks of the battlefield, did the fighting and, happily or unhappily, escaped with their shattered lives. The following observations appeared on the financial page of *The Times* of the 31st December 1917: 'The artificial character of the money market under war conditions is apt to obscure the real meaning of fluctuations in money rates. The Government, having reserved to itself the power to be practically the only borrower, is in a position to dictate, within limits, almost any terms it pleases. Consequently money rates no longer respond to an unrestricted law of supply and demand, but merely to the actions of a borrower who fixes his own terms. The reduction in Treasury bill rates ought not, therefore, to

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be regarded as marking any fundamental change in monetary conditions, but simply as a change in the attitude of the Treasury. And its principal effect will be to cheapen the cost of financing the war, so far as that is done by temporary borrowing, and to make more attractive the longer term National War bonds and other fixed interest bearing securities.'

One might infer from this that the Government were mere candidates for as much as they could obtain of a certain fixed quantity of money, and that, instead of taking their proper place in the queue and paying the price determined by a natural law of supply and demand, they arbitrarily took what they wanted at the price they chose to pay. The truth of the matter of course was that being themselves the lawgivers and the creators of the money as well, they ought never to have entered the money market in that way at all. They had at last come to see that their policy, if such groping is to be dignified by that title, of paying such high interest was unnecessary and wrong. Nevertheless, on the 29th December 'the Bank of England announced that it would accept under discount at the rate of 4 per cent per annum British Treasury bills, having not more than six months to run, in payment for application for National War bonds. This is a very attractive offer to holders, since until Monday last these bills were being sold at $4\frac{3}{4}$ per cent discount. Their holders are given an opportunity of making a substantial profit on the bills provided they convert them into National War bonds. Put in another way, holders of the bills in effect can purchase National War bonds at a discount. The object of making this generous offer is, of course, to reduce the amount of Treasury bills outstanding.' The bank-rate, since it was reduced on the 5th April 1917, had remained static and ineffective. The rate allowed by the Bank of England on three-day deposits by the joint-stock banks was reduced from 4 to $3\frac{1}{2}$ per cent on the 14th February

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but the special rate on foreign deposits was maintained at 4½ per cent. On the date last mentioned the rate for three and six months' Treasury bills, which were offered daily, was reduced from 4 to 3½ per cent, showing clearly enough that if the policy was to be continued of paying for public credit, it was at all events quite unnecessary to pay as much as the Government had been doing.

In the course of a speech in support of the War Bonds Campaign delivered at the Aldwych Club on the 26th February, Mr. Bonar Law, after referring to the diminishing subscriptions to the war loan and the overgrowth of the floating debt, which gave a most undesirable appearance of financial instability, went on: 'In finance more than anything else appearance is reality, for credit depends not merely on what things are but on what people think they are, and it was becoming necessary to take steps to meet that situation. The natural thing would have been to raise another loan. I need not say I consulted friends in the City who are best able to advise me [*i.e. the bankers who had pressed him to issue his 5 per cent loan at 6 per cent!*], but the difficulty of raising another loan was this. In the first place the very success of the January loan, which was due to a considerable extent to the fact that people not only gave money which was available but pledged their credit, had caused this result, that even nine months afterwards a large part of the advances made by the banks had not been repaid. It was certain therefore that if a loan were issued it could not be so successful or anything like so successful as the previous loan. One reason was that in January there was a feeling, widely held throughout the country, that there would probably be a Victory Loan—the last loan. It was a hope which I shared myself, and I believe now that but for the collapse of Russia that hope would have been realized. But Russia did collapse and I felt that if we issued a loan, though no doubt it would be successful, it

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would fall far short of the previous loan, and what I dreaded was that it would give an impression, not so much to our people at home who understood, but to our friends abroad and to our enemies, that a smaller loan of this kind meant a slackening of the effort and of the determination of the people to end the war in the only way in which we are determined it shall end.' It is needless to comment on this beyond remarking that it further illustrates the difficulties which the borrowing method creates for the Government.

The Chancellor appealed to the public to buy war bonds, to the heads of the great financial institutions to take them instead of Treasury bills, converting their holdings of the latter into the former as far as possible, and to everybody to save and so invest as much as possible of their bank balances. The object of the former was, of course, to relieve the Treasury of some of the expense, uncertainty and anxiety attending perpetual renewals, while the latter was intended to secure funds in a way that would partially sterilize the fresh spending power which the Government's borrowing policy was continually creating. Observing that it was good for the depositor, as he would get a higher rate of interest from the State than from the banker, Mr. Bonar Law said: 'It is good for them and it is good for the State. The advantage to the banks is not quite so obvious. (Laughter). It would naturally pay them to receive the money from the people at a low rate and to lend it to the State at a high rate. But I am glad to say the bankers are helping in this.' He had given expression to the same views in almost the same language in speeches delivered at the Royal Albert Hall on the 22nd October and at the Free Trade Hall, Manchester, on the 7th November of the previous year. The assistance rendered by the banks, however, cost them nothing, because the fresh money continually issuing from the Treasury found its way into their deposits, on which they paid in the aggregate very little in-

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terest, and enabled them very profitably to increase their advances. The most advantageous system for the banks would not have been that suggested by the Chancellor, but the very one he seems to have regarded as disadvantageous to them, namely, a continuation of loans by them to their clients for investment in war bonds. Since the utmost economy was a vital necessity as long as the war lasted, no greater service could have been performed than to encourage the masses to save, as the War Savings Associations organized by Sir Robert Kindersley and his coadjutors were so effectually doing. The campaign thus opened, and assisted by the 'Business Men's Week' which began on the 4th March, gave a renewed stimulus to the purchase of War Bonds and War Savings Certificates, on which the Government relied throughout 1918.

On moving a new Vote of Credit for £600,000,000 on the 7th March, Mr. Bonar Law informed the House of Commons that 'taking the average daily expenditure of £6,750,000, which is rather more than the average sum during the financial year up to the present time, this sum would last to the end of June.' Our advances to Allies up to the 9th February had amounted to £1,264,000,000 and to the Dominions £180,000,000. Inclusive of such loans, the national debt was expected to reach the figure of £5,900,000,000 by the end of the year. Having dealt with the financial aspect of affairs, Mr. Bonar Law next gave a review of the military situation. Although he anticipated an early attack by the enemy on the Western front, he hardly prepared the House for the terrible ordeal which actually awaited the men in the field. Relieved from danger on the east by the Treaty of Brest-Litovsk, which was signed on the 3rd March, and holding the inner lines, Germany was 'about to take full advantage of the concentration of her powers thus permitted and to throw her whole weight against the recently extended British front, aiming her

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blow particularly against the positions newly taken over from the French. The situation there rapidly became more menacing for us, not the less so because, as events were to prove, this was to be the enemy's final effort for victory. The storm broke on the 21st March and the weeks of bitter struggle which followed, when the desperate attempt to capture Amiens and separate the allied armies was foiled, are a part of the military history of the war. When, on the 22nd April, Mr. Bonar Law introduced what was to be the last budget of the war, though hardly the last war budget, the impression of the fierce German onslaught was not only fresh in everybody's mind but the reality was still in progress, though it had in fact been already broken, and General Foch had in the previous week received his appointment of Commander-in-Chief of the allied armies in France.

These stirring events prepared the House of Commons and the country for the fresh taxation which even Mr. Bonar Law could no longer avoid. He began his speech by acknowledging the financial assistance which the United States had afforded the Allies since she entered the war, informing the House that the total sum advanced was £950,000,000 sterling, £500,000,000 to this country and £450,000,000 to the other allied or, as the Americans preferred to call them, associated nations. At the same time, that is during the previous financial year alone, we ourselves had advanced to the latter £505,000,000. 'But there is something anomalous', he said, 'in this arrangement. It is almost, in a sense, absurd that we should be borrowing with one hand, while we are lending with the other. The result of that is that our accounts are inflated apparently—that, in fact, to that extent our credit is weakened. I have, therefore, been in communication with Mr. McAdoo, the Financial Minister of the United States on this subject, and Mr. Crosbie, the head of the Financial Mission of the United States to Europe, is on the point of

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returning to Washington to consult his Government, and I am making to him certain suggestions as regards advances to the Allies, which, if adopted, will have the effect of lessening to a certain extent our burdens, while in no way increasing the total obligations of the United States. From the way in which not only the United States Government but Mr. McAdoo himself has shown every desire to co-operate both with us and the other Allied Governments, I am sure that he will give these suggestions most sympathetic consideration.⁵

After very briefly reviewing the revenue side of the public accounts for 1917-18 and explaining an arrangement that had been arrived at whereby the Canadian Government were to grant us a credit in dollars to enable us to pay for our purchases in Canada while we were to grant them a credit to enable them to pay for their purchases in Europe, so that exchange operations might be minimized by leaving the balance only to be dealt with, the Chancellor of the Exchequer expressed his acceptance and approval of the rule he had adopted from Mr. McKenna that the revenue should be maintained at a figure which should allow of the payment of interest, and some provision for sinking fund, on the debt without necessitating fresh borrowing or taxation after the war. The national debt, he estimated, would amount to £7,980,000,000 by the end of the financial year, that is the 31st March 1919. 'Previously, in counting over our liabilities,' he said, 'I have deducted altogether the advances to the Allies and to the Dominions. I do not propose to take that course to-day. We cannot ignore what has happened to Russia, though even now I do not admit, and do not believe, that we should regard the debt of Russia as a bad debt, because sooner or later, in spite of what is happening now and whether it should or should not be divided, there will be an ordered government in that country. The natural resources of Russia are great. Those resources can only be exploited

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with the aid of capital, and, whenever there is a government, foreign capital will be required, and they will realize that it will be unobtainable unless previous debts are paid. It is very necessary, I think, in dealing with the national accounts, to treat them in the same way as a business firm would treat its own accounts, and for the time being we must make allowance not only for what is happening in Russia, but for the possibility that at the time the war ends we may not be able to rely on receiving immediately the interest due to us by all our allies.' In framing his estimate he now, therefore, halved the debt due to us from our allies and omitted that from India and the Dominions altogether. He mentioned that the addition to taxation contained in his proposals, estimated to yield £14,000,000, amounted to well over 60 per cent of the total tax revenue before the war, which he had already described as *normal*, a term that has since been fearfully abused. Such comparisons, however, to be of any value must be based on stable criteria, which our money did not afford, especially after the inflation the Government had so largely caused; and why in particular the revenue figure of 1914 should be considered as *normal* is not at all clear. Mr. Bonar Law again made a comparison between the British and German financial positions, from which it appeared that, if all the same items were taken into account, their daily expenditure actually exceeded ours. Yet we had raised nearly three times as much by taxation as they had. If they could obtain so much more by loan than we, with our vastly greater resources, it is surely all the more to be wondered at that we should have experienced so much difficulty in that regard. As to their burden of debt being so much greater than ours while the yield of their taxes was so much less, it made it all the more likely that the enormity of the former would excite indignation and be repudiated. We now know that it was all to be wiped out by the total collapse of their monetary system.

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Proceeding, Mr. Bonar Law proposed that the standard rate of income-tax should at last be raised from 5s. to 6s. in the £ and that the super-tax payable under the graduated scale should be increased up to a maximum of 4s. 6d. in the £ the limit of exemption being reduced from £3000 to £2500 'Every Chancellor of the Exchequer', he said, 'and, I think, almost everyone, is inclined to be tempted by the facility with which revenue can be raised by this tax. I do not think it is right to be too much influenced by that consideration. I think the House of Commons, and hon. Members in every quarter of it, should take into account seriously what is the effect of an income-tax on anything like this scale, not only to the individuals who have to pay it, but on the whole trade and industry of this country. I should have been glad if it had been possible to leave it at 5s., but that is impossible and I propose to increase the rate of income-tax by one shilling and make it 6s. in the £. [Hon. Members: "Hear, hear!" and "Not enough!"]. I hope the exclamations I have just heard reflect the general view of income-tax payers.' It is really preposterous that the Chancellor should have been specially concerned about what he imagined to be the views of a certain class when providing for the common needs of the whole nation. Of course, nobody likes paying taxes, but the money had to be found, and Mr. Bonar Law should have been encouraged to increase them by so many hearty expressions of support. Yet he was all hesitation and apology! There could be no more just tax than this, and by the Chancellor's own testimony it is a particularly easy way of raising revenue. That is a very important consideration which ought in no wise to be ignored or minimized. It is nonsense to talk of the effect it has on the whole trade and industry of the country, for it is no worse in that respect than any other form of taxation; nay, it is better than most by reason of its fairness and the slight interference with business which its collection

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causes. There is no other tax that is easier to understand and to compute. Indirect taxation is particularly hard on the poor because it is not graduated and admits of no reliefs or allowances, and it is not uncommonly taken advantage of by traders to make a disproportionate addition to their prices. In reference to the taxes on income, Mr. McKenna rightly said in his reply: 'My right hon. Friend says quite truly that taxation must not cripple industry. But in the war, while nearly every major industry in the country is controlled, how can taxation injure industry? It is quite true that if you take beyond a certain amount in the way of income-tax you prevent those profits being put to reserve and new capital being built up. With that limitation, the taxation which is taken by way of Income-Tax is taxation which is withdrawn from means of expenditure by the people and it is not injurious to business in time of war, but it is most helpful to the country itself by preventing wasteful expenditure.' Mr. McKenna said he would have been quite willing to see a further addition made to the income-tax and the super-tax. That was quite in the right spirit and one can only lament that he was not animated by it when he himself presided over the Exchequer.

The combined burden of these two taxes at the rates proposed was 6s. 5d. in the £ on an income of £3000 per annum, 7s. 2d. on £5000, 7s. 9d. on £7000, 8s. 4d. on £10,000 and 9s. 3d. on £20,000. That was not an intolerable burden after three and a half years of the most devastating war the world had ever witnessed, and again it is to be remembered that those who were supposed to bear the brunt of this taxation enjoyed at the same time altogether exceptional opportunities for making money. At these rates a man making £5000 a year would have to pay £1791 13s. 4d., which would leave him £3208 6s. 8d. net. If he were to double his income, and a great number were able to do that and much more in those days, he would have to pay £4166 13s. 4d. on his £10,000,

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and that would leave him £5834 6s. 8d., i.e. his original income plus one-sixth, all free of tax, or his original income after deduction of tax plus more than three-quarters. So it was that, in spite of war taxation, many a profiteer enjoyed a far higher net income than he had ever had before. Mr. Bonar Law said: 'There is, however, one thing in connection with the Excess Profits Duty which I propose to do, and that is to stop a leakage which was not intended in the Act. It has been found that in some cases goods which, if sold in the ordinary course, would be liable to Excess Profits tax have been sold either by selling the whole business or in winding it up, and have so escaped,' He was bringing forward a Resolution, he said, to stop that, but it was not to be retrospective. Huge amounts of income which had thus been treated as capital accordingly went scot-free!

Various other taxes were either increased or for the first time imposed, but the total addition to the revenue was estimated at no more than £114,000,000, making a total of £842,050,000, and leaving an estimated deficit two and a half times as great, that is no less than £2,130,147,000 to be obtained by the usual borrowing process! Mr. Bonar Law had a painful sense of the burdens laid on the rich taxpayer, but he might have derived considerable consolation from the reflection that more than 70 per cent of the fresh taxation he was imposing was to be distributed as additional interest among the fortunate owners of the war loan, and they were not chiefly found among the poor! In the ensuing debate on the Budget Resolutions, Mr. Sidney Arnold made an admirably reasoned plea for a capital levy, but it received no serious attention. Mr. Baldwin, then Joint Financial Secretary to the Treasury, said: 'There are one or two things I should very much like to mention respecting the extravagance in the early part of the war, and, having the opportunity, it is very difficult to neglect it. I was not in office at that time. I was engaged in business,

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and had every opportunity of seeing the beginning of an orgy of extravagance, with which it has taken the most serious efforts of the Government of this country for the last two years to grapple. Indeed, it was an open question for some time whether the Government or the extravagance would come out on top.' In winding up the debate on the Third Reading of the Finance Bill, Mr. Bonar Law remarked that no Finance Bill in his time had gone through the House with so little criticism and with such evidence of goodwill from every quarter of the House; but he rightly recognized that it was no proof of the merits of the budget. Far too little interest indeed had been taken by members of Parliament in that most important branch of their duties since the beginning of the war. The general level of the discussions on financial matters was on anything but a high plane of intelligence for men of affairs. They often revealed an extraordinary ignorance of the subject and it was frequently observed how thin was the attendance during their progress. The fact that proper control of expenditure by the Treasury was impossible in the circumstances of that time made it especially important that Parliament should be vigilant to see that the money was created and taxation imposed in a way to prevent any new concentration of wealth.

Mr. Bonar Law said: 'I only claim that it is recognized by everyone that, at all events, we have tried to deal justly with the taxpayer, and, in imposing this immense burden, to spread it fairly over those who are called upon to bear it.'⁵ We do not question the uprightness of his intentions, but we can only say that they did greater credit to his heart than to his head. He went on: 'It is a fact that this budget which has gone through imposes a larger amount of taxation than any budget ever before produced in any country. It has gone through after criticism in Committee stage and on Report with the result that the total changes in the Bill will not make

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a difference of quite £2,000,000 in the amount anticipated at the time I introduced it. I will tell the House exactly why that has happened. It is because the House of Commons in this respect represents the country. Those who are called upon to bear the burden know that it is necessary in the interests of the nation, and they therefore bear it cheerfully. Their representatives in the House of Commons have acted in their name in treating the budget in the same spirit. An additional reason in my opinion why it has gone through so easily is to be found in the fact that every member of the House realizes the position in which, from the military point of view, we stand as a nation; and while they felt that the taxation had to be raised, they also felt that this was not the time to throw any obstacle in the way of the Government getting the money necessary to carry on the war.' Mr. Bonar Law was always apologizing for the taxation he was imposing when it was far less than it ought to have been, always speaking of his endeavours to distribute it fairly while failing to do so, but the worst evil we repeat was the method of creating the money, the effect of which was that the slow and painful efforts that had been made since the latter part of the nineteenth century to effect a juster and more beneficial distribution of claims to wealth was not only reversed, but within a few years there resulted a greater concentration in the hands of a few than there had been in this country perhaps for a century.

In moving the Supplementary Vote of Credit for £700,000,000 on the 1st August 1918, Mr. Bonar Law said: 'We have become accustomed to talk of thousands of millions quite freely and no one's imagination can picture what £1,000,000,000 really means. It is not a question merely of money. It is a question of man-power and labour represented by the expenditure of that money, and perhaps, though it is rather a crude way of putting it, the Committee will be able to form some estimate of what it means when I tell them that

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£1,000,000,000 represents the labour of 10,000,000 men for a whole year.' Precisely, and when those 10,000,000 men have been working for a whole year producing the materials for the nation's need or fighting the nation's battles, why should a small section of that same nation be credited with the value of their labour? If that effect of our wretched system of war finance was not appreciated by Parliament, it is not surprising that its simple victims should be ignorant of it. The profiteering, however, which they did see and feel roused their anger to such a pitch that strikes broke out all over the country, extending even to the police. Luckily our enemies were rapidly approaching exhaustion, otherwise such a state of affairs must have been fraught with much greater danger. Bulgaria capitulated on the 31st September; Austria and Turkey collapsed a month later; and on the 11th November Germany herself was obliged to accept the terms of an armistice dictated by the victorious Allies.

On the day following this great event, the 12th November, another Supplementary Vote of Credit for £700,000,000 was asked for and on that occasion Mr. Bonar Law informed the House of Commons that we had, up to the 19th October, advanced £1,465,000,000 to our allies, namely £568,000,000 to Russia, £425,000,000 to France, £345,000,000 to Italy and £127,000,000 to the smaller states of the Alliance, and £218,500,000 to the Dominions. He said: 'I should have liked very much, if it had been possible, to deal with our general financial position at the end of the financial year on the lines of my budget speech, but more fully than was then possible. But I may point out to the Committee, as far as I can, how the position stands. According to the Budget Estimate the total debt for which we would be responsible at the end of the current financial year, after allowing for the obligations due from our Dominions and Allies and reckoning the latter category at one-half of their full amount was

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£6,856,000,000. If, as we believe, the war is practically now ended, then, of the money which will be spent out of the Vote of Credit which we are now asking, part will be spent on demobilization, which, had the war been going on till the end of the year, would have been war expenditure of a later year. We can now look, therefore, upon that as the limit of the debt for which we are responsible.¹ I believe I am right in saying that the total production of this country, in spite of the millions of men who have been removed from it, is greater than it was before the war. When all this additional labour comes back the production ought to be enormously greater. I think the work will be there and the credit will be there. I do really believe the future prosperity and well-being of the people of this country depend upon the extent to which capital and labour can work together more harmoniously than they did in the past, having as their main object the increased production of this country.'

From the foregoing it would really seem as if Mr. Bonar Law had a glimmering of the fact that it was the fruit of labour that was the material thing and that the financial side was after all only the accounting for it. Of course, it was of very great importance that the latter should be soundly conducted, but while he spoke as if he realized that too, his policy does not give the impression that he understood how it was to be achieved. The well-founded hopes which he expressed were therefore to be frustrated. While the Consolidated Fund Bill was under discussion on the 18th November he said: 'None can have had the handling of this gigantic expenditure without realizing that, however great was the apparent prosperity of the country and however large the production, it was all on an artificial basis, and that it was when the war ended that the real nature of that basis would become apparent. Therefore, it is obviously the duty of anyone responsible

¹ **Too soon, too soon!**

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for the finances of the country to control them as rigorously as they can, and to come back as quickly as possible to the ordinary methods of peace finance.' Mr. Bonar Law is here paying rather a backhanded compliment to himself, for surely the artificiality of the system consisted not in what he described as the *apparent* prosperity wrought by increased production, but in that very borrowing that he so much favoured, the ordinary methods of peace finance consisting in providing for irrecoverable expenditure by taxation. What he and too many other highly placed men have failed to recognize is that while the material prosperity of a country may be made to appear unreal, and can even be seriously retarded by bad accounting or finance, the finest system of the latter ever devised could never alone give us the former, which depends upon useful production *whose fruits are in peacetime made easily accessible to all.*

At the earliest possible moment after the signing of the Armistice, that is on the 25th November, the Government dissolved Parliament and appealed to the country as a coalition, the usually specious arguments in favour of which having much real validity in such extraordinary circumstances. It was fortunate that they were able to secure the co-operation of a number of Labour ministers in spite of resignations. Of all the fine phrases and promises contained in the election manifesto signed by Mr. Lloyd George and Mr. Bonar Law two are of particular interest here. That, namely, ' . . . to bring into being such conditions of living for the inhabitants of the British Isles as will secure plenty and opportunity for all'; and 'Active measures will be taken to secure employment for the workers of the country.' After all the strain and suffering of active warfare, millions of men were looking forward to a new life in that 'land for heroes' which the Prime Minister had promised them. It was to be a testing time for statesmanship, offering alike uncommonly dangerous pitfalls

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for purblind blundering ministers and unparalleled opportunities for those endowed with courage and breadth of vision. The overwhelming majority which was secured by the coalition was a foregone conclusion and they retained and won a considerably greater number of seats than were proportionate to the votes cast for them. The Labour Party, which had wisely decided to separate itself from the Government, nearly quadrupled its vote, but its representation in the House of Commons by sixty-two members, though showing a remarkable increase, was, on the contrary, small out of all proportion to their strength in the country. Nevertheless, owing to the division in the Liberals, they successfully asserted their claim to be the official Opposition, which marked a great advance in their status. Their moderate programme of national reconstruction included 'a just and generous provision for the discharged soldiers and sailors, apart from either charity or the Poor Law, alike in respect of pensions, medical and surgical treatment, reinstatement in civil employment at trade-union rates of wages and complete security against involuntary unemployment.' This surely ought to have been regarded as an obligation of the very first order, binding the whole community irrespective of party. It was nevertheless to be in a large measure evaded. Countless indeed are the men whose youth was sacrificed and constitutions were undermined in the service of their country who have since experienced the bitterness of unemployment and want through no fault of their own.

During the war, when such a large proportion of the national resources in man-power and materials was required for the prosecution of the conflict, it was of course necessary that the Government should exercise a controlling and restraining influence over private activities in many different spheres. One of its measures was the appointment in January 1915 of a Committee of the Treasury with the general duty

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of supervising capital issues so as to put a curb on dispensable peace-time production. With the conclusion of the war the necessity for such restrictions disappeared and nothing was more urgent than to facilitate and promote the resumption of ordinary industry so that the hordes of men who would shortly be returning to civil life might find profitable occupation, and the commodities of which the whole world had been starved since the autumn of 1914 should be supplied as soon as possible. It was indeed a very happy coincidence that at the very time when labour and materials were to be released on such a gigantic scale the need for both should be so intense. It was truly a magnificent opportunity for constructive statesmanship to exploit and set the shattered world on a happier path. The Government was for some time yet to be in need of large sums for the extraordinary expenditure which would naturally attend demobilization and the clearing up of affairs in many different theatres of war. They laboured, however, under the strange but common delusion that money was a necessarily limited quantity and that the more industry obtained the less there would be for the Exchequer! They did not appreciate that, broadly speaking, the one needed money for labour and raw materials while the other needed it for payments which would be used to purchase the manufactured fruits of the former, so that the requisite credit operations, instead of being mutually exclusive, were in fact to a great degree complementary. The first of the many appalling blunders they made, therefore, was to allow only a partial relaxation of the restriction on new issues. But we propose to deal with that in another chapter.

In the new Government, Mr. Bonar Law having been appointed Lord President of the Council and Leader of the House of Commons, control of the Exchequer was taken over by Mr. Austen Chamberlain. The budget which he introduced on the 30th April 1919 revealed an expenditure for the

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past financial year of £2,579,301,000, the daily average up to the date of the Armistice having been £7,443,000, and £6,476,000 since. The actual revenue amounted to £889,021,000 and left a deficiency 'to be made good by borrowing' of £1,690,280,000. Mr. Chamberlain stated that of the total sums expended between the 1st April 1914 and 31st March 1919, no less than 71.51 per cent had been provided by borrowing, that is not of war expenditure alone but of the total for all purposes, and included in this period were eight months of peace! The Chancellor said: 'That is a record which I believe no other belligerent can equal and the sacrifices that it indicates place us in a good position to face our future difficulties.' The sacrifices Mr. Chamberlain was thinking of were those entailed by the small percentage raised by taxation, not the far greater imposed by borrowing; and, instead of placing us in a good position to face our future difficulties, the method pursued largely created and very greatly intensified them. Those who had helped to defeat the enemy abroad were to be saddled for the rest of their lives with the payment of a heavy tribute to that select band of their fellow countrymen at home who had 'patriotically lent' money to the Government in the way we have seen. Certainly the least dangerous form of patriotism was the most profitable! Among those who were to be subjected to this levy there were no doubt many who had worked at home for increased rates of pay which had been no more than sufficient to meet the higher cost of living, but of those who were to benefit there must have been very few indeed who had served with the forces abroad.

'Of the capital debt incurred,' said the Chancellor, 'internal debt accounts for approximately £6,085,000,000 and external debt for approximately £1,350,000,000. A considerable part of the debt is represented by National War bonds payable at a premium, and the premiums on these bonds

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represent a further liability of £51,716,000. Further, the War Savings certificates are allowed for at 15s. 6d. each and, if they are all held for five years, they will be repayable at a £ which would then involve an additional obligation of £65,000,000. Finally, our foreign debt is largely repayable in foreign currency and the sterling equivalent of the debt must necessarily vary according to the state of the exchange at the time when repayment becomes due. Against this large total we hold certain assets. First, there are the obligations of our Allies and Dominions amounting on the 31st March this year to £1,739,000,000. Of that sum £171,000,000 was due by the Dominions and £1,568,000,000 by our Allies. I think the Committee will desire to know how that sum was distributed. Russia owes £568,103,000; France £434,490,000; Italy £412,520,000; Belgium £86,779,000; Serbia £18,643,000 and other Allies £47,915,000. Next to the debt from the Dominions and Allies there is the remaining liability of India in respect of the 5 per cent War Loan, which amounts to about £30,000,000. There are also assets of a substantial character acquired out of Votes of Credit and now no longer required which will be disposed of as opportunity offers. I shall return to that subject later. Finally, there are the payments that we shall receive in respect of indemnity from our enemies. But when every proper allowance is made for these assets, the amount and value of which, as well as the date at which we may expect to receive payment for them, is necessarily uncertain, the burden of debt left to us is still very formidable.' The amount to be provided for interest had now reached £360,000,000.¹ With the realization of certain Vote of Credit assets and the return to the Exchequer of unexpended balances of Appropriations in Aid by the War Office, the Admiralty and the Ministries of Munitions and Shipping, Mr. Chamberlain anticipated a revenue of £1,159,650,000

¹ About twice as much as the total national expenditure before the war!

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and estimated an expenditure of £1,434,910,000 leaving a deficit of £275,260,000. All these figures were naturally little more than guesses, for nobody could tell what Government stores would fetch, what debts might be paid, etc. Allowing for certain contingencies and further demands, he reckoned that the maximum amount of new money that it would be necessary to borrow was £300,000,000, but he pointed out that there were also Treasury bills amounting to £957,000,000 and £455,000,000 of Ways and Means advances, £245,000,000 of Exchequer bonds maturing and £96,000,000 of foreign debt to be paid off, which would altogether entail reborrowing a sum of £1,753,000,000. Mr. Chamberlain increased the duties on beer and spirits, as also on death duties on estates exceeding £15,000, but made no change in the taxes on income. He prematurely reduced the Excess Profits Duty from 80 to 40 per cent, and his budget was notable for the establishment of Imperial Preference and the beginnings of protection in this country. The suggestions for a capital levy which he condemned in unmeasured terms were far more cogently supported by Mr. Sidney Arnold in the debates that followed.

The Treaty of Peace was signed by the German Delegates at Versailles on the 28th June, but it was to take a long time and much agitation to get public expenditure reduced to anything like a peace level. The borrowing which had become a regular habit with the Government had almost inevitably led to extravagance and waste. A fourth series of National War bonds had been issued in the beginning of February, Five per Cents redeemable in five years at 102 or ten years at 105 were issued at par, and Four per Cents (income-tax compounded) redeemable at par in ten years were issued at 101½. War Savings certificates and Treasury bills also continued to bring grist to the mill. The rates for three and six months' bills respectively were 3½ and 4 per cent

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until the 6th October, then 4½ and 5 per cent till the 8th November, on and after which 5½ per cent was allowed on both maturities. At the beginning of June authority of Parliament was obtained for the issue of a new loan to provide for the repayment of any maturing securities issued under the War Loan Acts 1914-18, or of any Treasury bills or Ways and Means advances, plus a sum not to exceed £250,000,000 for supply services of the current financial year. It was issued in two forms: (1) 4 per cent Victory bonds at 85, redeemable at par by annual drawings, for which a cumulative sinking fund was established, and (2) 4 per cent Funding Loan at 80 redeemable at 100 at any time between 1960 and 1990 at the option of the Government. Both were to be accepted at their nominal value (100) in payment of death duties, thus allowing an indefensible rebate on these of no less than 15 per cent in the one case and 20 per cent in the other. It was further announced that the 4½ per cent War Loan 1925-45, 5 per cent Exchequer bonds 1919-20-21-22, 6 per cent Exchequer bonds 1920 and all National War bonds issued before the 1st February last past would be accepted at their par value in exchange for fully paid allotments of the new issues.

At a meeting held at the Guildhall on the 16th June with the object of starting a campaign in favour of these, Mr. Chamberlain said: 'I have received from all the bankers of the United Kingdom whose names appear in the prospectus of the new Government issue permission to state publicly on this occasion that they are willing to make reasonable advances at a rate not exceeding bank-rate, varying, to approved customers to enable the latter to apply for the new stock or bonds.' The rate commonly charged for such accommodation was 4½ per cent, and the banks later guaranteed that even if there should be a rise in the bank-rate their original terms for these advances would remain unaltered until after the last instalments were due in January 1920. It will be convenient

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to mention here a few further particulars in regard to the financial situation. On the 21st March the dollar-sterling exchange which the Government had maintained at \$4.76½ to the £ since 1915, was unpegged, and, after some fluctuation, gradually fell to \$3.76½ to the £. On the 22nd July the Bank of England ceased to allow interest on three-day deposits by the joint-stock banks and early in October the special rate on foreign deposits was finally discontinued. Bank-rate was raised from 5 to 6 per cent on the 6th November, but while it increased the cost of internal borrowing it could no longer exercise any influence on the exchanges. Far from having a deflationary effect, it merely gave an added excuse for the further inflation of prices, and there were many signs that in the upper regions of finance it was not appreciated that the old mechanism would no longer work under the entirely changed conditions. The figures of the London Bankers' Clearing House this year reached £"28,415,382,000 showing an increase of £7,217,870,000, while the deposits of twenty-two British banks, which had been £875,000,000 in 1914, totalled £1,477,000,000 in 1918 and £2,117,000,000 in 1919.

We have now seen how the war was financed by the Government of this country. It was often said that the financial burden was far too great for the generation which had to wage it, and that common justice demanded that part of it should be borne by posterity, who would benefit by the immense exertions that had been made and by the blood that had been shed in defence of their liberties no less than of those who had been engaged in the struggle. This is sheer nonsense and conceals a perversion of that justice to which it makes a specious appeal. If the world continues to pursue some of its present policies, whose effects will also form part of its heritage, our posterity may well have their own share of warfare to wage. The posterity of the war period are already partly

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with us, only too many of them suffering the miseries of unemployment, and they are not at all disposed to be grateful to their predecessors for going to war and making so many sacrifices for them. Certainly we do not seem to have made their path so easy as to deserve much of their gratitude, and we cannot expect them to be deeply affected when we tell them that we have made our own just as hard. Moreover, with the one dubious exception mentioned below, there is no possibility of their lightening the burdens of their forbears. Posterity can no more pay for our past labours or consumption than they can fight our past battles. Except for the much smaller external debt, which was not incurred until the United States came in towards the end of the struggle, and whose settlement has so far baffled us, we paid for the war during its progress, as we were bound to do, by extra work, self-denial and avoidance of waste. During that period a great number of factories that would ordinarily have been turning out all manner of things for our convenience and pleasure were dedicated to the manufacture of arms, munitions and other vital necessities of the moment, besides which not only were all who were capable of any task, young and old of both sexes alike, fully employed, but they worked far more assiduously than in peace-time. At the end of the war, however, they found that during its continuance they had become mysteriously indebted to certain of their fellow countrymen to the tune of several thousands of millions of pounds! How and why was that? Nobody would seriously contend that the creditors had worked harder or made greater sacrifices than the rest. No. The explanation is to be found in the so-called borrowing by the Government, as we hope we have succeeded in proving.

By the 31st March 1920 Great Britain's deadweight debt amounted to £7,828,779,095, more than five-sixths of which was internal! Now, at first sight, that might seem an appalling

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handicap for a nation which is in urgent need of reorganization, re-equipment and reconstruction, but when one reflects that it owed more than five-sixths of the amount to itself the matter wears a very different aspect, and one might very reasonably enquire how, when the debtor and creditor are one, be it individual, corporation or state, the debt can have any real existence at all. Leaving aside mere book-keeping, a single entity cannot really be indebted to itself, cannot at all events be thereby embarrassed; and if ever a nation ought to be regarded as a single entity it must surely be when it is fighting for its collective interests, its honour or its independence. War compels sacrifice and this should as far as possible be borne in just proportion by every one of the subjects of a state engaged in one. It is only right that those who have most material wealth at stake, particularly if not called upon to risk their lives in its defence, should bear a greater share of the expense, and it is evident that any individual whose capital has not been diminished at least proportionately to the national loss of wealth must have evaded or escaped his proper contribution. Those whose capital has increased during the conflict must not only have escaped that part of their duty but must actually have profited by their country's agony. Many, alas, did so greatly during the last war! Those who bore the brunt of it could never have accumulated very much even if the total amounts placed to their credit in their service pay books or at their agents had been left untouched, and a great number of them did not survive to enjoy even the little they had so painfully earned!

A nation may defer payment for its imports from abroad as long and as far as it can obtain sufficient external credit, but not at all for its own productions. The latter may be financed in a way to delude its people into the belief that it is postponing part of the burden, but when the matter is carefully examined it becomes apparent that it is wholly borne by its

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own industry at the time. If the labour and materials were not then forthcoming no amount of financial legerdemain or accounting would be able to supply them or compensate for their lack. This was seen by the writer of No. 16 of the pamphlets on Reconstruction Problems, published by the Government in 1919, *Prices During the War and After*, and well expressed in these words: 'You can pay for a war either by increased productive activity or by rigid economy in consumption. You can throw a burden of interest on posterity, but you cannot make posterity provide the shot and shell, the corn and the cotton that you want. If you cannot increase your production or diminish your civilian consumption sufficiently to meet your war needs posterity cannot see you through.' In this connection it will be profitable to consider, in addition to that already quoted, the following paragraphs of the Report of the Committee on National Debt and Taxation presided over by Lord Golwyn (1927, cmd. 2800¹):

'76. While the internal debt is owed by the nation to some of its citizens, the external debt is owed by the nation as a whole to other countries. Now in the main to the United States of America. The external debt did not, at the time when it was contracted, exhaust any of this country's wealth; instead, the lending countries transferred to us part of their wealth, and we gave them in return a claim on our subsequent production. In consequence our wealth is now being consumed year by year in payment of interest and Sinking Fund, the payment taking the form of an export of goods and services which do not pay for any imports in return.

'77. This is obviously a real and heavy burden to the country as a whole, and is directly attributable to the external debt; it is in quite a different category from the transfer within the country which the internal debt necessitates. The difference must, however, be traced to the fact that the war ex-

¹ See ante, pp. 36-7.

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penditure associated with the external debt laid no burden upon us, as that associated with the internal debt did* In the one case we were using goods and services lent to us by other countries—resources which were of the utmost value in enabling us to finance the war; the transactions did not hurt us at the time, but the debt had afterwards to be repaid. In the other case we were spending our own wealth, and as a community were suffering at once, although the apportionment of the burden is still proceeding.'

The immediate loss, it is true, was due to the expenditure, but the particular method of financing it entailed far more serious losses and other consequences of the most disastrous kind in the future. Instead of being glossed over, it ought therefore to have engaged the special attention of the Committee. Those claims to future goods and services given to the subscribers of the so-called war loans, for the most part in exchange not for their own money but for additional money created by the Government, caused an extremely harmful transfer of wealth within the community for no counter-vailing advantage whatever. The external debt, on the contrary, was created, as the Committee said, by the transfer to this country of a part of the wealth of the lending country, payment for which was deferred, and, since the creditor has not found it convenient to take goods and services in return, our efforts to make it have broken down. The internal debt remains an effective and crippling dislocation of claims arising out of '*spending our own wealth*' when we '*as a community were suffering at once*'. The Committee rightly say that 'the war expenditure associated with the external debt laid no burden upon us as that associated with the internal debt did', and the burden in the latter case, we should remember, was not laid on our internal creditors any more than, if as much as, the rest of the nation. In these circumstances it is strange that the Committee should have taken a

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more serious view of the external debt, than of the internal.

Our methods of financing the war thus enabled those who bore the least worthy part in it to make fortunes out of it. When, on the other hand, the survivors of those who had been engaged in the carnage came home and sought, after terrible years of absence, to re-establish themselves in civil life, they were not only grushed by the weight of taxation, some £360,000,000 of which was annually required to pay *interest* on the *debt* that had been contracted in their name in favour of their more fortunate brethren at home, but they were also confronted by a frantic recrudescence of profiteering. They found decent accommodation almost unobtainable, while the happy owners of houses were able to increase their rent-rolls by several hundreds per cent by charging the former rent of a mansion for a mere cottage, miserable attic or gloomy basement. This could not be justified by the greater cost of repairs and decorations, because the privilege of bearing these was thrust upon the tenant. Many an officer whose nerves had been shattered in the inferno of the trenches had to be content to pay a preposterous rent for three or four tiny rooms in a noisy mews. The Rent Restriction Acts, which were meant to protect the poorer classes, led to an immense amount of litigation and caused at least as much injustice as they afforded relief. They bore very hardly upon people whose small savings had been invested in small properties. They only applied to existing tenancies and in a great number of cases were used as a cloak for shameless profiteering in sub-letting, so that many a humble soldier who hoped to be able to settle down and found a family after serving his country abroad had to pay the rent of a whole house for a single room in it. Freeholds were exceedingly hard to find since the owners could obtain their value by the simple expedient of charging a handsome premium for a mere term of years at an inflated rent with all sorts of unconscionable

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covenants to be fulfilled by the tenant at its expiration. It is no exaggeration to say that this was the rule, not the exception. The increased assessments, too, which aroused the indignation of many a pious profiteer but really fell upon their victims, were the effect not the cause of the inflated values which have ever since weighed with such intolerable hardship upon people of limited means. The ostentatious prodigality and arrogant competition of those who had become rich in the ways indicated tended to maintain the burdens thus created. Premiums were rampant. There were long waiting lists for motor cars largely composed of people who had put their names down not because they wanted the vehicles but that they might sell their priorities to those who did. Typewriters and other necessities were dealt in very much as tickets for the tennis at Wimbledon are every season, but were much less easy to dispense with and accordingly afforded much higher prizes with less risk.

The partial suspension of production of those things that were not required for the prosecution of the war, which became more and more necessary as it proceeded, had naturally created a severe shortage of almost everything that is required in ordinary times, and those who had already made their fortunes out of the war were on the spot at the psychological moment and well provided with capital for the exploitation of this fresh opportunity. The result was that by 1920 prices even in this well-regulated country rose to above three times what they had been in 1913, and, whatever the cost-of-living index may indicate, a comparison say of a man's hosiery bill of to-day with one of twenty years ago would show that many indispensable articles still cost more than double what they did then. Rents are still a scandal notwithstanding a certain decline, absorbing far too large a proportion of small and moderate incomes. There has undoubtedly been inflation, but of a character and origin very different

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from that generally represented. It was not initiated by the printing of bank-notes nor aggravated by our abandonment of the Gold Standard. It began with bad public finance, none the less bad because traditional, and has been appallingly magnified by all the resulting evils of profiteering and speculation in rents, foodstuffs and other material necessities, in currencies and securities. As to passing on some of the burden to posterity, we can rob future generations of part of their birthright by the reckless waste of our national resources, we can injure them by the inculcation of false standards and ideals, by corruption of our blood in worse than the old legal sense, by faulty internal organization, by the bequest of an unjust distribution of rights and obligations; but fortunately we cannot relieve ourselves by shifting any of our present burdens on to their shoulders. That instalment of the posterity of the war period whose presence we are now embarrassed with do indeed seem to be paying and suffering to no small extent for what happened before they put in an appearance amongst us, and it is largely as a plea in their behalf that this book has been written. Their difficulties as well as those of their elders have their origin in the indefensible policy of imposing upon the war's victims and their heirs financial obligations in favour of the war's beneficiaries (strange that there should be any!) and their heirs, obligations arising out of a common national calamity!

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With the Committee of Imperial Defence meeting at regular intervals, it might seem strange that we should have failed to elaborate any plan for the financing of a European war, for the most effective allocation of man-power, or for the radical reorganization of industry to adapt it for the very much greater and very different kind of production that would be required in such a contingency. Our unreadiness at the end of last century, though not yet fully revealed by the report of Lord Elgin's Commission, had become sufficiently evident during the course of the South African Campaign to excite a good deal of critical attention. The costly blunderings of the authorities on that occasion, resulting from previous neglect, together with the beginnings of uneasiness at the trend of German policy, caused a deputation to wait on the Prime Minister on the 5th March 1902 to urge the necessity for an enquiry into the supply of foodstuffs and raw materials in time of war. Mr. Balfour received the suggestion with sympathy, remarking that the Government were not likely to underrate the importance of the subject. He added that it might also suggest lines of action which would mitigate what he regarded as the greatest evil which they had to fear, namely the rapid rise of prices certain to follow on the outbreak of war, but he thought we should do ill to establish a Government machinery which would hinder the natural commercial machinery with which

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this country was supplied. That was the *laissez-faire* attitude, dear to the money-makers of the nineteenth century, which now finds but few advocates even in the affairs of peace and has become extremely dangerous in those of war.

The possibility of this country being drawn into a war on the Continent after the renunciation of our former policy of Splendid Isolation was of course foreseen, and from that time the portents became almost daily more ominous. Provision was accordingly made for the despatch across the Channel of an Expeditionary Force in case of such a development, but its organization and equipment were more suitable for those colonial operations to which our experience had by then been so long confined. Of the magnitude, duration and very different nature of the struggle to which such a measure would be no more than the prelude, our authorities seem to have had a most inadequate idea. Whatever strategic plans may have been worked out, there were none at all for the continuous supply and financing of the enormous material requirements of the years of highly mechanical warfare that lay ahead of us. When suddenly faced by the crisis the Government had therefore to improvise as well as they could, and a great deal had to be done in a very short time. In those circumstances they could not do otherwise than proceed by rule of thumb, but inasmuch as we only got through by a miracle, and have ever since suffered terribly for our muddling, ought we not to review the methods that were then developed, consider their effects and apply our past experience in the preparation of a comprehensive scheme for immediate adoption in the event of a similar emergency arising in the future? In 1927 a law was passed in France empowering the Government in the event of war to mobilize the entire population, to take over private property, and apply both to the needs of the State. That is a law which must appeal to every honest patriot and ought especially to commend itself to pacifists as

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well as all true believers in democracy, for it would deprive war of any attraction for those who might otherwise hope to profit by it and would spread its burdens more equally in case it should prove to be unavoidable.

As a result of the representations of the above-mentioned deputation, the Royal Commission on the Supply of Food and Raw Materials in Time of War were appointed on the 27th April 1903, under the chairmanship of Lord Balfour of Burleigh, and they concluded their labours in the course of 1905. Their report was complicated by an unusually large number of separate reservations. The suggestions of an influential section of the commissioners that arrangements ought to be made for the storage in this country of larger reserves of grain was dismissed by the majority as being disadvantageous and unnecessary as long as we maintained a strong fleet. Attention was more particularly directed to the problems of maritime transport, and among the economic influences which they apprehended might tend to produce the effect which Mr. Balfour foresaw were: '(1) An increase in general freights other than that caused by the necessity for heavy rates of insurance, (2) insurance of the vessel against war risk, (3) insurance of the cargo against war risk, the insurance of the vessel and cargo against ordinary marine risks being assumed to remain unaffected, and (4) in addition there would also be a rise due to the influence of a deficient supply, if appreciable in amount, upon market price.' They further contemplated the possibility of what they called a psychological rise which they anticipated might be caused by panic owing to uncertainty, but the event fortunately proved that the country was to be immune from that. Their report contains the following expressions of opinion: '(149) A rise in prices under apprehension of a maritime war, and still more on the outbreak of hostilities, seems to us, not only possible or probable but, at any rate for a time, practically

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certain. (162) Another consideration which we have thought it necessary to take into account is that those who had goods to sell might hold them in hopes of a further rise in price and thus cause an artificial shortage of supply.¹ (253) We do not therefore apprehend that any situation is likely to arise in which there would be a risk of the actual starvation of our population into submission. But we do regard with much concern the effect of war upon prices, and especially therefore on the conditions of the poorer classes; for they will be the first to feel the pinch, and it is on them that the strain of increased prices would chiefly fall. We do not, however, look with any great alarm on the effect of war upon prices, so far as concerns what we have referred to as the economic rise in prices, i.e. the increase likely to be produced by the enhanced cost of transport and insurance in time of war. We consider that the addition to the price of commodities under this head will be covered by a moderate percentage on their ordinary cost, and we believe that even this moderate increase might to a large extent be obviated by the adoption of a scheme of national indemnity.'

Mr. (afterwards Lord) Runciman, who spoke from the point of view of the owners of 'tramp' steamers, said that in case of war with a Continental Power he did not expect any general laying up of steamers of this class, but he did anticipate a great rise in the price of freights. Mr. Henry Wilding (of the Leyland, Dominion and American Lines) held that the sailings of their ships in time of war might become irregular but would not have to be discontinued unless the rates of insurance became so heavy, and cost of freight were so much increased in consequence, that the demand would be killed. In expressing this view he explained that it must be considered as subject to the British Navy retaining command of

¹ This possibility was provided for by 'The Unreasonable Withholding of Food Supplies Act, 1914'.

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the sea, though even in this case he thought that some captures would inevitably take place. Sir John Hopkins was also of the opinion that the prices of our supplies would be greatly increased in war and gave as his reason that they would be tremendously driven up by the advance in insurance and freightage. In one of the supplementary reports the following conclusions were recorded: '(i) That the rise in prices in such a war as we refer to is certain to be great, and in some contingencies, which are far from impossible, it may be immense; (2) that for how long or for how short a period the rise may be continued, no one can pretend with any confidence to foretell, and (3) that to leave out of account in dealing with this question the great possibility, if not indeed the certainty, of such a rise, would involve a very grave responsibility which we at least could not consent to take upon ourselves.' The Government, therefore, had ample warning of the likelihood and danger of a great rise in prices; but of the various predisposing causes reviewed they made preparation to meet only one. That certainly appeared to be generally regarded as the most important, but they were to learn that the public protection of shipowners from the most serious risks of war would not suffice to guarantee the public against high freights and the evils issuing therefrom.

In 1908 a Treasury Committee, under the chairmanship of Mr. Austen Chamberlain, which had been appointed to consider the alternative recommendations of the Commissioners, rejected both the schemes of national indemnity and of State insurance, partly because of the apparent impossibility of estimating the gross liability that they would entail and of guarding against fraudulent claims, partly because some of the principal underwriters were of opinion that the market would be equal to the special strain without Government assistance. The congenial conclusion was therefore reached that nothing needed to be done. It seems that neither the

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underwriters nor the Treasury Committee realized what a serious menace to shipping the submarine offered. Meanwhile, however, certain developments had been taking place which moved the Government to reconsider the suggestion of State insurance. The insurance of British ships against war risks, as far as the hulls were concerned, had recently passed from the underwriters into the hands of mutual insurance associations or clubs. Of the total steamer tonnage of the United Kingdom engaged in foreign trade, which was valued in 1911 at £127,000,000, some £30,000,000 was covered by the North of England Protecting and Indemnity Association, some £27,000,000 by the London group of War Risks Associations and some £30,000,000 by the London and Liverpool War Risks Insurance Association, leaving a balance of shipping valued at about £40,000,000 apparently uninsured against war risks apart from any funds that may have been set aside by the owners themselves for that purpose. So there was now in existence an effective machinery for the control of values and the settlement of claims which it would be easy for the Government to support. These associations or clubs fully covered the risks of war only so long as this country was neutral, being strictly limited in a war to which it was a party. In the latter case vessels actually at sea or in an enemy port on the declaration of war or the outbreak of hostilities were held to be covered until the time of first arrival at a British port or a neutral port which was a safe place for the ship to lie in. The period of cover while in such a safe port varied. Every vessel was deemed to be already insured against all perils covered by an ordinary marine insurance policy and must continually sail under the British flag. Therefore all British ships, of which their owners were not prepared to run the risk of total loss without compensation in case of this country being involved in war, would have to seek safety in port as quickly as possible, and it might be expected that the

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high seas would soon be almost cleared of them. That would obviously be fatal to national as well as to private interests.

A scheme for the insurance of British ships and of cargoes carried in them was accordingly prepared by a sub-committee of the Committee of Imperial Defence on the 7th May 1913, and adopted by the Government. This was based on the co-operation of the associations or clubs, which had been previously consulted. It was arranged that they should issue policies as original insurers to cover King's enemy risks on all voyages current at the outbreak of war up to the safe arrival of the vessel at her original port of destination and for ten clear days thereafter, and on these no part of the premiums was to go to the State. Similar policies were to be issued in respect of voyages undertaken after the outbreak of war at rates of premium to be quoted from time to time, which were never to exceed 5 per cent or be less than 1 per cent, and the State undertook by way of reinsurance 80 per cent of all such risks, on condition that Government orders were obeyed as to the movements of the ship, which was also required to be insured in the ordinary way against all ordinary marine risks. In case of total loss the value of the ship was to be taken as its first cost less 4 per cent, with a minimum of 30s. per gross registered ton. Cargoes were also to be insurable under similar conditions, if carried by a ship thus covered, the premium to be charged at a flat rate irrespective of the voyage undertaken or the character of the cargo, the rate for sailing vessel cargoes being double that for steamer cargoes. The rates originally charged were, for hulls 1 $\frac{1}{4}$ per cent for the single and 2 $\frac{1}{2}$ per cent for the round voyage, for cargoes 5 guineas per cent, but they were rapidly and substantially reduced. The scheme was to be managed by the associations or clubs, who were to bear all the expenses incident thereto, a running account to be kept between them and the State of the premiums and losses, the balances being settled quarterly. The

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State was to bear a rateable proportion of expenses in the settlement of claims. Four-fifths of the premiums were to go to the State, but the associations or clubs were to be at liberty to reinsure elsewhere if they preferred to do so. The Government had the right to appoint two representatives who were to be entitled to attend meetings of the committees. Thus a serious problem was solved for the shipowners through the beneficent intervention of the Government, but the country had to pay none the less dearly for their services.

Now, the Government were able to take over the whole of the railways of Great Britain without trouble or delay when the need arose, because it had already been provided for by Section 16 of the Regulation of the Forces Act, 1871, and, in the House of Commons on the 16th November 1914, Mr. Walter Long bore witness to the remarkable smoothness of the operation. He said the control had worked without a single hitch and with a most wonderful regard for the convenience of the public at large, in spite of the huge numbers of troops and quantities of war material that had to be carried, and he regarded it as 'one of the most successful enterprises ever undertaken in this country'⁵. In Committee of Supply on the 14th December 1916, Mr. Bonar Law said that it was a good bargain for the State: 'It was good, not merely from the point of view of the convenience, the immense convenience, which central control gives, but it has been good also financially.' The companies were guaranteed a profit equal to the average of the last three years of peace, any deficiency due to increased working expenses to be met by a Government subsidy on condition that railway rates were not raised. At the end of the war, the Railways Act of 1921 provided for the payment of £60,000,000 into a deposit account that was to be opened at Glyn Mills Currie & Co.'s bank entitled 'The Railways Compensation Account' and 'The payment of the said sum shall be in full discharge and in satisfaction

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of all claims which might otherwise have been made by any railway company in Great Britain to which this section applies for compensation under the Regulation of the Forces Act, 1871, the Ministry of Transport Act, 1919, or otherwise, arising out of or in respect of the possession by the Crown of the undertaking railroad or plant of such railway company or the exercise of the powers conferred by those Acts. Provided that the rights and liabilities of the Crown or the Minister on the one hand, and of the railway companies on the other, under the terms of the agreement or arrangements relating to the possession by the Crown of the railways, shall, so far as regards the making good of any deficiency in the net receipts of the company (including the payment of interest) up to the end of the period of possession, and in relation to any sums expended and liabilities incurred by the companies in respect of repairs and renewals effected before the end of that period in accordance with the said agreements and arrangements, subsist and continue.'

This measure directly led to and greatly facilitated the badly needed amalgamations and improvements which were afterwards carried out in virtue of the same Act of Parliament, and it is much to be regretted that the taking over of merchant shipping on similar lines had not likewise been provided for. The Admiralty were indeed empowered by a proclamation, based solely on the Prerogative, that was issued on the 3rd August 1914, to requisition British ships for use as transports and auxiliaries, and 'for other similar uses', a phrase which was gradually stretched so as to include, first, ordinary commercial cargoes for the Government, then space for the Wheat Executive, and finally a large and growing proportion of British and Allied imports, until the Ministry of Shipping was created by statute and invested with very wide powers. The Admiralty Transport Arbitration Board was appointed on the 4th August 1914 to fix the terms of

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hire and compensation for losses and to deal with all claims arising out of the requisition in case of the failure of previous negotiations between the Admiralty and the owner direct. On the 31st August Lord Mersey was appointed President of the Board, its rules were amended and added to, and the panels from which the members were to be chosen, consisting almost wholly of shipowners and others closely connected with the industry, were enlarged. For the guidance of the Board, the President entrusted to six panels of members the task of preparing schedules of approximate rates applicable respectively to ocean-going passenger liners, passenger steamers in the coasting and cross-Channel services, oil tankers, colliers, tramps and cargo liners. The panels were entirely composed of shipowners with the exception of one Government nominee in each case, and Lord Inchcape (of the P. & O.S.N. Co.) acted as chairman of them all. Thus were evolved what came to be known as the Blue Book rates, which were embodied in a series of unanimous reports presented on the 22nd October 1914, and Lord Inchcape said he trusted that shipowners would not look upon them as a minimum on which increases might be built. But, although they were generous enough at the beginning, the growing costs, no doubt partly caused by the enormous rise in the earnings of the free ships, soon began to bear hardly on those whose ships were requisitioned, and this led to a request being made to the Director of Transports on the 1st March 1915 for an upward revision of the rates. Certain concessions were thereupon made, to be retrospective as from the beginning of the year, on condition that the new rates should be regarded as final for the remainder of the war. It might, however, have been fairer to the owners of requisitioned ships, as it certainly would have been to the public at large, if the Government's control had been extended to the whole of our shipping from the outset.

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Already by the beginning of 1915 the cost of living had risen so far and was causing so much unrest that the Prime Minister (Mr. Asquith) felt obliged to accede to the request for a debate on the subject, and it was opened by Mr. Ferens on the nth February. Mr. Asquith admitted the gravity of the matter but contended that the rise had been less than might have been expected. Taking five of the vital necessities of life he said that prices compared with those prevailing just a year before showed the following advances: wheat 72 per cent, flour 75 per cent, British meat 6 per cent and foreign 12 per cent, sugar 72 per cent and coal 15 per cent. Even if these figures had been accepted they would have been bad enough, but they were criticized as being an understatement of the true facts. He made some cloudy comparisons with certain earlier periods, going back to the conditions following upon the conclusion of the Franco-Prussian War, the only possible relevance of which could have been to show that, being forewarned, the Government should have been forearmed. He said: 'There has been a very substantial rise in coastwise freight. When I say substantial, I might say enormous. Whereas compared with the pre-war rate—if I may use that expression—of 3s., freights had risen three weeks ago—that is coal from Newcastle and Tyne ports to London—to 13s. 6d. and even to 14s.' He also mentioned as contributory causes of the rise in prices the fact that 13.9 per cent of the number of coalminers employed in July had joined the forces, as had 10 per cent of the railway employees and no fewer than 6000 dock labourers of the port of Liverpool alone. He did not express his determination that the patriotism of these men should not be the cause of increasing the cost of living for their families in order that others might make their fortunes. 'We must all recognize', he said, 'that we are in a state of war and that the safety of the country and the prosecution of our cause demand sacrifices on the part of the working

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classes, who have not been behind or the least to recognize the fact.⁵ The more honour to them and to all those of every class who rose to their duty at such a critical time; but their conduct made that of the profiteers and shirkers only the more reprehensible. The Royal Commission referred to above also said of the poorer classes, when it was suggested that they might give trouble if too much of the burden were thrown upon them: 'We believe in their patriotism, and in their loyalty to the Constitution, and we desire to place on record our conviction that the working classes of to-day are no more likely than their predecessors to urge the Government, on account of any privations affecting themselves, to make an inglorious peace. We believe they are ready to bear with fortitude, for the sake of their country, hardships as great as were ever borne by their forefathers.'⁵ For the sake of their country, yes, but not for the sake of those who merely seek to profit by its dangers and its trials!

Continuing the above-mentioned debate, Mr. Asquith said: 'We will consider any practical suggestions from any quarter. . . . We shall not close our ears to any proposals that may be made.'⁵ He had none of his own to make! But he always manifested the strongest disinclination to interfere with what he was fond of calling the normal operations of trade, and suggestions that business men should be hindered from making unconscionable profits were generally met by the objection that restrictions would be most harmful to industry. He held that 'the only result of fixing maximum prices, an experiment which has been suggested, and which the German Government have made with the most disastrous consequences, has been to lead to evasion and confusion and the frustration of the purposes which they had in view.'⁵ So there was nothing to be done but to wait and see!

Notwithstanding these smug assertions, the time was to come when consideration for the safety of the country, if not

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for fair dealing among its citizens, would compel the adoption of measures of control whose great value, only lessened by the delay, would soon become evident. Mr. Clynes very naturally expressed grievous disappointment with such a speech, characteristic of the man though it was, observing that 'The free play of competition is just what we have not got. What we have got is combines, syndicates and rings which arrange the prices for themselves.' Mr. Bonar Law, who was certainly no revolutionary, said: 'I entirely agree with what the hon. Gentleman [*Mr. Clynes*] said, that at a time like this we are not to be bound by any maxim of supply and demand. We ought to be bound simply by what, in the existing facts of the situation, we believe would be the best method of dealing with the facts as they exist. The organization of the nation in time of war does not consist merely in sending men to the front and equipping them, but consists in organizing the whole life of the nation.'⁵ Referring to one of the greatest causes of discontent, which was continually cropping up, he observed: 'I know a little about the profit of ships when they are well-managed, and in spite of the drawbacks which I have pointed out—the delays and much higher cost of running—I have not the smallest doubt that well-managed ships to-day are making simply enormous profits, and that those profits come from the very cause for which the people of this country are making sacrifices in every direction, and even giving their lives. . . . British owned ships are under British control, and we have just as much right—I do not know whether this is good Tory doctrine or not—to seize this part of the national organization, as I believe we have, if the necessity arises, to seize every able-bodied man in the country.' It has been argued that a rise in freights was inevitable owing to the shortage of tonnage relative to the demand, but, while that might necessitate the curtailment or exclusion of certain kinds of cargo, it does not

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in our view justify the raising of freight rates in time of war. An increase in running expenses of course might, but the evil went far beyond that, and during the first part of the war what determined the acceptance of cargo was not its general usefulness but the amount of profit it offered to the individual shipowner. It was just such exploitation of the vital needs of the nation, made possible by the crisis through which it was passing, that led to the introduction of price control and rationing in other spheres. The argument is not strengthened by the further assertion that we could not prevent an increase in the rates charged by foreign shipowners. Possessing about half the working tonnage of the world, we could have been to a very considerable extent independent of these if the Government had not allowed British vessels to be diverted for the carriage of cargoes between neutral ports in order that private interests might profit by the high rates thereby obtainable. That traffic, it is true, was afterwards limited by the Licensing Committee but not until late in 1916.

In view of the war losses to which it was particularly exposed, and from which in the later stage of the conflict it suffered heavily, it might have been supposed that shipping could not be a very profitable enterprise during a world war; but the owners enjoyed, besides the protection of the Fleet, the enormous advantages of the State insurance scheme which we have outlined. In such circumstances, apart from the dictates of patriotism, they might fairly have been considered to lie under a particular obligation to serve their country to the best of their ability. No doubt there were those who did. Yet, notwithstanding the amount of tonnage requisitioned at Blue Book rates and the subsequent control of the Ministry of Shipping, many also contrived to make some of the largest war fortunes. Mr. Houston said: 'The only fair way of assessing the profits of the shipping business is to make a comparison over a period of years. During the

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last twenty years I very much question whether the whole capital invested in shipping, probably amounting to over £200,000,000, has paid 2 per cent interest. I know that at times shipping makes big profits, but at other times losses are incurred.' Nevertheless individual shipowners have managed to make fortunes at all times, and is it proper to take advantage of the national agony to make up for previous lean years? During the war shipowners began by raising freight charges to unheard-of heights and then the enhancement of the value of their ships resulting from their increased earning power was made a ground for yet further increases. Such ever-widening vicious circles became a familiar feature of all trading at that time and were similarly justified. The only way to prevent the inequalities and injustices which are thus brought about is for the Government to have a complete scheme ready for immediate application when the moment arrives, as in the case of the railways. It is then expected and accepted without question.

On the 17th February, during the continuation of the debate on the prices of the necessities of life, Mr. Runciman said: 'There is only one way by which, by commandeering the whole of the mercantile marine, you can hold the balance fairly as between all routes and all merchants and all consumers, and that is that you must become not only shipowners, but merchants. Indeed, you must become not only an individual merchant; you must become a super-merchant, the only merchant—the only merchant in wheat, the only merchant in hides, the only merchant in wool, the only merchant in oil. I know the hon. Gentleman [*Mr. W. C. Anderson*] who spoke last thinks that is next door to the Millennium. We may argue about that on some other occasion; but I implore him not to try to bring about the Millennium in the middle of a great war.' That is the time above all when it is necessary for the State to undertake so much, and it was

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forced upon it by the end of the following year. The pity was that there should have been no previously prepared scheme to be brought into force as soon as we entered the war. Time after time it was found necessary to take restrictive action of various kinds, but by then great evil had already been done. Sir William Walton told the Select Committee on the Indemnity Bill (No. 136, 1920) that instances came under his observation in which the War Office had paid most extravagant prices for shipping services in the early days of the war, as indeed they did for most things. To give just one of countless other instances, there was the appointment of an agent, through the Office of Works, for its huge purchases of timber on the basis of 2½ per cent commission on the net value, which within three months yielded to that fortunate individual no less than £15,000 remuneration! This, too, was said to be economical in view of the extortionate quotations that were received from the timber merchants direct! Such outrageous advantage was taken of the public need on every hand as obliged Government departments to seek ways of protecting themselves, and this led to the gradual development of the 'costing system', of which the Second Report of the Committee of Public Accounts, 1916, contains the following succinct statement: 'On the outbreak of war the peace system (of competitive tender) was modified as being too slow to meet the requirements of the Army, and the War Office at once resorted to direct negotiation, appointing expert agents to go round and buy from stock, or negotiate direct deals with the manufacturers. The whole procedure, however, was soon found to be unsatisfactory, as Government were taking nearly as much as some industries could produce, and in some cases wanted far more, so that all the goods offered had to be accepted irrespective of prices. A method therefore had to be devised which should secure supplies for the Army and yet protect the public interest by seeing that the prices paid were

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fair and reasonable. This took some time to evolve, but in June 1915 the War Office began to require manufacturers in submitting their prices on tenders to justify those prices by giving a statement of the cost of manufacture; and in some cases, where these were clearly exorbitant, negotiations were entered into to reduce the prices asked. Further developments took place from time to time, and culminated at length, on the 15th February 1916, in an amendment to the Defence of the Realm Regulations, by which power is given in the last resort to requisition the output of any factory in the country and pay for that output at a fair agreed price, which the contractor has to show to be reasonable by producing his costs of manufacture and satisfying the expert advisers of the department. This has had the effect of breaking up and preventing *combinations of manufacturers against the Government.*'

It was the rise in the cost of living, which the original lax methods inevitably brought about, and the attraction of men for the public service at unnecessarily high pay that started demands for higher pay all round, than which nothing could afford a better cloak and opportunity for profiteering. The feeling that advantage was being taken of the country's difficulties continually to put up prices and the hardships resulting therefrom caused widespread discontent, leading in one place after another to slackness and strikes on the part of the workmen. The too ready presumption that, in disputes between them and their employers, the employers were always in the right and they were always in the wrong, when they were making certainly no less a contribution to the common task, must have been exasperating in the extreme to the malcontents, and there was little to be wondered at, though much to be deplored, in the persistent state of unrest. Instead of at once recognizing that it was the imperative duty of the Government to protect the country from being fleeced by unscrupulous persons in its dire need, the President of the

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Board of Trade (Mr. Runciman), like his chief, was far too prone to assume the role of apologist or *advocatus diaboli*, an attitude that was by no means helpful. It must have seemed to the working classes that while extortionate profits were regarded as sacrosanct their demands for wages to cope with them were always stigmatized as unpatriotic; yet the former were often mere additions to superfluity while the latter were not infrequently needed to maintain some poor standard of living. In the House of Commons, on the 15th March, Sir A. Markham said: 'As he [*the Chancellor of the Exchequer*] is no doubt aware, the price of coal in Wales was advanced at one moment on Saturday for a further 5s. a ton. The price has now been advanced from 70 to 100 per cent, but the miners in the meantime have not received a penny increase in wages. What is the feeling among the working classes when they see these large prices prevailing at a time when everybody ought to be working in the interests of the nation to produce all the munitions of war possible? A certain selfish class of people want to take advantage of the necessities of the nation to make large profits during the war. I think the House feels very strongly that this is not a time for any section of the community, especially those who are unable to be fighting at the front, to make profits of this kind.' The situation rapidly grew worse and disquieting rumours began to come through of serious losses among our men at the front owing to shortage of ammunition, the Germans then turning out no less than one hundred times as many high-explosive shells as we were!

On the 15th March Lord Kitchener made a grave speech in the House of Lords, in the course of which he said: 'The work of supplying and equipping new armies depends largely on our ability to obtain the war material required. Our demands on the industries concerned with the manufacture of munitions of war in this country have naturally been very

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great, and have necessitated that they and other auxiliary trades should work at the highest possible pressure. The armament firms have responded to our appeal and have undertaken orders of vast magnitude. The great majority also of the employees have loyally risen to the occasion and have worked, and are working, overtime and on night shifts in all the various workshops and factories in the country. Notwithstanding these efforts to meet our requirements we have unfortunately found that the output is not only not equal to our necessities but does not fulfil our expectations, for a very large number of our orders have not been completed by the dates on which they were promised. . . . The supply of war material at the present moment is causing me very serious anxiety. . . . Labour may very rightly ask that their patriotic work should not be used to inflate the profits of the directors and shareholders of the various great industrial and armament firms, and we are therefore arranging a system under which the important armament firms will come under Government control, and we hope that workmen who work regularly by keeping good time shall reap some of *the benefits which the war automatically confers on these great companies.*" Six days later, taking advantage of his presence at Liverpool, where he had gone to review troops about to embark for service abroad, he handed to the dockers' leader there, Mr. James Sexton, a letter in which he expressed his surprise that there was a certain section among the dockers of Liverpool who refused to work overtime and on Saturday, so leading to congestion at the docks which caused serious delay of munitions and food required by our men at the front. He appealed to the men through their leader to do everything in their power to help their comrades in France, and added that if his appeal failed he would have to consider what steps would have to be taken to secure an improvement. This had little effect and in the end it was found that the best way was to

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subject the men to military law. A scheme was therefore sanctioned for organizing them as 'civilian soldiers', and thus was formed the Dockers Battalion of the Liverpool Regiment. They were to be employed on home service only, to receive both Army and Civil pay, each man being guaranteed a minimum wage of 42s. a week, and only members of the Dockers' Union were to be eligible; so that they were far better off in every way than the thousands of their comrades who were serving their country in the trenches. Although we may not consider their treatment too generous, it affords all the same yet another example of the discriminating methods, never in favour of those who have to face the greatest discomforts and dangers, which a country must resort to if it has no scheme ready for impressing the whole of its industry and citizens into the public service in a national crisis of the gravity and magnitude of the last great war.

Labour was not to be coerced into subserving the selfish ends of those who were only thinking of their own pockets, but a letter signed 'Engineer' which appeared in *The Times* of the 31st March 1915 testified from the writer's personal experience how readily and splendidly it would respond to an honest appeal to its patriotism. He said that, after he had explained the situation to the men and exhorted them to put in 72 hours a week at least, 'The first week practically all the men worked over 100 hours, and must have averaged 80 ever since. . . . They have had two days' holiday at Christmas and are to have one at Easter. We have given no war bonuses or other monetary considerations beyond the ordinary overtime rates.' On the 5th June the Management Committee of the General Federation of Trade Unions issued a manifesto warning the Government that 'a fortnight hence may see the whole of Lancashire in the throes of a gigantic industrial dispute' owing to 'the failure of the Government to deal effectively with food and coal prices, and with war profits',

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particularly 'the failure to deal with the coal question when the conspiracy to increase prices seemed so obvious⁵. The matter was again debated in Committee of Supply on the 10th June, when Mr. Runciman said: 'The rise in the price of wheat, great as it has been, has not been a rise over which we can have much control, for the world's prices fix very largely the price that has to be paid here. Coal is in a different category. Coal is produced in this country and the price of coal is in no way dependent, or very little dependent, upon the world's direction outside.' He acknowledged that pit props were dearer and wages higher: 'But, when all is said and done,' he continued, 'the present pit-head price of coal is far in excess of what the expense justifies. The coalowners are engaged in a highly speculative industry. There are some years when they make fairly large profits, some years when they make losses. But I have pointed out again and again that they are not justified in looking upon this as one of the normal good years. Their getting high prices for coal depends, not on a trade boom at all, but on a state of war.' Turning to another gross case of profiteering that was of long standing, he said: 'The ownership of meat in the Argentine has been the subject of discussion in this House before now, and, as the Committee well know, the big American companies which went by the slang term of "The Meat Trust" control a very large share of the exports from the River Plate. *There is a certain amount of control by English companies, but they all act together, and if we had left the French and British military authorities to the mercy of those companies there is no saying what price they would have been able to extract out of them.*'

The development that next took place is described in an excellent article on 'War Control of Industry' by Mr. E. M. H. Lloyd in the last edition of the *Encyclopaedia Britannica*, which tells us that 'The system of State control of trade and industry in Great Britain which played so vital a part in the successful

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issue of the war was not planned as a comprehensive whole by anything in the nature of an economic general staff, but was built up gradually in a number of different departments as a series of partial adjustments to particular needs and emergencies. ... A proposal was made in October 1914 that the Government should take over the big armament firms as they had taken over the railways, but the authorities at that time shrank from assuming such a responsibility and preferred to rely on private enterprise and the law of supply and demand to produce an adequate flow of munitions. In June 1915, with the establishment of the Ministry of Munitions, the theory that industry could be left to adapt itself of its own accord to war needs was abandoned. National factories were built; raw materials of all kinds required for making munitions were imported on Government account and distributed at fixed prices; and manufacturers instead of being left to produce munitions or not as they thought fit, at prices determined by their own sense of propriety, were now compelled to produce them at prices based on cost, and if necessary were instructed how to do it. By requisitioning practically the whole output of the engineering industry and making use of nearly all the iron and steel obtainable for making munitions, the Ministry of Munitions virtually suppressed private trade and ignored civilian needs. The Army Contracts Department of the War Office, on the other hand, which continued to purchase food textiles, leather goods and other miscellaneous articles for the Army only needed a proportion, though a growing proportion of the national supplies. Civilian requirements had to be met and this introduced a competing demand which had somehow to be reconciled with military necessities. It was this that eventually led to the extension of State control to cover the supply and distribution of many of the necessities of life for the whole population.' The demand for more control and for the taxation of excessive war profits

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was at last becoming too strong for the Government to resist and the example of the Ministry of Munitions pointed the way.

The second of two articles on 'Holding Out' which appeared in *The Times* of the 17th July 1915 under the sub-heading of 'The Case for Thrift' contained the following: 'Our Allies and our enemies have, to different extents, placed in abeyance the laws of supply and demand and the influences of competition. France, by a noble effort of patriotism, has almost succeeded in abolishing bargaining in the service of the State. Our enemy, we know, has taken such measures as to substitute control wherever the principles of supply and demand were likely to operate against the interests of the State. We have allowed bargaining to rule, and it has been bargaining with one side bound to accept the terms offered by the other, for war has destroyed all balance between supply and demand; in some directions (notably in labour and freights) it has greatly reduced supply; in many it has vastly increased demand, while in some the State needs all there is and more. To expect men voluntarily to forgo what they know, or even suspect, that others are taking is to ask of human nature more than it has to give. Let us not blame too much the workmen who strike for higher pay; our working classes are suspicious; and it is only to be expected that they should want their share when they know (or suspect) that their employers would only be rolling it in the faster if no such demand were made.'⁵ It would perhaps have been fairer to describe the workmen as watchful rather than suspicious, and they surely had reason enough to be so! On the Second Reading of The Price of Coal (Limitation) Bill, which would not have been necessary or practicable if there had been no ground for their complaints, Sir J. Walton said: 'My belief is that the most unfortunate and lamentable stoppage in South Wales would have been averted, as would many

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other labour difficulties, had the Government boldly declared months ago that the increased profits of coalowners and of all other traders, manufacturers and taxpayers during the war would be taken as a war tax into the Treasury.'

With 200,000 miners on strike in South Wales in defiance of the Royal Proclamation under the Munitions of War Act, and similar trouble brewing in various other parts of the country, it was time to do something to remove some of the principal causes of discontent, and the Bill referred to was in due course passed into law, but such partial and piecemeal legislation, which incidentally affected different districts unequally, could be at best no more than stopgaps, dissipating time and energy in their preparation without leading to any enduring settlement. The facts elicited by the discussion of this measure were, however, valuable as refuting some of the charges against the men and as explaining some of the grounds of their dissatisfaction. Owing to the numbers who had joined the fighting forces, then no fewer than a quarter of a million, Mr. Runciman stated that: 'The numbers employed have been reduced in the proportion of seven to six, and the outputs have been reduced by only 10 per cent. If hon. Members are apt in mental arithmetic they will see that the output has gone down less rapidly than the enlistment has gone up.' The miners had therefore been reproached for a decline which was due to the patriotism of their fellow workers and when they themselves were actually producing more per head. It should be remembered, too, that it was men of the best physique who had gone to the battlefield. Mr. Runciman informed the House that 'A shilling rise in the price of coal *used within these shores in a year* represents no less than £9,000,000', and he pointed out that it not only directly affects every household in the country, but every town, every corporation, every gas, electricity and other public utility company, all the manufactures, the railways, the mercantile

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marine and the Navy. It therefore affords an egregious example of a tax, of no inconsiderable weight when the rise mounts to the heights it did during the war, imposed upon the whole community in favour of a very small percentage of it.

The admirable volume on *The War and the Shipping Industry* by C. Ernest Fayle, of the series on the Economic and Social History of the War published under the auspices of the Carnegie Endowment for International Peace, tells us that 'the effect of war conditions during 1915-16 was to drive up freights on all routes to a height which left even the level of the boom years 1912-13 far behind, and though running expenses [*among which of course coal was an important item*] had also increased, the earnings and profits of shipowners, during the first two or two and a half years of the war, exceeded anything that the oldest shipowner could remember. . . . Every increase in the cost of transport added to the financial burden of the war, and the enormous profits earned by free shipping had, as we have seen and shall see, many undesirable effects from the point of view both of the nation and of the shipping industry itself.' The author again remarks in another place that 'large as were the fortunes made by individual owners, the abnormal boom of 1915-16 was bad morally, and in the long run financially, for the shipping industry as a whole . . . the result of the abnormal freights obtainable and the abnormal dividends distributed was to attract into the industry outside speculators who had little experience or knowledge of the business, whose attention was concentrated on immediate profits, and whose eager demand for tonnage new or second-hand, accentuated the inflation of values and helped to prepare the way for a disastrous crash after the war. This evil was increased by the application of the Excess Profits Duty to shipping earnings and its inapplicability to the sale of ships. In the view of many old-established

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owners it became more profitable to sell their fleets than to run them, and the result was to increase the speculative at the expense of the more stable elements in the industry.⁵ Mr. Fayle deals with the whole complicated problem in a spirit of fairness, with a knowledge and thoroughness that are beyond reproach, and it were much to be wished that so valuable a study of a subject of such great national importance were widely read. A tax of 50 per cent on excess war profits was one of the features of the third war budget which was brought in on the 21st September 1915, but it was subject to all kinds of allowances, reliefs and abatements. Mr. Barnes observed in regard to it: 'Needless to say, we welcome that tax as at all events better than nothing, or rather let me say as a substitute for something much better which might have been done long ago. We have been urging upon the Government right from the beginning that they should have assumed control of certain industries having to do with the supply of goods and so have prevented these profits from accruing altogether. . . . Having regard to the great need of the country, having regard to the sufferings and privations of those who are fighting for us, why should any man either by increased profits, and I should even say by increased wages [Hon. Members: 'Oh!']—I am quite prepared to deal with wages as well, should that be necessary—I say why should any man benefit financially as a result of the nation's need?' He suggested that the rate ought to be 80 per cent, not whittled down by all sorts of reductions, and there were many of all classes inside and outside of the House of Commons who held the same view. It was in fact afterwards raised to 60 per cent in 1916 and 80 per cent in 1917.

On the 17th February 1916, the day after the opening of the new session of Parliament, Mr. Peto moved an amendment to the Address in these words: 'But this House humbly expresses its regret that your Majesty's Government have not

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taken measures to utilize economically the available merchant tonnage by placing it under the control of a central expert authority, with full power to requisition and direct the movements of all vessels, and fix and limit remuneration for transport services of all kinds during the war.' Mr. Runciman's speech, though directed against the measure, rather tended to show the necessity for further extending the powers exercised by the numerous bodies he mentioned, the Admiralty Transport Department, the Requisitioning, the Licensing, the Allocation or Shipping Control, and the Port Transit Committees. Almost everything was now being run by similar committees and when compulsory military service had placed first part and then the whole of the fit manhood of the nation at the disposal of the Government, in the early months of 1916, it seemed high time that supplies, transport and industrial machinery should be more completely regulated by the authorities. That more centralization would be in the interests alike of economy and efficiency seemed assured by the success of the Ministry of Munitions which was just now becoming evident. Of its extended powers, Dr. Addison tells us: 'The first and most dramatic use of those powers occurred in February 1916, after it had been found that, making generous allowances for repayment of factory costs, many types of shell cases were being obtained at little more than half former contract prices in the national factories and elsewhere.' He found that the savings effected by the examination and control of costs through the system set up by the Munitions of War (Amendment) Act were 'of a prodigious character'. He says: 'Wages rose materially throughout the war, but the economies effected in other directions made further reduction in the level of shell prices possible notwithstanding the additional labour rates.' What was of still greater importance, the output was enormously increased and accelerated.

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The intensification of the German submarine campaign caused increasingly serious losses as 1916 wore on, and there were many signs that unless more complete and energetic steps were taken to organize the nation and make fuller use of its resources we should never win the war. There was little promise of this under the existing regime, but the changes which were made in December, when Mr. Lloyd George had succeeded Mr. Asquith as Prime Minister, infused a new spirit into the affairs of the nation at a most critical moment. Beside the War Cabinet of Five, the creation of Ministries of Labour, Food and Shipping and the appointment of a Director of National Service were among the innovations which were to end the pretence of 'business as usual' when the whole nation was engaged in a life or death struggle and private trade simply meant private monopoly. The Government had taken over the coalfields in South Wales and Monmouthshire as from the 1st December and placed them with the three existing Committees under a Controller of Coal Mines, who was further assisted by an Advisory Committee composed of owners and miners. By March 1917 the control had been extended over the whole of the United Kingdom and practically everything was now subject to Government regulation in one form or another. In the statement of the new Government's policy which Mr. Lloyd George made in the House of Commons on the 19th December, he said: 'I think my right hon. Friend has already indicated to the House what we propose to do with regard to shipping. It was never so vital to the life of the nation as it is at the present moment, during the war. It is the jugular vein which if severed would destroy the life of the nation, and the Government felt that the time had come for taking over more complete control of all the ships of this country and placing them in practically the same position as are the railways of the country at the present moment; so that during the war shipping will be

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nationalized in the real sense of the term. The prodigious profits which were made out of freights were contributing in no small measure to the high cost of commodities, and I always found, not only that, but that they were making it difficult for us in our task with labour. Whenever I met labour under any conditions where I would persuade them to give up privileges I always had hurled at me phrases about the undue and extravagant profits of shipping. This is intolerable in war time when so many are making so great sacrifices for the State.'

Mr. Bonar Law confirmed from his own experience the difficulty of obtaining concessions from labour as long as such gross profiteering was allowed to go on. He had frequently condemned the latter in strong terms, and returned to the charge during the Committee Stage of the Finance Bill on the 3rd July 1917. 'It is utterly disgraceful,⁵ he then said, 'that in a time of war any class of the community, while others are suffering every kind of privation, should be able to make profits such as I am now going to point out. I do not say it is the fault of the shipowners—I think it was the fault of the Government—but it is absolutely disgraceful that it should have been allowed.' He told the House that he had himself invested in fifteen different shipping companies a total sum of £8100. 'Five per cent on that, which in ordinary times I should have been glad to get, would be £405. For the year 1915, instead of £405, I received £3624, and for the year 1916, I received £3847,' and that, he said, was after the payment of excess profits duty! He continued: 'I agree it is a great advantage to the country that there should be money put into ships if necessary, but prudent managing shipowners do not divide all the profits. There is something to come to me later. One of these steamers has either been sold or sunk, I do not know which. Either way, she has been turned into money for me. In that ship I had £200, and after the very

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handsome dividend which I received, on liquidation I received a cheque for a little over £1000. That is not my only experience. There was another shipping company in which I invested £350. The other day I received a letter from the managing owners of that company, saying that because the cost of building was so high and likely to continue high, it was not probable that they would wish to invest the money in ships for a long time to come; therefore they were going to make a dividend out of the surplus capital. For that £350 capital, on this division, I received a cheque for £1050. That is the trade we are ruining!' The last remark referred to the complaint of the shipowners of the effect of the Excess Profits Duty.

Dr. Addison, speaking on the Supplementary Vote of Credit on the 12th November 1918, said: 'I believe a good many of the mistakes made during the war have been due to the fact that we have not had a common policy in obtaining Government supplies, and we have never had a body of men whose business it was to work out a common policy. We have never had a Minister responsible for Supplies, and the result was that I found myself at the Ministry of Munitions without any guidance whatever when we had to purchase great masses of stores, and we had to invent as we went along all kinds of costing systems so as to give us some guide as to what we ought to pay, because it was quite obvious that the lowest tender was no guide whatever under the special circumstances.'

It has not been our purpose to trace in detail the sordid history of profiteering during the last war, but only to bring out by a few examples the great danger of neglecting to provide as far as possible against its practice during such a crisis at least. Similar scandals have attended every previous occasion of the kind and have been followed by enquiries and disgraceful revelations, but hardly any steps have been taken

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to prevent the recurrence of the evil. It is only by Government organization of all the activities and resources of the country approximating to that which was brought about during 1917 and 1918 that unconscionable overcharging, inefficiency and discontent can be averted; and, seeing that these cost the lives of an untold number of men, it is nothing short of criminal to leave such matters to the chances of hurried improvisation when the crisis is upon us and irreparable damage has already been done. It is indeed extremely unlikely that there will be any opportunity to do this on another occasion. Becoming, as it is, daily more difficult to draw a clear distinction between the civil and military spheres, unreadiness in the one as in the other may not merely delay the victory but be fatal to the defence of the country. Moreover, the preparation of a plan based on a thorough investigation of what was done during the last war while many of those who took part in it still survive might teach us much that could be applied with great advantage in time of peace.

VIII

The War Excess Profits Duty

As we have seen, it was not until the 21st September 1915 that Mr. McKenna announced the Government's intention to introduce a special tax in respect of profits which had increased during the war period, and so much disingenuous nonsense has been uttered about the crushing burden of the Excess Profits Duty that it may be worth while to consider it before proceeding to examine the fruitless attempts to redress the financial situation which were made after the termination of the war. The proposal drew from Sir Frederick Banbury the enquiry: 'If the right hon. Gentleman puts a big burden on the wealthier classes, where are they going to get the money to subscribe to his loans? It is very essential now and will be still more essential after the war that capital should be kept in the country to develop trade.'⁵ This was a well-worn argument against the taxation of the rich, and the honourable member added that he thought *excessive wages* ought to be taxed. Mr. (afterwards Sir Robert)¹ Houston, who according to Mr. Bonar Law appeared before the House as 'a victim of injured innocence', expressed himself as very glad to have the explanation offered by Mr. McKenna that if a man earned more than fifty shillings a week he would have to pay income-tax the same as anyone else. This shipping magnate said 'it has been a great anomaly and injustice that the unfortunate clerk who earns £165 a year has had to pay

1 **Baronet; one of the remarkable Birthday Honours of 1922!**

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income-tax while the working man who has been earning anything from £5, £6 or £8 to £10 a week has escaped taxation'; but that did not prevent himself from taking careful steps to evade his own share, after having made a great fortune out of his country's distress! He said it was 'a dangerous thing to unduly tax capital because capital is a very sensitive thing', far more so, it appears, than its owner is apt to be, in a creditable sense, for he afterwards gave point to the warning by placing his own beyond the reach of the Chancellor of the Exchequer.¹ 'Therefore, if the right hon. Gentleman', he continued, 'is going to tax all so-called profits, he is going to diminish the capital which will be required and ought to be available after the war.' Another member in the same line of business, Mr. Holt, used similar arguments and observed that those who had increased their incomes during the war had shown spirit and enterprise; and more sense, it may be supposed, than those who had expended such qualities on the field of battle.

By the majority the Excess Profits Duty was accepted as a necessary and just measure, but, whether or not it was due to the corrupting influence of rapidly growing wealth, it was very noticeable that it was just those who were profiting most by the war who were most anxious to avoid any of its burdens. Mr. Fayle mentions the various devices of the shipowners to

¹ According to a Press Association announcement quoted in *The Times* of 21st April 1926, Sir Robert Houston's will was proved in Jersey the day before, and it contained the following: 'I declare that I have given up and relinquished my domicile of origin and have taken up a Jersey domicile until the end of my natural life.' In that happy island, where one is virtually free from taxation, the amount of the deceased's fortune does not have to be disclosed, but the widow in this particular case voluntarily offered payment to the Chancellor of the Exchequer of £1,500,000 which she computed to be the amount in death duties on her share alone of the estate. She afterwards offered a sum of £40,000 for income tax in 1932. These were accepted as a moral if not, on account of the change of domicile, a legal debt to the Treasury, but the Government rightly declined as inconsistent with its public dignity another offer of £200,000 towards the

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conceal the full extent of their profits and so evade much taxation, e.g. by 'lumping together the book value of the fleets and the total outside investments with the profit from voyages. . . . Further, many companies preferred, either with a view to future stability or from fear of the odium attaching to abnormal dividends, to capitalize a portion of their current earnings. All this, coupled with the fact that some companies deducted unspecified sums for depreciation and reserves before stating the "profit from voyages", makes many of the accounts extremely unreliable.' The Excess Profits Duty was first imposed by Part I I I of the Finance (No. 2) Act, 1915, in these terms: '38—(1) There shall be charged, levied, and paid on the amount by which the profits arising from any trade or business to which this Part of this Act applies, in any accounting period which ended after the fourth day of August nineteen hundred and fourteen and before the first day of July nineteen hundred and fifteen, exceeded by more than two hundred pounds the pre-war standard of profits, as defined for the purposes of this Part of this Act, a duty (in this Act referred to as "excess profits duty") of an amount equal to fifty per cent of that excess.' Where the accounts of a trade or business had not been made up for any definite period, or a year or more had elapsed without accounts being made up, the accounting period was to be taken as not less than six months nor more than a year ending on a date to be deter-

cost of National Defence. On the 28th June 1934 Mr. Stourton asked the Chancellor of the Exchequer if his attention had been drawn to the death of Sir James Knott 'who amassed a fortune in the North of England and left £5,000,000 which sum in its entirety escapes death duty payable in the United Kingdom due to the fact that he had abandoned his English domicile and acquired a domicile in Jersey'. That happy island, where all the advantages of British citizenship might be enjoyed unimpaired without any of the expense of protecting them, was so much favoured by our wealthy war profiteers as to engage the attention of both the Inland Revenue authorities and Parliament, but it was never found possible to check the abuse.

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mined by the Commissioners of Inland Revenue. Subsection (3) provided that 'Where a person proves that in any accounting period which ended after the fourth day of August nineteen hundred and fourteen his profits have not reached the point which involves liability to excess profits duty, or that he has sustained a loss in his trade or business, he shall be entitled to repayment of such amount paid by him as excess profits duty in respect of any previous accounting period, or to set off against any excess profits duty payable by him in respect of any succeeding accounting period, such an amount as will make the total amount of excess profits duty paid by him during the whole period accord with his profits or losses during that period.' The duty was to be paid on all trades and businesses except (a) husbandry in the United Kingdom; (b) offices or employments; and (c) any profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on, and in which no capital expenditure is required or only capital expenditure of a comparatively small amount, but including the business of any person taking commissions in respect of any transactions or services rendered, and of any agent of any description (not being a commercial traveller or an agent whose remuneration consists wholly of a fixed and definite sum not depending on the amount of business done or any other contingency).

The ordinary pre-war standard of profit was taken to be the average of the profits in the two best of the last three pre-war trading years; but, where such average profits were at least 25 per cent below those of the three preceding years, the standard might upon application be based on those of the four best of the last six pre-war trading years. Further, upon application, a 'percentage' standard might be substituted for the ordinary profits standard. That was to be based on a percentage on the capital employed in the business at the

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end of the last pre-war trading year, 6 per cent in the case of companies and 7 per cent in the case of firms. The latter was increased to 8 per cent as respected accounting periods ended after 31st December 1916. Power was also given to the Board of Referees appointed for such purposes to increase the statutory percentages allowed in the case of particular classes of industry in which capital is subject to special risk or special wastage, or where the yield on capital is necessarily deferred; also for pre-war munition firms such as could not be fully remunerative except in time of war, and to make appropriate arrangements as respects the percentage standard of industries (e.g. underwriting) where the capital employed is small compared with the capital at risk. Where the taxpayer elected to take a profits standard, (a) an addition to that standard was in certain conditions made in respect of capital first employed within a specified period before 1st August 1914 and not remunerative or not fully remunerative in the pre-war period. The period referred to was originally fixed at three years (before 1st August 1914), but in the ascertainment of liability for any accounting period ending after 31st December 1916 account was taken of capital first employed within six years before 1st August 1914; (b) where two or more distinct and independent industries were carried on by a business, and a loss was sustained in one of them in the pre-war period, that loss might in certain circumstances be disregarded in computing the profits standard. Where the taxpayer elected to take a percentage standard, capital lost in trading in the last six pre-war trading years was added to the capital existing at the end of that period and the percentage was calculated upon the sum so arrived at.

From the profits of a period of liability there was deducted a percentage on any increase in the amount of capital employed in the business in that period as compared with the standard capital. This percentage was originally 6 per cent

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for companies and 7 per cent for firms, but was increased to 9 per cent and 11 per cent respectively as respected accounting periods ended after 31st December 1916 and 11 per cent and 13 per cent respectively as respected accounting periods ended after 31st December 1919. The increased relief last mentioned naturally benefited a new business which had been commenced either since the outbreak of the war or so recently before that it had not had a pre-war year of trading. For example, an assessment for the period of one year to 31st May 1920 on a business started in November 1914 with a capital of £100,000, which had been increased to £200,000 during the period assessed, would be allowed 11 per cent if it were a company, or 13 per cent if it were a firm, on the whole £200,000. The additional relief applied also to the particular classes of industry to which increased statutory percentages were conceded by the Board of Referees. It was provided by the Finance Act of 1917 as follows: '26—(4). Where the pre-war standard of any trade or business does not exceed five hundred pounds and the profits of the accounting period, after any adjustment in respect of increased or decreased capital, are less than two thousand pounds, subsection (1) of section thirty-eight of the principal Act shall have effect as though for two hundred pounds there were substituted two hundred pounds with the addition of one-fifth of the amount by which the profits of the accounting period are less than two thousand pounds; so, however, that, if there has been a loss in the accounting period, then for the purpose of ascertaining the amount of any repayment or set-off under the principal Act the addition allowed shall be such as if there had been neither loss nor profit, and that where the accounting period is a period of less than a year, this provision shall have effect as if there were substituted for two thousand pounds and two hundred pounds respectively a proportionately reduced amount. The foregoing provision shall apply

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where the pre-war standard of profits exceeds five hundred pounds, subject to this qualification, that the amount of the addition shall be reduced by the amount by which the pre-war standard exceeds five hundred pounds.' The Act of 1920 provided in respect of the foregoing that for any accounting period ending after the 31st December 1919 two thousand pounds should be substituted for the five hundred pre-war standard and four thousand pounds for the two thousand profit-limit of the accounting period.

The position under the original Excess Profits Duty Act may be illustrated as follows: supposing that a business has a pre-war standard of £500 and that the profits for the year 1916 amounted to £1000, the charge of duty was as follows:

	£	£
Profits of year 1916	1000	
Pre-war standard	500	
£200 allowance	200	700
Excess profits		£300
Duty at 60 per cent		£ 180
Profit remaining after payment of duty		£820

The following shows how the additional relief allowed by the 1920 Act applied:

Standard £1000	Profits £2500
Allowance: one-fifth of £4000 less £2500, i.e. £300	

Calculation of Duty on Profits of £2500			
<i>Less—</i>	£	£	
Standard	1000		
£200 allowance	200		
Additional allowance	300	1500	
Excess profits chargeable		£1000	
Duty at 60 per cent		£ 600	

Seeing that the relief where standard was under £2000 would in the absence of special provision be withheld when

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the standard exceeded that sum, a business whose standard was just over £2000 might be hardly treated as compared with those whose standard was just under that amount. The same point arose in connection with the more restrictive concession granted in the 1917 Act and was there met by a subsidiary relieving provision, which was continued. In the first instance the allowance in the case of a business whose standard somewhat exceeded £2000 was treated as if it were under £2000, but from the allowance so calculated a deduction was made of the amount by which the standard exceeded £2000, the balance remaining (if any) being the measure of the allowance actually granted. So there was a gradually diminishing measure of relief in cases where the standard was somewhat in excess of £2000 up to the point at which the increase in the standard in itself reduced the excess profit by an amount equivalent to the allowance itself. This is illustrated as follows:

Standard £2075. Profits £3000.

Full allowance: One-fifth of £4000 less £3000, £200. This sum (£200) falls to be reduced by the amount by which the standard exceeds £2000, i.e. by £75 leaving a net allowance of £125.

Calculation of Duty on Profits of £3000

<i>Less—</i>	£	£
Standard	2075	
£200 allowance	200	
Additional allowance	125	2400
Excess profits chargeable		£600
Duty at 60 per cent		£360

The Finance Act of 1920, Section 45 (1), provided that in respect of accounting periods ending after 31st December 1919, 'For the pre-war standard of profit there shall, on the application of the Tax-payer, be substituted a standard (in this section referred to as "the substituted standard") of an amount

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equal in the case of a trade or business which had no pre-war trade year to the statutory percentage on the average amount of capital employed in the first accounting period, and in the case of any other trade or business to the percentage standard, with the addition in either case of a sum of five hundred pounds in respect of each working proprietor in the trade or business: provided that (a) the amount of the substituted standard shall not, as respects any trade or business, exceed the sum of seven hundred and fifty pounds in respect of each working proprietor in the trade or business; and (b) in computing the profits of a trade or business in any accounting period as respects which the substituted standard is in force, no deduction shall be allowed in respect of the remuneration of any working proprietor; and (c) where the accounting period is less than a year the substituted standard shall be proportionately reduced; and (d) where a substituted standard has been adopted in the case of any trade or business for any accounting period the provisions of paragraph (4) of section twenty-six of the Finance Act, 1917, as amended by this Part of this Act shall not have effect as regards that trade or business in respect of that accounting period.⁵ A working proprietor was defined as one who had during not less than one-half the accounting period worked full time in the actual management or conduct of the trade or business, but no person was to be deemed a working proprietor in the same accounting period in respect of more than one trade or business. A trade or business carried on or owned by a company or other body corporate whose directors had a controlling interest were brought within this category, the description of director being defined as any person engaged in the management whose remuneration was provided out of the funds of the trade or business.

According to the foregoing provisions, if a small private business so required, the pre-war standard might be taken as

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£500 for each working proprietor plus the statutory percentage on the pre-war capital. So, for a business with four working partners and a capital of only £1000 which made a pre-war profit of £400 a year a standard of £2080 might be claimed in lieu of £400. In the case of a business with four working partners and a capital of £15,000 the substituted standard would be limited to £3000, being £750 in respect of each working partner. A similar standard applied to new businesses. Thus, if two men who had been engaged before the war in some employment at £150 a year each were to set up a new business with a capital of £500; instead of a profits-standard of £300 they would be entitled, after the passing of the 1920 Act, to substitute a standard of £1000 plus the allowance of 13 per cent on their capital. The same would apply to a private limited company as respects working directors. These reliefs did not apply to public companies, but on the 28th June 1916 in Committee on the Finance Bill, Sir J. Harwood Banner called attention to section five of the Fourth Schedule of the No. 2 Act of 1915, which provided that allowances for the remuneration of directors, managers, and others person concerned in the management of the trade or business when dependent upon profits should not exceed the sums allowed for those purposes in the last pre-war trade year, or a proportionate part thereof. He said: 'The arrangements made with the managers—and the war has caused very large sums to be payable—provide for, say, salary plus 10 per cent on gross receipts; salary plus 25 per cent on profits; and the profits made in the war and the proceeds which have been entailed by the war have amounted to very large sums. I have in my own experience seen sums paid in one case amounting to £15,000, in another to £50,000 or £60,000, and in another case amounting to nearly as much as £80,000 or £90,000 in respect of these particular arrangements.' With the object of dealing with this, section 49 of the

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1916 Act empowered the Commissioners of Inland Revenue, if they should think fit, to treat any company or body corporate whose directors had a controlling interest therein as if it were a firm and they were partners, and to refuse to allow a deduction in respect of any increase in the remuneration of directors of any trade or business. But, in reply to a question in the House of Commons on the 29th April 1918, Mr. Bonar Law pointed out that in the case of an employee-director an allowance of £2000 in any year was always made over and above the amount of the pre-war remuneration before any tax was charged.

There were various other reliefs and allowances in addition to those we have mentioned, deductions from the profits for the extinction of a pre-war loss, also on account of the postponement or suspension owing to the war of renewals or repairs and, in certain special cases, on account of the obsolescence or exceptional depreciation of value, owing to the war, of buildings, plant and the like, employed in the business. Also, subject to a qualification affecting shipping, where in one accounting period an excess profit arose, but in another accounting period a deficiency of profits below the standard was sustained, there was set off against the duty a percentage of the deficiency of profit, that percentage being equivalent to the rate of Excess Profits Duty in force in the accounting period in which the deficiency occurred. Notwithstanding the consideration for business interests which was shown in its imposition, however, Excess Profits Duty was very largely evaded, by the treatment of profits reinvested in the business as capital, by the sale or winding-up of the whole concern, including the stock, and in various other ways. It was attempted to deal with the particular abuse last mentioned by section 35 of the 1918 Act, but that was surely rather late in the day, and the law was not made retrospective, nor was the exaggerated value of goodwill taxed when sold. In his evi-

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dence before the Select Committee on Increases of Wealth (War), Sir John Anderson, Chairman of the Board of Inland Revenue, said: 'A great deal of "war wealth" has no doubt not come to the notice of the taxing authority and could only with great difficulty be discovered at its source', and 'It is often said that very large fortunes have been acquired by persons who have evaded war taxation by definitely fraudulent means, such as the elimination of particular transactions from the books of their trade and the keeping of double banking accounts. Rumours of this kind are probably much exaggerated, *but that they contain a substantial measure of truth is beyond doubt*. It would be more than unfortunate if gains of this character, which have escaped existing taxation, should escape the contemplated duty as well.' The clandestine remittances to the Treasury of 'conscience money' from time to time afford evidence of the fact, though the consciences of profiteers are not so susceptible as all that. The Excess Profits Duty which was originally imposed and fixed at 50 per cent by the Finance (No. 2) Act 1915, was increased to 60 per cent in 1916, to 80 per cent in 1917 (when the much evaded Munitions Levy that had been first imposed in July 1915 was merged therein), reduced to 40 per cent in 1919, again increased to 60 per cent in 1920, and finally abolished in 1921.

It has often been spoken of by interested parties as ruinous. That may be said truly enough of the effects of the enormous profits themselves on those from whom they were ultimately drawn, but it is ludicrous to apply such an epithet to the effect of the taxation on those who enjoyed them. To revert once more to the flagrant case of shipping, Mr. Fayle says of the year 1916: 'There were in truth many owners as ready to sell, at the high prices now ruling, as others were to buy. The uncertain duration of the boom, the large proportion of profits absorbed by taxation and the prospect of more extended requisitioning, all combined to suggest the attractiveness of a

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less speculative investment. An owner who sold for £300,000 a fleet that had cost him £100,000 could obtain from investment in War Loan an income equal to 15 per cent on his original outlay free from both Excess Profits Duty and from the fluctuations of the industry. No part of the Government's shipping policy has been more sharply criticized than the exemption from taxation of these huge profits. It certainly appeared inequitable that an owner who relieved himself from all obligations by the sale of his fleet should be permitted to reap the full benefits of capital appreciation, while those who continued to discharge their normal functions were subject to special war taxation.' Referring to such sales, he says: 'It was the rumour of approaching absorption which forced up the £10 shares of the Pyman Steamship Company from £24 to £46 10s. in a single fortnight. A feature of several of these transactions was the demand by managers of large sums as compensation, running up to as much as £250,000 in the case of a single company, the original share capital of which was only £280,000. On these demands 'Fairplay' commented severely, holding that, while managers were justified in accepting voluntary offers of compensation, there was an element of blackmail in refusing, without payment, to carry out their obvious duty to the shareholders by accepting an advantageous offer.' The pity is that the duty should have been repealed just when the fever of profiteering was rising to new heights.

NOTE

Replying to a question by Sir B. Falle in the House of Commons on the 24th February 1921, Mr. Chamberlain said: 'The actual facts are that the profits on which trades and

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businesses have been assessed since 1914-15 on the basis of a three-years average are £800,000,000 less than the profits which would have been assessable if the assessments for each year had been based on the profits of the year of assessment.'

IX

Abortive Attempts to Redistribute the War Burden

It will have been seen by the particulars we gave in the last preceding chapter that the special taxation of inflated profits made during the war was not by any means as ruinous as it was represented to be, on the contrary a very mild one in the circumstances. Yet, notwithstanding all the reliefs and allowances, as well as the evasions, which were undoubtedly very considerable indeed, the net yield of the duty was no less than £1,200,000,000, and that was in respect of a period of little more than six years. Compare this with the following: 'The Great War Pensions expenditure during the year ended 31st March 1933 amounted to about £47,265,300 and for the current year, ending 31st March 1934, it is estimated to amount to £45,218,300. This will bring the aggregate expenditure of the Ministry of Pensions since 1917, and of the service departments from 1914 to 1917 together, to £1,108,000,000.' This is for a period of *twenty years*, and it includes all administrative expenses! Thus it is seen that while war profits, which account for our enormous internal war debt and many private obligations as well, are a colossally heavy and continuing burden, war pensions are a comparatively light and rapidly expiring liability. Although the profiteers protested that they had not benefited unreasonably by their trading activities and that most of what they had gained had been taken from them, the fact remained that, by the time peace had been signed, the State found itself indebted to

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some of its subjects to the tune of £6,000,000,000 odd above what it owed them before the war! If that did not roughly represent the sum of the profits remaining in the hands of those who had benefited by the great trial to which the nation had been subjected, what did it represent? Was it the value of the services rendered to the country by the creditors over and above those rendered by the rest of the community? This was the sort of question that occurred to a great many people, and there was a pretty general feeling that common fairness and the interest of the nation alike demanded a redistribution of the war burden.

During the discussion of the first war budget, on the 17th November, 1914, Mr. Watson Rutherford quoted with approval Mr. Lloyd George's words: 'This is a national matter; this touches every person in the United Kingdom; it touches every pound's worth of property in the Kingdom; it has got to be met in an all-round fair way, so far as we reasonably can, everybody contributing up to the amount of their ability,' and said he believed that it was possible to get the whole money at once in the fairest possible way to the whole community by making a levy of 5 per cent on the £12,000,000,000, which he took to be the capital value of property in this country capable of bearing such a charge. The £600,000,000 so obtainable would, he thought, meet the whole cost of the war and even leave over a considerable balance for pensions! 'I am sorry', he continued, 'that this great national emergency has not been met by a great national tax, however small the amount, upon capital. I believe everybody who has got money invested in the whole Kingdom would have gladly parted with a proportion, with a small fraction, say—and 6d. in the £ would produce £300,000,000—which is half the money—they, at all events, would have parted with a small fraction on the assumption that the matter was finished with, and that they were not going to have this terrible demand

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upon income which is going to amount to a quarter of the income of many people.' Pursuing the same subject on the 23rd November on the Second Reading of the Finance Bill, he said: 'I have received a very large number of communications on the subject, and I am bound to say that I have received an amount of support I could hardly have expected. The fact is that if the Chancellor of the Exchequer had come to the people of this country and said, "I want you all to contribute in proportion to your means in this great calamity to meet the expenses involved by it", I believe the people of England would have readily done it. The communications which I have on this point satisfy me that it would have been so.'

From that date the suggestion that there should be some sort of capital tax or, as some put it, a conscription of wealth for the purposes of the war was frequently brought forward, but the Government preferred to keep to their loan policy. Replying to a deputation from the Trade Union Congress on the 14th November 1917, Mr. Bonar Law said: 'The question whether or not there should be conscription of wealth, then, is entirely a matter of expediency and I think it is a matter which concerns mainly, not the working classes, but the people who have money. In my opinion it is simply a question whether it will pay them best to have a general capital levy and reduce the National Debt as far as you can or have it continued for fifty years as a constant burden of taxation. Perhaps I have not thought enough about this to justify me in saying it, but my own feeling is that it would be better both for the wealthy classes and the country to have this levy out of capital and reduce the burden of the National Debt.⁵ When he said he thought it would be better for the country, did he think the working classes had no rights in it, since he had already expressed the view that it was a matter that did not mainly concern them? If we succeed in our task we shall

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have shown that it concerned them vitally and that the existence of this huge debt has, by its paralysing effect impoverished the whole country, to the greater detriment of the poor naturally than of the rich.

In his budget speech of the 30th April 1919, Mr. Austen Chamberlain expressed his views in regard to the matter in these words: 'There has been a good deal of discussion of late about a levy or tax on capital. If by a tax on capital is meant a small annual charge, then I think that that charge is as widely distributed and more fairly and conveniently raised in the shape of our Income Tax. If, on the other hand, there is meant a large levy on capital, then I beg the Committee to consider what the result might be. It is a bad time to propose such a tax when for the past five years you have been begging people to save, and when you are still obliged to ask them to save and to give you their savings. It is a bad time to tax those who have responded to your appeal by reducing their expenditure and making economies and to let those go free who disregarded your instructions, and who spent their money when it was not in the interest of the State or in ways which were not in the interest of the State.

'But consider a levy on capital apart from the circumstances of the moment. The death duties make such a levy once in a lifetime, and at a time when the taxpayer receives an accession of income, and since they are levied only at death, and we do not all die at the same time, the process of making the valuation and of levying the tax is a task of manageable proportions. It can be done justly and fairly as between man and man, and it can be done with a minimum of evasion or fraud. And since only a portion of the capital of the country is dealt with in any one year the tax is paid without any disturbance of credit and without any depreciation of securities to the detriment either of the State itself or of the individual. If a levy was to be made on all the capital of the country at one

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and the same time by the tax collector all these disadvantages would be lost. To make an efficient valuation fair as between man and man and fair as between the revenue and the State would exceed the power of any revenue administration in the world, and I make bold to say that our administration is the best. It would exceed their power at any time, and still more now when the staff is still depleted owing to the war, and when they are charged with the overwhelming new responsibilities which the war has brought. It would be open to all the objections and all the difficulties to which the simultaneous valuation and taxation of the whole land of the country gave rise under the Land Value Duties and it would be open to that objection on a vaster scale, because you would have to value not only real but personal property. Since very few people would have money lying idle sufficient to pay their obligations under the tax, it would mean an immense disturbance of credit. Everyone would be seeking to sell securities of one sort or another, and where all are sellers, who would be buyers, and who shall measure the loss to the country by the depreciation of all securities?¹ Who shall measure the loss to the individual through the same cause?

'If, to avoid these difficulties, the State takes payment in kind, then all the difficulties of valuation still remain. The State cannot refuse to accept property of any kind at valuation put upon it, and we should be left the owners of odd parcels of shares in every conceivable part of the country and in every conceivable undertaking, many of them of very doubtful value and very difficult to realize. I will only add that if it were thought that this expedient, once resorted to, would, as might well be the case, and as some desire should be the case, be resorted to again at every moment of difficulty or of extravagance, it would then be the greatest possible discouragement to industry and enterprise that the mind of

¹ Who indeed?

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man or Parliament could devise. It would be the strongest deterrent to saving and the creation of new capital, and it would be the strongest incentive to wasteful expenditure and to dissipation or withdrawal of existing capital. I say boldly that whatever be our views on the distribution of wealth or on the respective shares of the fruits of industry to which capital and management and labour are entitled, our great need now and for years to come is that we should have not less capital but more capital, and I hope the Committee will lend no countenance to so hazardous, and in my opinion, so disastrous an expedient.'

On the 29th October following, after repeating some of these supposed objections to a capital levy and adding that it would have a most deterrent effect on the influx of foreign capital at a time when we did not want to deter foreigners from investing here, he said he had already in the middle of the summer instructed the Board of Inland Revenue to explore the possibility of making a special levy on wealth accumulated by reason of, out of, or during the war, and submit the best scheme they could devise with suggestions as to the rate at which it might be levied and the yield which might be expected from it. On the 16th February 1920, a Select Committee of the House of Commons was appointed to enquire into the proposal to impose a tax on war-time increases of wealth, to report whether such a tax were practicable, and, if so, what form it should take. Mr. Austen Chamberlain, whose views on the subject had apparently undergone a radical change, told the Committee that, in his opinion, 'there was in principle nothing to be said against such a tax, that there was a very strong feeling in favour of it throughout all classes of the community, and that the widespread feeling that immense increases of wealth had been obtained during the war—and often in consequence of the war—by certain citizens, whilst a large number, and perhaps

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the bulk of the citizens, were either no better off or absolutely impoverished in comparison with their previous position, raised a feeling of unrest and disquiet, a sense of injustice which really menaced not merely the accumulations of wealth during or by reason of the war, but all accumulated wealth.' He expressed an earnest hope that they might succeed in their task.

In one of the memoranda submitted by the Board of Inland Revenue it was assumed that an ideal tax would seek to discriminate between various classes of wealth, e.g. (a) wealth obtained by dishonest practices, exorbitant charges or evasion of direct taxation; (b) wealth obtained through the favourable situation of a particular class of property owner, e.g. wealth obtained through the sale of ships which were in the ownership of the individual at the outbreak of war, and which acquired an exceptional 'scarcity' value, or through the ownership of exceptional stocks of commodities, which, owing to restricted supply and abnormal demand, acquired such a value, e.g. cotton, leather, timber; (c) increased wealth arising from increased earning power and alteration of prices, illustrated by the increased value of land or the increased value of ordinary shares of great numbers of companies; (d) increased wealth arising from exceptional efforts and exceptionally valuable services; (e) increased wealth derived from normal saving out of ordinary business profits or other sources of income; and (f) increased wealth derived from exceptional savings and by special effort for the purpose of investment in war loan and the like. The Board, however, came to the conclusion that, desirable as it might be to discriminate between those who had profiteered and those whose wealth had grown from other causes, it would in practice be impossible to do so. They quoted the recent book on *Taxation and the New State* by Mr. J. A. Hobson in which the author, recognizing the difficulty of earmarking and weighing up the character of differ-

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ent types of increase of wealth, made the general proposition that increases of wealth during the war had an exceptional 'ability to pay' and that that ability increased as the ratio of the increase grew. He suggested that the larger the ratio of increase the greater the presumption that, in part at any rate, the increase had come into the hands of its owner as the result of fortuitous circumstances or even of culpable practices, and he therefore advocated the exemption of small proportionate increases of capital and the imposition of a progressive duty upon larger increases. This was the principle upon which the Board thought it would be best to proceed.

In the carefully considered scheme which they had prepared at the request of the Chancellor of the Exchequer and laid before the Committee they came to the conclusion that the only practicable method of approaching the problem was by making a comparison of the aggregate wealth of individuals as ascertained by a valuation at two dates, those suggested being the 30th June 1914 and the 30th June 1919. Taxpayers liable would be required to furnish returns giving particulars of their wealth both at home and abroad at the two dates and stating the value of the assets at the two dates. These returns would be subject to revision. It was contemplated that the duty would be payable either in cash or by the transfer of Government stock or other approved securities, and in cases where the payment of the duty in a lump sum would involve the taxpayer in difficulties, e.g. where a taxpayer's resources were locked up in business, payment would be accepted in instalments with interest over a period of years. The scheme provided for the constitution of a strong appellate body to decide disputed questions (subject to an appeal to the Courts on points of law), and for the imposition of heavy penalties, including imprisonment, to check evasion. For the purpose of illustration two graduated scales were submitted under which duty would be charged at rates ranging from 28 per cent to

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nearly 80 per cent on the amount of increase shown by the two valuations, subject to a general tax-free allowance, in one case of £2000 and in the other of an amount equivalent to 10 per cent of the pre-war wealth. Under both scales it was suggested that persons whose post-war wealth did not exceed £5000 should be exempt from the tax. It was estimated that the yield of duty would amount to £900,000,000 and £1,000,000,000 respectively.

Reference was made to an estimate that had been published by Dr. (afterwards Sir Josiah) Stamp in the *Economic Journal* of September 1918, where £5,250,000,000 was given as the amount which should be added to the aggregate pre-war wealth of individuals which would be subject to, and likely to be revealed for the purposes of any general capital levy which might be imposed at the termination of the war. The Board observed that the amount reached by Dr. Stamp might be described as a net figure of increase, representing the aggregate increases appertaining to those individuals whose capital wealth had increased in value during the war diminished by the fall in value of the capital of those whose wealth had decreased. They were of opinion that Dr. Stamp's estimate was considerably above the mark. Their own estimate, based on the same general principles, was £4,000,000,000, and they remarked that, as the proposed levy would apply only to those whose wealth had increased, it was necessary to make a further investigation to ascertain by what amount this would have to be increased to arrive at the gross figure representing the estimated aggregate of those fortunes which showed a net increase. Their calculations resulted in a final figure of £4,180,000,000. Their estimate of total post-war wealth was £13,046,000,000; and, excluding all individual fortunes which did not exceed £5000, they estimated that 340,000 persons were enjoying an increase of £2,846,000,000 between them, which gives an average of

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£8370 odd each. But even taking the most conservative pre-war estimate and supposing there had been no addition to the real wealth of the country, the rise in values alone would surely give an amount expressed in terms of money considerably higher than that arrived at by the Board. It is always to be remembered that £6,000,000,000 odd had been added to the claims of subjects against the State, and the object of the scheme was to diminish these. Naturally this would not affect the total amount of real wealth in the country, but only lessen the existing number of deferred internal claims to it, both present and prospective. The intention and final effect of a levy of the nature contemplated should be to bring about a deflationary readjustment by reducing the swollen corpus of notional wealth as expressed in money and causing a partial redistribution of rights to real wealth. The former would of course bring down values and the latter would be achieved by fixing a moderate limit of exemption from the levy and imposing it according to a graduated scale. This was an eminently desirable aim in the interests, as we have said, of national recovery no less than of distributive justice; but, although the Inland Revenue authorities on whom the burden of assessment and collection would fall declared it to be quite feasible, it was to be defeated owing to the half-hearted weakness of the Government and the narrow-minded selfishness of the few who were too often consulted and too exclusively followed.

Mr. Austen Chamberlain, in trying to justify the final rejection of the proposal, said: 'Anybody who recalls, as my right hon. Friend the Member for Peebles (Sir D. Maclean) recalled, my first observations in the House on the subject of war-wealth will know that I did not approach the question as a convinced or enthusiastic supporter of the idea of a levy.⁵ No; the tergiversations of the Chancellor of the Exchequer in regard to this matter were indeed remarkable, as anyone may

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see who compares the evidence he gave at the Committee's first meeting with his speeches before and afterwards. He now (8th June 1920) informed the House that 'The whole world of banking, commerce, finance and industry, much as they dislike the Excess Profits Duty, much of my time as they have taken up in denouncing it and insisting on its intolerable character, prefer the evil that they know to the more vague and less precise, and therefore the more terrible, evils of a War Levy. Is there not reason for it? I have done my best to bring home the dangers which lurk in the solution which they have chosen, so that they should not take it with their eyes closed.⁵ Were they the only people to be considered? When did they ever accept burdens of any kind willingly? The Chancellor might surely have regarded himself as representing the other members of the community as well, the millions who had toiled, fought, bled and died in defence of the very interests which now revolted against the yielding up of any of the *profits* that had been made out of the bloody sacrifice! He might not improperly have stressed the fact that *the more vague and less precise, and therefore the more terrible, evils of war* itself surpass even those of a war levy. Instead of reminding them, as he now did, that he had himself 'dwelt upon the extreme difficulties of reconciling the broad general lines of equity on which such a tax must proceed with justice in individual cases' among those *who had been enriched*, he would have done better to spare a thought for *those who had suffered*, recalling that natural 'sense of injustice which menaced not merely the accumulations of wealth during or by reason of the war, but all accumulated wealth', which he had in the meantime, with apparent earnestness, impressed upon the Committee. Whether it was that he felt the danger had passed, he revealed his changed orientation by the following words: '. . . let me say also that I desire to recognize, and I hope my right hon. Friend, the Member for Miles Platting

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does recognize, the spirit in which the well-to-do and the rich have borne the immense financial sacrifices which have been asked of them during the war. They have been borne as patriotically as any sacrifices called for from any class of the community. An hon. Member opposite sneers. I do not know why. [*Was there any cause for wonder?*] The greatest sacrifice of all—the sacrifice of blood—was made in equal measure by all [//]. The financial sacrifice was made, as it rightly should be, in far larger measure by the well-to-do. It has been made by them without a murmur, to their credit be it said.⁵ How does this accord with the repeated denunciations of the Excess Profits Duty referred to above? There are the pages of *Hansard* to bear witness that, whenever it was a question of taking away some of the colossal profits that were being made, the Government were again and again warned of the danger of depriving manufacturers of any *inducement* to increase their output. One might wonder what were the inducements that led the men in khaki 'over the top', when there was any top left!

The question of a capital levy for the reduction of war debt was again examined during 1924 and 1925 by the Golwyn Committee on National Debt and Taxation. They referred to the dangers which would attend the administration of such a levy in case it should cause systematic obstruction or widespread anxiety, which had been pointed out by the Board of Inland Revenue in their submissions to the War Wealth Committee five years before, and they endorsed the Board's view that its success would depend upon its acceptance by the majority of taxpayers as a fair though onerous burden. They said: '703. The proposal that a levy should be imposed upon all accumulated capital wealth, and the proceeds used specifically for the redemption of debt is so far-reaching and has been so actively debated that it stands out as having a strong claim to special consideration. ... 710. It seems clear that a

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levy would be less readily accepted now than it would have been in the first year after the war. . . . 711. The Board of Inland Revenue, while they view the levy as "a task of the first magnitude" even under the most favourable conditions, do not regard the inherent difficulties as too great to be overcome. They state—thus confirming the supposition of the Trades Union Congress—that from the technical point of view the difficulties of assessment would normally be less than in the case of the proposal for a levy on war wealth, which was under consideration in 1920, and which they held to be workable. They add that the task of valuation would be "essentially similar to that regularly undertaken for the purposes of Estate Duty", 725. The general opinion of witnesses who advocated a levy was that a yield in the neighbourhood of £3000 millions should be aimed at, and that the scale should be regarded as subordinate to this yield rather than determining it. . . . 730. At the time when the levy was first brought into prominence, the price-level was of course much higher than at present. In 1919-20 and 1920-1 it was 261.1 and 270.6 respectively, or above the level at which borrowing in the three years preceding had taken place. The level for 1923-4 was 154.3, for 1924-5, 166.1, for 1925-6, 155.1. The extent of the fall proves how strong was the case for a Capital Levy after the war, so far as it rested on the high price-level then ruling. It is clear that in present circumstances the argument is no longer the same.¹ 741. . . . The Federation of British Industries, who thought that the only fall in the price-level likely to take place in the future would be a very gradual process caused by cheaper methods of production and new inventions, suggested that, with the return of this and other

¹ A decline in the price-level does not diminish the load of debt. On the contrary, by increasing its commodity value, it makes it more oppressive. How, therefore, does this weaken the argument in favour of extinguishing or at least reducing it?

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countries to a Gold Standard, the price-level would in future become a world price-level. If and so far as there were control by a conference of the central banks of the world, indications seemed to point to a notable influence in favour of a rising rather than a falling level. . . .*

In an article in the *Encyclopaedia Britannica*, Sir Josiah Stamp has reviewed the objections that have been raised against the policy of a capital levy and the rejoinders that they have brought forth. We will now examine the former and, as the latter appear to us to be inadequate, we will give our own answers, enclosed within brackets to make them more easily distinguishable.

(i) A successful levy, although definitely aimed at relieving war debt, can give no guarantee against repetition for other purposes in the near future, because no Government can bind its successors. Indeed the more successful the levy the greater the incentive to repeat it. As a consequence of this fear accumulation of capital would be restricted and slow, all industrial progress being thereby retarded. [As to future measures, there is no reason to suppose that the Government of the day will be any less competent to decide than any of its predecessors — it is very much to be hoped that it may be more so—but the necessity for this particular one would probably not arise if the concentration of wealth caused by profiteering and public borrowing were stopped. As long as these abuses continue the periodical application of this corrective is much to be commended. Our views as to the accumulation of capital will be given in a future chapter, but with regard to the retardation of industry nothing could have a worse effect than the load of war debt.]

(2) The financial operation would be so huge as to destroy its own basis by depressing prices. If the Treasury were satisfied to take only cash this would involve putting large blocks of shares on the market for which there would be no

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ready sale, panic prices would ensue and confidence be destroyed. If the Government were to accept large numbers of industrial securities in payment they would be unable to realize them without disastrous consequences, and the mere passive holding of them would bring no relief to the budget. While the banks and finance houses could talk the market into a state of panic, their goodwill would avert any depression of prices. [The depression of prices implies an exactly corresponding increase in the value of money. As to putting large blocks of shares on the market it is to be remembered that the cancellation of war debt involves an exactly equivalent reduction in the number of securities. Any industrial securities that might have to be sold by those who were subject to the levy would therefore be required for the investment of the amounts repaid to those who were exempted by reason of the smallness of their capital. But, as the Inland Revenue authorities foresaw, by far the larger part of the operation would consist of the surrender of war loan for cancellation by those subject to the levy. The last sentence of the above embodies a startling fancy for which, if it had any substance, a far more drastic remedy would be called for, and applied by any government worthy of the name, than any yet suggested. Apart, however, from any considerations of honour or public duty, how could such procedure possibly advantage the banks and finance houses? The foregoing objections would appear to be founded upon the inconsequent assumptions which Mr. McKenna voiced, when he appeared before the Colwyn Committee on the 3rd July 1924, in these words: 'You levy a high tax upon capable business men who are using their accumulations successfully. You reduce their power to carry on. You provide a considerable sum that goes to the holders of the debt. Those holders of the debt want to reinvest their money, therefore, in other businesses. Every sort of company prospectus will be brought out by business

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men, or assumed business men, and they will subscribe to these new companies; 50 per cent of them will be rotten and the capital wasted. Now you have taken that 50 per cent from the men who are using their money well and you have handed it over to gentlemen who may be going to use it ill and waste it. That is the evil.' Were there not equally good grounds for inferring the opposite of the view expressed in the last sentence? Did one ever hear such a farrago of gratuitous assumptions? The whole argument against a proposal to *deflate*, if you please, by extinguishing a huge body of empty claims which a comparatively small section had unjustly accumulated against the entire people, and for the interest on which a third of the national revenue had to be handed over every year, is about as typical of the bankers' outlook as anything we could quote and that must be our excuse for devoting so much space to it. Mr. McKenna's contributions to the problem, put forward with indubitable sincerity and occasionally brightened by hopeful signs of independence, have been extremely wavering and very seldom helpful. The rejection of the levy did not save us from the crop of bogus flotations and the mishandling of money which he predicted as a result of its adoption, and the able men in the City, even those of his own trade, were duped by the malefactors in at least as great a degree as were those of much less experience and pretension. Not a few of the capable business men who had been enriched by their country's misfortunes had betaken themselves and their wealth to the Channel Islands and the Riviera, and it might have been a fortunate thing if their power to carry on *had* been reduced, for the mere manipulation of money for their own ends by those who have large surpluses to play with is of extremely questionable utility to genuine business. Those who remained, for all their war gains, seemed unable to extricate their industries from the muddle they had got them into, and the losses consequent

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upon their repeated applications to the court to sanction heavy reductions of capital were an infinitely more expensive method of deflation than that offered by the capital levy, in other words by wiping out our iniquitous internal war debt.]

(3) The payment of such a levy would be ruinous to a private business, for it would oblige it to raise mortgages or debentures which the uncertain financial future would make very costly. [The Inland Revenue authorities said 'the total duty payable out of the resources actually sunk in or normally used for the purpose of private business must be very limited in amount, and the proposal to pay by instalments assures that the business capital need not normally be drawn upon in the slightest degree to meet the liability to the Levy; and that so far as cash is obtained under the Levy which might have been invested in industry and is used to pay off Treasury bills, the cash is again available as a basis of credit if it is required by industry.' The uncertainties of the financial future were due to the existence of the incubus which the levy was to remove.]

(4) So much of the wealth of the country is held on contingent titles, such as life interests and reversions, that the valuation of these would make an insoluble problem. However actually correct the values might be at the time, the results would be belied by subsequent events, and whenever duty was being paid by instalments there would be overwhelming demands for adjustments, reducing the levy to chaos. [How easily these people are baffled! Such matters were fully investigated by the Inland Revenue authorities and perfectly workable solutions found. Those who have had the custody since the middle of 1914 of moneys which were required to be kept invested in stocks and shares authorized by law for the investment of trust funds know well enough that any temporary advantages that may have accrued there-to from the high rates of interest, and any additions to capital

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that may have been obtained by such investments or re-investments as they were able to make in war loan, have been more than offset by the depreciation in their holdings of similar securities acquired before the war. With even greater force does this apply to cases in which they have been obliged to sell first-class industrial securities when precluded from reinvesting the proceeds in any but trustee securities. There were no overwhelming demands for adjustments in regard to these, because it was realized that they would never have been listened to. In the case of the levy, the resulting reduction in the number of Government securities would of course *raise*, not depress, the value of those that remained, and it is not likely that the holders would then wish for any revision. It is those who invested profits made during the war who gained by the war loans and it was their gains that caused losses to others.]

(5) This relates to the deflationary effect of the levy. Some financial circles held that the sudden cancellation of £3,000,000,000 of debt, according to the programme of the Labour Party, would remove from business a large amount of collateral security. This would cause credit to be withdrawn and restricted, resulting in fluctuating prices disastrous to business and employment. [The deflationary effect would, on the contrary, cause a rise in the value of the remaining securities, fewer of which would be needed as collateral for the same amount of money. Why was there so much excitement about inflation if deflation was not considered desirable? The Government can always create any collateral that is needed for the assistance of industry, as they have frequently done in the past, by the issue of Exchequer or Treasury bills, but there is no reason why they should pay for the privilege. It is only a question of making a just and sound use of public credit, for which this book is a plea. War loan is only collateral *wind* and it blows only ill to the country.]

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(6) The wealth-accumulating classes would not only have to give up part of their existing fortunes, but also to suffer future taxation as high or higher than before. This would strike at the root of all thrift and lead to national wastefulness, since the other classes could not save an equivalent sum. [There are no wealth-accumulating, but only claim-accumulating, classes and our views on the supposed virtues of thrift for the provision of capital are given elsewhere. Some of our critics will naturally test the methods we recommend by criteria drawn from those we condemn. It is an old subterfuge, but those who can appreciate rational argument will easily see through it. Why the partial abolition of the public debt burden and the more even spread of wealth should increase the need for taxation is not apparent to us. The naive, though familiar, argument that the rich must not be taxed lest they be left with no wealth for future taxation needs no comment.]

(7) This deals with the price level, and the contention that it would be advantageous to repay debt before a fall in this was countered by the assertion that the operation of the levy itself would bring about a fall and so make the remainder of the public debt more onerous. It was said that there were more factors making for a rise than a fall in prices and that future repayment of debt would be easier than present. [The fall came about notwithstanding the defeat of the proposal for a levy, and it was caused by the paralysis of business which might have been averted by its adoption. The Government were enabled to effect great savings through conversions of war loan that were made possible by the low rates of interest *that resulted from the inability of depressed industry to make profitable use of credit*. If the war loan had been altogether extinguished, as it ought to have been, there would of course have been no interest to provide for it. The value of the forecasts of these sages, like that of their arguments, has been made sufficiently evident by what has since happened.]

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The opponents of the levy finally said that the whole basis of the scheme was fallacious as it was assumed that it would set free interest on £3,000,000,000 of debt, say £150,000,000 a year, and allow of a corresponding amount of fresh expenditure or reduction of taxation. It ignored the progressive features of the existing income-tax, super-tax and death-duty schemes. *[There is nothing progressive about the restrictions on trade caused by the undue concentration of deferred claims. The object of the levy was the same as the graduation feature of the taxes mentioned, whose effect had been nullified by the enormous accumulations of so-called war wealth.]* Taking large sums from individuals would reduce their future tax-paying power *[Again!]*, the budget would be seriously affected and all that could be reckoned upon would be a certain net saving. One authority estimated that in the long run out of a saving of £140,000,000 something between £90,000,000 and £98,000,000 per annum would have to be set aside to make good the effects of the levy on future revenue, so that the net advantage to the budget would have to be reduced to some £42,000,000 or £50,000,000 a year. Sir Josiah Stamp says: 'No effective counter statistics have been put forward to alter this result.'⁵

We are astonished at this last expression coming from such a respectable source. The effect of the war loan issues, by artificially creating a large number of new interest-bearing claims on future production in favour of a small section of the population, was to diminish the proportion formerly held by the majority. The cancellation of a part of these would naturally have redressed the balance to that extent; and would not industry have been assisted by the more even diffusion of purchasing power among those whose demands for its products were restricted by poverty? Would not the greater prosperity thus achieved have lessened unemployment and the budget have profited by increase of revenue

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while being relieved of expenditure on interest and the dole? We must always beware of sticking too closely to the mere money argument or we shall confuse the symbols with the real things. The profiteers were not to be required to give up something that was justly theirs, only to restore part of what they had unjustly taken, and this consisted not in actual wealth but in claims to future wealth whose production was hindered by their existence and would be quickened by their extinction. One of the greatest objections to the war levy was the impossibility of discriminating between their unholy gains and previously existing accumulations which had only been increased by the inflation of values. But was it right that the struggle should cost even the latter nothing beyond contributions from income? Even if the nation had not been actually impoverished, as many of these said that it had, was it not time that those who had most to lose should share out some of it with those who, having little or nothing themselves, had worked, fought and suffered so valiantly for others and their property?

If the war loan had been held only by those who had benefited by its creation, the simplest plan would have been to cancel it, but of course that was not the case. The profiteers had made a virtue of investing in it, but, as we have before pointed out, the policy of public borrowing not only facilitated and encouraged their exploitation of the public, but also provided them with a safe means of preserving and further enlarging their gains at the public expense. What would they have done with these if there had been no war loans? They would have been obliged to spend them in improved plant and fresh business enterprise. If they had failed in that they would have lost their money, while if they had succeeded they would at least to that extent have served the general interest. As it was they made fortunes, sold their entire businesses or shares in them at figures based on activi-

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ties that were nearing their end, and invested the proceeds in war loan, which, being saleable even to foreigners who would not have looked at our industrial securities, made it easy for them to take themselves and their fortunes out of the country and to escape their share of its burdens.

As we have seen, two parliamentary committees had been set to work, within the space of five years, to investigate the possibility of the successful imposition of some sort of war levy which should do something to redress the situation and both had reported favourably. The Inland Revenue authorities had devoted a vast amount of time and labour to assisting them with alternative schemes based upon elaborate researches and calculations. Yet both were turned down by Governments of the same political complexion and composed to a large extent of the very same men. Their earnestness in this matter may be measured by the fact that they were actually laying their plans for the restoration of the Gold Standard while the Colwyn Committee were still engaged upon their enquiries! The results of their action are well enough known, though far less understood. Instead of lightening the burden that had been placed upon the many for the advantage of the few, it was made considerably heavier; £568,417,000 was added to the capital of the internal debt by the post-war conversions and the latter benefited correspondingly. This apparent impossibility of getting back profits made out of the country's difficulties makes it all the more urgent that steps should be taken to prevent them at the beginning. If Sir Josiah Stamp has given us the main arguments of those whose opinions were most acceptable to the Government we may cease to wonder at the Valley of Desolation into which they led us.

X

Problems of Currency and Exchange

In January 1918 the Treasury and the Minister of Reconstruction appointed a Committee with Lord Cunliffe, then Governor of the Bank of England, as its chairman 'to consider the various problems which will arise in connection with the currency and the foreign exchanges during the period of reconstruction, and report upon the steps required to bring about the restoration of normal conditions in due course'. The following words were subsequently added to the terms of reference, 'and to consider the working of the Bank Act 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable*. The members of the Committee were nearly all bankers obsessed with the shibboleths of the Gold Standard and their meagre reports are among the most unimaginative and depressing official documents ever printed.

Their main conclusions were: 'In our opinion it is imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be grave danger of a progressive credit expansion which will result in a foreign drain of gold menacing the convertibility of our note issue and so jeopardizing

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the international trade position of the country/ They therefore recommended the cessation of Government borrowing as soon as possible after the war,¹ the provision of an adequate sinking fund out of revenue, so that there might be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt, and the old remedy of 'the raising and making effective of the Bank of England discount rate, which before the war operated to check a foreign drain of gold and the speculative expansion of credit in this country. . . . The issue of fiduciary notes should, as soon as practicable, once more be limited by law, and the present arrangements under which deposits at the Bank of England may be exchanged for legal tender currency without affecting the reserve of the Banking Department should be terminated at the earliest possible moment. . . the Note Issue should be entirely in the hands of the Bank of England. The Notes should be payable in London only (subject to special arrangements for Scotland and Ireland) and should be legal tender throughout the United Kingdom.' As regards the control of the Note Issue they made the following observations: ' (1) While the obligation to pay both Bank of England Notes and Currency Notes in gold on demand should be maintained, it is not necessary or desirable that there should be any early resumption of the internal circulation of gold coin. (2) While the import of gold should be free from all restrictions, it is convenient that the Bank of England should have cognizance of all gold exports, and we recommend that the export of gold coin or bullion should be subject to the condition that such coin and bullion has been obtained from the Bank for the purpose. The Bank should be under obligation to supply gold for export in exchange for its notes. (3) In view of the withdrawal of gold from circulation, we recom-

¹ So far so good; but this was not because borrowing was considered to be in principle wrong.

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mend that the gold reserves of the country should be held by one central institution and that all banks should transfer any gold now held by them to the Bank of England. . . . Having carefully considered the various proposals which have been placed before us as regards the basis of the fiduciary note issue, we recommend that the principle of the Bank Charter Act, 1844, should be maintained, namely, that there should be a fixed fiduciary issue beyond which notes should only be issued in exchange for gold. The separation of the Issue and Banking Departments of the Bank of England should be maintained and the Weekly Return should continue to be published in its present form. We recommend, however, that provision for an emergency be made by the continuance in force, subject to the stringent safeguards recommended in the body of the Report, of section 3 of the Currency and Bank Note Act, 1914, under which the Bank of England may, with the consent of the Treasury temporarily issue notes in excess of the legal limit.' That part of their duty which consisted in recommending any alterations in the constitution and functions of the Bank of England they despatched in a very few words to the effect that any changes which experience had suggested had been made during the war. There was fortunately no modern Bagehot on the Committee to make disturbing enquiries and suggestions. In paragraph 4 of their First Interim Report, which was issued on the 15th August 1918, they say with reference to their favourite system: 'When the exchanges were favourable, gold flowed freely into this country and an increase of legal tender money accompanied the development of trade. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold. The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its

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banking reserve, with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process were repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream.⁵

For Lord Cunliffe and his colleagues, it should be observed, money was synonymous with gold, and because of its incompatibility with the Gold Standard they rejected the suggestion that that which was needed for internal trade and that which was needed for imports might with advantage be separated, as they are now, so that our manufactures need no longer be depressed by an increased burden of interest through the raising of the bank-rate at the very time when we should prepare to increase our exports to correct an adverse balance. According to them movements of gold depended upon and in turn controlled the flow of commerce, and were a sure index of its healthy or unhealthy condition, but that was never more than partially true. The crude mechanism of the Gold Standard might have worked without revealing its defects in its halcyon days when the metal was fairly evenly distributed among the nations according to the volume of their commerce, and its monetary use was mainly confined to the settlement of genuine trade balances. But its immediate collapse whenever subjected to any unusual strain and its damaging reactions thereto ought long ago to have awakened bankers, financiers and economists to its grave shortcomings. To listen to its advocates, one might suppose that the crises of 1792-3, 1796-7, 1825, 1837-9, 1847, 1857, 1866, 1914 and

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1931 were due to the breakdown of some paper system of credit which was on each of these occasions saved by gold, instead of the exact reverse!

Of the disasters of 1792-3, Macpherson, in his *Annals of Commerce*, says: 'Many houses of the most extensive dealings and most established credit failed, and their fall involved vast numbers of their correspondents and connections in all parts of the country. It was impossible to raise any money upon the security of machinery or shares of canals, for the value of such property seemed to be annihilated in the gloomy apprehensions of the sinking state of the country, its commerce and its manufactures, and those who had any money, not knowing with whom they could place it in safety, kept it unemployed and locked up in their coffers.' The Government were appealed to by the merchants in the City to assist them by advances of Exchequer bills, and Pitt, who was then Prime Minister, wisely consented.¹ 'The very first intimation of the intention of the legislature to support the merchants operated all over the country like a charm and in a great degree superseded the necessity of the relief by an almost instantaneous restoration of mutual confidence.'⁵ In *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* published in 1802, the author, Henry Thornton, says: 'The success of the remedy which the parliament administered denotes what was the nature of the evil. A loan of Exchequer bills was directed to be made to as many mercantile persons, giving proper security, as should apply.'¹ It is a fact worthy of serious attention that the failures abated and mercantile credit began to be restored, not at the period when the Exchequer

¹ It should be observed that an issue of Exchequer bills (or Treasury bills, as they would be nowadays) which is usually regarded as public borrowing, for which interest has to be paid, is here requested and made as a loan for the assistance of the mercantile community. The explanation of course is that public borrowing results in an addition to credit and the Government quite unnecessarily pay a section of the public for making it,

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bills were actually delivered, but at a time antecedent to that era. It also deserves notice that though the failures had originated in an extraordinary demand for guineas it was not any supply of gold that effected the cure. The fear of not being able to obtain guineas which arose in the country led in its consequences to an extraordinary demand for bank notes in London, and the want of bank notes in London became after a time the chief evil.'

In the alarm caused by the threat of invasion in the latter part of 1796 and the beginning of 1797 great numbers of people sought to convert as much as possible of their *property*¹ into cash and that led first to the failure of numerous small country banks and finally so depleted the gold reserve of the Bank of England that the suspension of cash (which at that time meant gold) payments² was ordered by the Privy Council and afterwards confirmed by Parliament. In Sir Inglis Palgrave's *Dictionary of Political Economy* it is stated that 'At a meeting held in the City to consider the difficulties which appeared during 1796-7, resolutions respecting "the alarming scarcity of money were passed, affirming that this scarcity proceeds chiefly, if not entirely, from an increase in the commerce of the country and from the great diminution of mercantile discount which the Bank of England has thought proper to introduce in the conduct of that establishment during the last three months.' During the severe crisis that arose in 1825, after the resumption of gold payments, Huskisson, the Chancellor of the Exchequer, was petitioned by the

¹ By property is clearly meant credit balances, which always exceed the amount of gold available. If property in the sense of land or goods were meant it would obviously involve no more than a transfer of cash from the buyer to the seller, and not necessitate any increase beyond that required to finance a larger number of transactions. This in such circumstances would be offset by low prices.

² The term cash, which properly applies to legal tender in any form, has been customarily restricted to gold when applied to the meeting of claims by the Bank of England.

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City merchants to make an issue of Exchequer bills to ease the situation, but he was afraid to apply the remedy which Pitt had demonstrated to be immediately and completely successful! The Bank of England, which had aggravated matters at first by its reluctance to make advances from a fear of endangering its reserve, finally restored confidence by reversing its attitude at the Government's request. Seven years later another panic was only averted by a strange chance thus described: 'The accidental discovery, for such it was said by Mr. Harman in his evidence in 1832 [Bank Charter Report] to have been, of an amount of £1 notes¹ which had been put away in the bank, was doubtless a fortunate circumstance; for although the sum was not large (between £700,000 and £800,000), it served to meet the peculiar difficulty of that time, which consisted in an extensive discredit of the small note country circulation. And it is probable that it had an immediate and very great effect in stopping the demand from the provinces for gold.'⁵

The Bank of England only just managed to overcome difficulties that were coming to a head in 1839 by borrowing £2,000,000 from the Bank of France, and the next panic followed the passing into law of Peel's Bank Charter Act of 1844. The crisis, which was brought on, as in the previous and most of the succeeding cases, by a mad orgy of speculation, reached its height in 1847. The book last quoted tells us: 'Meanwhile the anxiety and alarm prevailing were causing a general hoarding of coin and bank notes, and it really appeared not unlikely that the banking department of the Bank of England might be compelled to stop payment while there was more than £6,000,000 in specie in the issue department. The Chancellor of the Exchequer (Sir C. Wood, after-

¹ Just a packet of paper! In case it had not been found, why could it not have been made? The real wealth was in existence and only required the credit vouchers to enable the merchants to circulate and exchange it.

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wards Lord Halifax), was urged by many deputations and remonstrances to relax the Bank Act, but declined. At last on the 22nd or 23rd October some of the leading City bankers had an interview with the Prime Minister, Lord John (afterwards Earl) Russell, and, on explaining their necessities, the desired relaxation was given.' No Government after 1847 ever hesitated to suspend Peel's Act when the necessity arose, and this mode of procedure in conjunction with the rapid increase in the use of cheques delivered us from the undesirable restriction of credit which was intended by the provisions in regard to the fiduciary issue. The fact that crises have become notably less frequent and still less severe is clearly due to the displacement of gold by the paper cheque; and, seeing that the suspension of the Bank Act has always availed to stop panics in the past, there is every reason to suppose that we are secured against their recurrence in the future now that currency notes have taken the place of the sovereign. Ricardo said: 'On extraordinary occasions a general panic may seize the country when everybody becomes desirous of possessing himself of the precious metals as the most convenient mode of realizing or concealing his property—against such panic banks have no security on any system.'⁵ So it was thought in those days. But, as Bagehot said, 'All that a banker wants to pay his creditors is a sufficient supply of the *legal tender* of the country, no matter what that legal tender may be.'⁵ As long as it is not again provided by law that this may be exchanged for gold on demand at the central bank nobody will be misled as to its true nature and function, and the miseries and confusion which attend panics will fall into the limbo of forgotten things.

To come back to more recent times. What are we to think of those who attempted to revive the Gold Standard when the bulk of the metal was being drawn into the coffers of one or two nations to be jealously retained there as the most de-

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sirable possession for its own sake or to be used as an accumulator of deferred claims to what rational people regard as real wealth, and when the movements of the rest were dictated sometimes by the greed for unearned increment, sometimes by the panic of avarice and sometimes by political considerations, with never the least regard for the needs of commerce? These conditions had not fully developed when the Cunliffe Committee issued their Final Report, but the indications should have been sufficient to warn them, and they never saw any reason to revise their views even in the light of what afterwards occurred. We could not emphasize more strongly the disastrous nature of the remedy provided by that Gold Standard whose restoration they urged than by quoting paragraph 5 of their Interim Report, which reads as follows: 'If the adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure above described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the tradition of London as the financial centre of the world. But the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by check-

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ing imports and stimulating exports, corrected the adverse balance which was the primary cause of the difficulty.' An excellent system, to be sure, which postpones new enterprises, forces goods on a weak market and diminishes the home demand for consumable goods by throwing men out of employment as a preliminary to the stimulation of exports! In the article on Great Britain in the *Encyclopaedia Britannica* another protagonist of the same system, Mr. R. G. Hawtrey, says: 'But a contraction of credit, while it brings depression, bankruptcy and unemployment, nevertheless, after the passing phase of stringency, causes a rise in the prices of fixed interest securities and favours funding operations just because it diminishes the profits of production and trade.' That no doubt accounts for the benevolent smile and helping hand with which the recipients of fixed interest are accustomed to meet the bankrupt and unemployed victims, though one may suspect that the latter would prefer the comfort and independence of prosperity.

The First Interim Report of the Cunliffe Committee is by no means a diffuse document, though about six times as long as their Final Report, the only other they ever issued, which was little more than a brief recapitulation of the conclusions already arrived at and a confirmation of the recommendations previously made. We may therefore allow ourselves to quote the two remaining paragraphs devoted to the currency system before the war. 16) When, apart from a foreign drain of gold, credit at home threatened to become duly [*? unduly*] expanded, the old currency system tended to restrain the expansion, and to prevent the consequent rise in domestic prices which ultimately causes such a drain. The expansion of credit, by forcing up prices,¹ involves an increased demand

¹ By lessening interest rates it has in fact the very opposite effect. It was the false assumption on the part of the Bank authorities here repeated which led to the scarcity of money in 1796-7, which hindered business and caused the City merchants to protest. See *ante*, p. 217, and post, 247-8.

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for legal tender currency both from the banks in order to maintain their normal proportion of cash to liabilities and from the general public for the payment of wages and for retail transactions. In this case also the demand for such currency fell upon the reserve of the Bank of England and the Bank was thereupon obliged to raise its rate of discount in order to prevent the fall in the proportion of that reserve to its liabilities. The same chain of consequences as we have just described followed and speculative¹ trade activity was similarly restrained. There was therefore an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general. Domestic prices were automatically regulated so as to prevent excessive imports; and the creation of banking credit was so controlled that banking could be safely permitted a freedom from State interference² which would not have been possible under a less rigid system. ... (7) Under these arrangements the country was provided with a complete and effective gold standard. The essence of such a standard is that notes must always stand at absolute parity with gold coins of equivalent face value and that both notes and gold coins stand at absolute parity with gold bullion. When these conditions are fulfilled, the foreign exchange rates with all countries possessing an effective gold standard are maintained at or within the gold specie point.' Here we have an authoritative account of a currency conforming with the requirements of an effective Gold Standard, and its supposed virtues. We may feel that it is the abuse rather than the expansion of credit that should be guarded against, and that the latter by allowing of greater production should cheapen its fruits and thereby bring them within the reach of millions who need them without doubt but are debarred from buying either through too high prices or too light purses. The effect

¹ Only speculative.

² The bankers' bugbear.

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of the Gold Standard is to increase these disadvantages, as we see clearly enough by glancing at the few remaining countries which still labour profitlessly under its heavy yoke.

- In paragraph 16 of their Interim Report we find: 'A large part of the credit expansion arises, as we have shown, from the fact that the expenditure of the Government during the war has exceeded the amount which they have been able to raise by taxation or by loans from the actual savings of the people.'⁵ We are firmly of the opinion that the war could and should have been paid for wholly by taxation, *cheminfaisant*, but no serious attempt was made to do this. Admitting the very important fact that much, indeed nearly all, the money came neither from taxation nor from *the actual savings of the people*, the Committee say: 'They [*the Government*] have been obliged, therefore, to obtain money through the *creation of credits* by the Bank of England and by the Joint Stock Banks.' Yet they add in paragraph 17: 'A primary condition of the restoration of a sound credit position is the *repayment* of a large portion of the enormous amount of Government securities now held by the banks.'⁵ They do not see that the existence of these is entirely due to the 'borrowing'⁵ method, and that if the Government had confined this creation of credit for the public need to the Bank of England acting, not as a private corporation, but as their agents, there would have been no question of repayment.

There was absolutely nothing new in the prospective problem for the solution of which the Government sought the assistance of the Cunliffe Committee any more than there was in that body's recommendations. As Mr. Austen Chamberlain said in his budget statement on the 30th April 1919: 'The conclusion of that Committee, if it is to be criticized, will, I think, at any rate not be criticized as erring on the side of heterodoxy.'⁵ Exactly the same financial embarrassments produced by exactly the same causes followed upon the

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struggle with France during the closing years of the eighteenth and the opening years of the nineteenth centuries. Specie payments having been suspended in 1797 and the paper circulation having increased, the foreign exchanges became adverse to this country then just as they did as a result of the last war. A Select Committee of the House of Commons was appointed 'to enquire into the Cause of the High Price of Bullion'⁵ and their Report, which was ordered to be printed on the 8th June 1810, says, *inter alia*, 'It will be found by the Evidence that the high price of Gold is ascribed by most of the Witnesses entirely to an alleged scarcity of that article arising out of an unusual demand for Gold upon the Continent of Europe. This unusual demand for Gold upon the Continent is described by some of them as being chiefly for the French Armies, though increased also by that state of alarm and failure of confidence which leads to the practice of hoarding.' There we have the same old story, confusion caused by that desire for a *magot* securely put away in a stocking just as unprofitably as the laying up of talents in napkins two and a half millennia before! In the course of the evidence we find 'Sir Francis Baring has very justly referred to the Seven Years War and to the American War, and remarks that no want of Bullion was then felt in this country'⁵, which may probably be at least partly explained by the fact that we were not then on the Gold Standard. Although the Committee recognized that 'an increased demand for Gold, and a consequent scarcity of that article, will make it more valuable in proportion to all other articles; the same quantity of Gold will purchase a greater quantity of any other article than it did before'⁵, they and others went astray on many other points very much as their descendants have done.

Their Report expressed the opinion that the divergence then observable between the gold and the paper was caused by an over-issue of the latter and that it was difficult to resist

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the inference that a portion at least of the great fall which the exchange lately suffered must have resulted not from the state of trade but from a change in the relative value of domestic currency. The remedy suggested was then as more recently: 'That the system of the circulating medium of this Country ought to be brought back with as much speed as is compatible with a wise and necessary caution to the original principle of cash payments at the option of the holder of Bank Paper.' A sharp controversy was excited by these resolutions of the Committee. The directors of the Bank of England stated to the Committee 'a doctrine of the truth of which they professed themselves to be most thoroughly convinced, that there can be no possible excess in the issue of Bank of England paper so long as the advances in which it is issued are made upon the principles which at present guide the conduct of the Directors, that is, so long as the discount of mercantile Bills is confined to paper of undoubted solidity, arising out of real commercial transactions, and payable at short and fixed prices.' It might surprise one that this very sound Commodity Standard view should have emanated from the Bank of England and have been condemned by Bagehot in the strongest terms. He says the answers which the Directors gave to the Committee 'have become almost classical by their nonsense', and 'Very few persons perhaps could have managed to commit so many blunders in so few words'. But being, as he was, thoroughly imbued with Gold Standard ideas, it was perhaps only natural that he should be unable to appreciate that it was far more rational thus to relate money to merchandise.

One of the worst features of the use of gold for monetary purposes is that it enables large capital sums to be moved from country to country with comparative ease, causing that uncertainty and disturbance to trade and commerce from which the world has suffered so much in recent times. It

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deprives a country of capital and at the same time depresses the value of its currency. It is that more than anything else which has caused those violent fluctuations in the foreign exchange rates that have led to frequent demands for stabilization by the reinstatement of gold by those who have escaped from its thralldom, presumably on the homoeopathic principle of *similia similibus curantur*. The drain of gold for whose correction the bank-rate was formerly raised was more often than not due to seasonal imports of necessary foodstuffs and raw materials for manufactures whose partial export would afterwards put the country in credit, but the panic despatch abroad of capital in the form of gold, as long as it is used for money, is of no use whatever to a country; on the contrary often a permanent loss to it. The undue concentration of wealth, both nationally and internationally, that the war caused, led to those extraordinary peregrinations of such gold as was allowed to see the light of day which have been among the most deplorable phenomena of the post-bellum period and a constant provoker of others. Apart from the huge national demands, ill advised enough, the yellow metal was required by profiteers to convey their gains out of the country where they had been made, in order to escape taxation, as well as for speculators to gamble with abroad. It was for such objects mainly that the perpetual consignments were made, and they were further encouraged by the chronic state of fearful uncertainty which they induced. Hence the long succession of flights from the mark, the kroner, the franc, the lira, the pound, the dollar and so forth, to the great detriment of regular commerce, as were the indiscriminating restrictions whereby it was attempted to arrest the evil.

As long as we were on the Gold Standard refugee gold was used to purchase sterling, to be sold again on the slightest fear of loss or prospect of greater gain elsewhere, with the effect of artificially disturbing its value, and gained interest in this

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country. Since we have abandoned that standard and operated the Exchange Equalization Account it has not been turned into sterling on anything like the former scale, but stored in the strongrooms of our banks, like the family plate, for which a charge has been made, and such deposits do not affect our finances in the least. This shows that confidence in this country, even on the part of the chrysomaniacs is as great as ever, but the latter are haunted by the fear that they may lose money, as they have before (and gained it too, though they are apt to forget that), through changes in currency policy. It is just as well that the security they seek should be paid for instead of paying. These influxes of foreign gold ever ready to take flight again are in no sense a benefit but a great nuisance. After singing the praises of our financial system, Walter Bagehot says: 'But in exact proportion to the power of this system is its delicacy—I should hardly say too much if I said its danger. Only our familiarity blinds us to the marvellous nature of the system. There never was so much borrowed money collected in the world as is now collected in London.'¹ Of the many millions in Lombard Street the greater proportion is held by bankers or others on short notice or on demand; that is to say the owners could ask for it all any day they please; in a panic [*How that atmosphere pervades the pages of his book!*] some of them do ask for some of it. If any large fraction of that money was demanded, our banking system, and our industrial system too would be in great danger. Some of those deposits, too, are of a peculiar and very distinct nature. Since the Franco-German war, we have become to a much larger extent than before the Bankers of Europe. A very large sum of foreign money is on various accounts and for various purposes held here. And in time of panic it might be asked for. In 1866 we held only a much

¹ Bagehot here makes no distinction between gold and claims. Most of the borrowed money he here refers to consisted of the latter.

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smaller sum of foreign money, but that smaller was demanded and we had to pay it at great cost and suffering, and it would be far worse if we had to pay the greater sums we now hold without better resources than we had then.' In another passage, he says: 'Now that London is the clearing house to foreign countries London has a new liability to foreign countries. At whatever place many people have to make payments, at that place those people must keep money. A large deposit of foreign money in London is now necessary for the business of the world. During the immense payments from France to Germany the sum *in transitu*—the sum in London, has perhaps been unusually large. But it will ordinarily be very great. The present political circumstances no doubt will soon change. We shall soon hold in Lombard Street far less of the money of foreign governments; but we shall hold more and more of the money of private persons, for the deposit at a clearing house necessary to settle the balance of commerce must tend to increase as that commerce itself increases.¹ And this foreign deposit is evidently of a delicate and peculiar nature. It depends upon the good opinion of foreigners, and that opinion may diminish or change into a bad opinion. After the panic of 1866, especially after the suspension of Peel's Act (which many foreigners confound with a suspension of cash payments²), a large amount of foreign money was withdrawn from London. And we may reasonably presume that in proportion as we augment the deposits of cash by foreigners in London, we augment both the chances and the disasters of a "run" upon England.⁵

¹ It is worth noting that the money the Bankers' Clearing House has to do with is wholly in the form of claims, i.e. paper credit, not gold. The latter was never seen there.

² What the suspension of Peel's Act, in other words the Bank Charter Act, did was to remove the statutory limit to the fiduciary issue of notes, which could be paid out instead of gold if the demands for cash became too insistent. Both were legal tender and therefore cash.

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There is, of course, a distinction to be drawn between what we have called 'refugee gold' whose perpetual movements, dictated by the hope of unearned increment and the fear of loss, are not a help but a hindrance to commerce, and money deposited in London for regular commercial purposes. As to the latter, Mr. Frederick Hyde, then managing director of the Midland Bank, told the Macmillan Committee that 'The total of the deposits that we have from foreign banks, the total money that is placed in London that can be used in London, is more than twice the total of all our advances and all our acceptances to foreign banks put together.'⁵ Sir Robert Kindersley, a director of the firm of Lazard Brothers, merchant bankers, said, in his evidence before the same body: 'The great majority of the deposits of the average acceptance houses consist of foreign deposits . . . are deposits by those clients who are using us in other directions as well.'⁵ When it was suggested that all that this country got out of such transactions, in hard cash at least, was the commission, he answered: 'The commission. But, inasmuch as the fact that doing the business and having these foreign connections, brings in its wake large foreign deposits, England is not asked to finance any of these bills, it is not English money. Take my situation. My foreign deposits which I lend to the discount market or invest in Treasury bills, or use otherwise, are equal to the bills drawn upon me and therefore I get a commission, and London is not asked to produce any money for it because the foreign deposits which I have are sufficient to finance the bills.'⁵ Asked if such deposits would not be made if it were not for the acceptance business, he replied: 'I should say a very large proportion of them would not be made.'⁵ He estimated the amount of foreign deposits in this country at £200,000,000 gold. He also informed the Committee that during the American boom in 1928 the New York Stock Exchange had a call money rate averaging 8½ per cent between the 1st January

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and the 30th September, which attracted the liquid balances from this country, but that bills were not drawn on the London market in that connection. It is one of the virtues of bills of exchange that they are generally annexed to specific commercial transactions, in number automatically expanding and contracting with the volume of these; and although Sir Robert Kindersley learnt to his own astonishment that of a total of £350,000,000 of prime acceptances in 1913 no less than 60 per cent were finance bills, their true nature can generally be ascertained by those skilled in the business without great difficulty.

In the course of his budget statement on the 19th April 1932 the Chancellor of the Exchequer, Mr. Neville Chamberlain, said: 'During recent weeks the exchange position of this country has been one of considerable difficulty. There has been a great loss of confidence abroad and that loss of confidence has led to large accumulations of liquid capital which can very easily be moved from one financial centre to another and can therefore materially assist the operations of speculators. The effect of the transfer of this liquid capital is to exercise a very disturbing influence upon the exchanges—particularly upon the sterling exchange which is no longer linked to gold.¹ Since we were so successful in repaying the credits which were raised abroad last year, and in balancing the national accounts,² the tide of liquid capital has been setting very strongly in towards these shores. That is flattering to our vanity but at the same time it is sometimes a serious embarrassment to our trade, and, moreover, in so far as it does not represent a genuine and permanent improvement in the balance of trade it is apt to give rise to dangerous develop-

¹ Not for that reason, but because of confidence in paper sterling, which was again being bought. The gold link does not lessen, it aggravates the evil.

² Only made possible by going off gold.

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ment. In such circumstances nobody can say with certainty that the ebb may not set in presently. Therefore, I have been driven by the force of events to this conclusion, that, if we are to avoid violent and perilous fluctuations in our currency, especially those which are due to these speculative operations, if we are to enable this country to function effectively as the main international centre of the world, then it is essential for us to hold adequate reserves of gold and foreign exchanges, in order that we may meet any sudden withdrawal of short-dated capital and check and repel these speculative movements.' He then explained that he proposed to wind up the old Exchange Account and to use the assets as the nucleus of a new account to be called the Exchange Equalization Account, for which he asked for power to borrow up to £150,000,000. The details of the assets would not be published, but might take various forms, either gold or sterling securities or foreign exchange. That would give us a very large and extended power of purchasing exchange. 'The new powers, combined with those already possessed by the Bank, upon which, of course, the main responsibility for the management must continue to rest, will enable us to deal far more effectively than we could otherwise have done either with an unwanted inflow of capital, or, if the alternative should again arise, with an outflow of capital from this country.'

Mr. Chamberlain explained that the new Account could also be very conveniently used for the adjustment of accounts in the Issue Department of the Bank of England, these presenting some difficulty with the pound divorced from gold. 'Its liabilities for the Note Issue are in sterling. Those of its assets which may consist of foreign currencies fluctuate in terms of sterling; but so far as its assets consist of gold—including any gold that may be hereafter acquired—the law requires the gold to be valued at the old par. Thus the Issue Department cannot with the exchange at \$3.80 add £100

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to its gold holding without showing an apparent loss of £28; and, in the same way, it cannot sell £100 of its gold holding without showing an apparent profit of £28, while its holdings of foreign exchange fluctuate in value every week. Our currency authorities ought to be free to hold such amounts of gold and foreign exchange in the Issue Department as may be required without being hampered by technicalities of this kind.' Mr. Chamberlain felt it to be necessary to keep full cover for the Note Issue. 'I consider that at all times and in all conditions the assets of the Issue Department—that is to say the backing of our currency—should be consistently and conservatively valued, the gold in each return should be valued at the old par and all the foreign exchange at the current rate of exchange, irrespective of the purchase price.' He very properly disclaimed any intention of attempting to keep the sterling exchange at a fixed point, or even within a fixed range of values. To have done so would have been to subject sterling to the vagaries of foreign monetary policy, which would result in some cases in an over-valuation and in others an under-valuation. He still envisaged the possibility of our returning to the Gold Standard, and, as our currency was still so far anchored to gold that any excess of the fiduciary limit had to be covered by gold or foreign exchange, this was probably as far as he could go. It was in fact as far as it was then desirable to go. He quite rightly said that the advantages would far outweigh the risks of any losses.

The Exchange Equalization Account was set up by Part IV of the Finance Act 1932. The Treasury were thereby empowered to draw from the Consolidated Fund at their discretion sums not exceeding in the aggregate £150,000,000, in addition to the assets of the old Exchange Account (originally formed during the war with the object of acquiring foreign exchange, chiefly dollars, on the most favourable possible terms, as occasion offered, for the payment of pur-

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chases abroad, and afterwards of interest on our debt to the United States) at that time amounting to £25,000,000, and to invest the same 'in securities or in the purchase of gold in such manner as they think best adapted for checking undue fluctuations in the exchange value of sterling. Subsection (5) of section 24 of the Act reads: 'For the purpose of providing for the issue of sums out of the Consolidated Fund under the last preceding subsection or for the repayment to that Fund of all or any part of any sums so issued, the Treasury may raise money in any manner in which they are authorized to raise money under and for the purposes of subsection (1) of section one of the War Loan Act 1919, and any securities created and issued to raise money under this subsection shall for all purposes be deemed to have been created and issued under the said subsection (i).' Subsection (6) provides that 'The Bank of England may advance to the Treasury any sums which the Treasury have under this section power to raise.' The following provisions of Section 25 of the Act give the most material remaining particulars:

'25. (2) For the purposes of any valuation of the assets held in the Issue Department of the Bank of England being a valuation made before the winding up of the Account—

'(a) gold held in the Department shall be taken to be of the value of three pounds seventeen shillings and ten pence half-penny for every ounce troy of the standard fineness specified in the First Schedule of the Coinage Act, 1870 (hereafter referred to as "the fixed value"); and

'(b) assets in currencies other than sterling held in the Department shall be valued at the rate of exchange prevailing at the date of each valuation.

'(3) Whenever any gold is purchased or sold on account of the Issue Department during the existence of the Account, the amount by which the price of gold exceeds the fixed value thereof shall, in the case of a purchase, be made good to the

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Issue Department from the Account, and, in case of a sale, be made good to the Account from the Issue Department.

'(4) Immediately before the Account is wound up the amount by which the market value (as agreed between the Bank and the Treasury) of the gold then held in the Issue Department exceeds its fixed value shall be made good by the Department to the Account.

'(5) If, on any sale of assets in currencies other than sterling held in the Issue Department (whether the sale occurred before the establishment of the Account or occurs at any time during the existence of the Account), or on any valuation during the existence of the Account of any such assets, it appears that by reason of variations in rates of exchange, occurring at any time after the twenty-first day of September nineteen hundred and thirty-one, there has been any depreciation or loss in connection with these assets, the amount of the depreciation or loss shall be made good to the Issue Department from the Account, and if on any such sale or valuation as aforesaid it appears that by reason as aforesaid any appreciation or gain has arisen in connection with any of the said assets the amount of the appreciation or gain shall be made good from the Issue Department to the Account.⁵

The Treasury are empowered by the Act to cause the Account to be wound up at any time they may think it expedient to do so, and it is provided that it shall in any event be wound up not later than six months after the date on which the House of Commons resolve that it is no longer required for the purpose for which it was established, and the assets are then to be applied for the redemption of debt. By the Exchange Equalization Account Act 1933, the aggregate amount authorized to be issued out of the Consolidated Fund for the purposes of the Account was increased to £350,000,000.

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Thus has been evolved a piece of financial mechanism, admirable alike for its simplicity and its efficiency, which not only enables us to keep the exchange value of sterling steady but also to balance our international accounts with far less disturbance to trade than the antiquated methods of the Gold Standard. Under the latter, by the raising of the bank-rate, which, in a country whose strong creditor position was always being further strengthened, had the unnecessarily alarming effect of a danger signal, we were obliged to pay most dearly for these periodical adjustments, and our home industries, as we have before pointed out, were prejudiced just when they should have been given an added stimulus. This Fund enables us, on the contrary, to purchase gold and foreign exchange at the cheapest rate without any reactions on our internal finances, and, instead of being merely a temporary expedient pending our return to gold, it is far more likely to lead to the permanent abandonment of that metal as the basis of our money. As long as financially obscurantist countries go on demanding payment in that medium, to their own undoing, there is no reason why what may be available should not be acquired in this way. Payment might similarly be demanded and made in platinum without obliging us to adopt that metal as the standard of value and thereby subjecting our industry to the uncertainties of its supply and distribution, depending upon the crochets of hoarders and the cabals of dealers and manipulators. It is particularly worthy of record that on the 19th October 1934, upon the occasion of receiving the freedom of the city of Dundee, General Smuts said: 'One of the wisest steps Britain ever took was taken in 1931, when this country left the Gold Standard.' This is surely a remarkable observation to come from a statesman of such great distinction, who is also one of the joint leaders of the Government of the Union of South Africa, which is by far the most important gold producing area in the world!

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NOTE

Since this and the following chapters have more particularly to do with money it seems desirable to consider the true nature and functions thereof with some care, as they are very often misunderstood. Money might be defined generically as a numerical expression for the determination of the price or agreed exchange value of goods and services, for the facilitation of traffic therein and for the transfer of claims therein expressed. It is used in the two principal forms of currency and credit. The first of these consists of money tokens and vouchers, such as, in England, the current coin of the realm and the bank-notes which are authorized as legal tender. But these are only the small change of our commerce. By far the larger proportion of money that is used in this country takes no other form than rows of figures in books and on pieces of paper. These have to do with what are more particularly described as credit transactions, credit itself consisting in the present performance of services, delivery of goods or surrender of claims in consideration of the promise of compensating acts of a similar nature in the future, accepted on the faith of the debtor's prospective capacity and honest intention to discharge his obligation. Business, then, may be carried on by means of any one or more of the following forms of money: (1) Debit and credit entries in a ledger, i.e. book or paper credit; (2) the exchange of cheques, which are special orders for the transfer of that particular form of book credit known as 'bank money'; (3) bills of exchange, which are called instruments of credit and are the subject of a special body of law. They are now mostly used in international trade and are usually drawn in relation to the whole or part of a cargo. (4) Bank of England and currency notes, or (5) current coin of the realm.

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A great deal of confusion is caused in people's minds by the various inconsistent uses that are made of the term 'credit'.

When, for instance, a banker adds to his client's account a sum received in his behalf he is said to credit him therewith. When, again, a banker advances a sum to his client on the security of an easily realizable claim of greater value he is said to open a credit in his favour. Our definition would not apply to either of these cases, and we may anticipate a possible objection that this is hardly reconcilable with our own adoption of the description of 'bank money' as 'book credit' by pointing out that, whereas in neither of the examples just given is the banker trusting his client, but the reverse, the banker's entire deposits, out of which he makes his advances, are a mass of credit created out of the much smaller percentage of cash that his clients have entrusted him with. His whole business therefore rests upon and consists of, dealings with book or paper credit as we have defined it, based on a certain proportion of cash. Strictly speaking, credit can only arise out of somebody taking the risk of trusting somebody else.

One of the most perverse notions held in regard to money is that it should be regarded as a *store of value*. If anything of the kind is required, let money be employed to purchase the particular commodity or commodities it is desired to accumulate. As money in the form of cash is not merely the medium of exchange but also the basis of credit, for every pound, dollar or franc that is hoarded a far greater amount of money in the larger sense is withdrawn from circulation. The effect of such hoarding is therefore severely deflationary, and it is produced by the mere whim of the hoarder without regard to, or understanding of, the general needs of the community.

XI

Inflation and Stabilization

Most people have been perplexed by the strange and painful spectacle, with which we have too long been familiar, of poverty in the midst of plenty. Some have thought that a solution of the problem was to be found in the encouragement of industry by an abundance of cheap credit. But we have had that and the bankers have told us that it has not been made use of. Perhaps it is hardly to be wondered at that manufacturers should have no desire to borrow even at very low rates for the financing of production which they cannot dispose of, and, however much people may need their goods, they cannot acquire them without the necessary means. Others have thought the difficulty should be met by an expansion of the currency, a suggestion which has always immediately raised an alarmed cry of 'Inflation!'⁵ followed by lurid descriptions of the disaster into which it must plunge us, though when an increase of currency follows any addition to the Bank's stock of gold no harm seems to be anticipated or to arise. In any case, there is not much use in issuing fresh currency unless it can be got into the hands of the spending public (*pace* the Economy League!), and how is that to be done? Any suggestion of an increase in the lower salaries and wages would be at once indignantly repelled as an added burden to industry, though it might be thought that the spending thereof would be an aid to industry, which always seems capable of bearing the super-salaries quite comfortably.

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Others again, by a strange confusion of ideas, have thought that a rise in prices was the remedy, an odd one certainly for the relief of a situation in which large numbers of people are unable to buy even at the prevailing prices; but it goes without saying that this proposal never emanated from such unfortunates. It was one of those particularly favoured by the present rulers of our destinies, but whether they have actually learned something from experience or whether the reason is to be found in political considerations, it must be admitted that much less is now heard of the device last mentioned. Less, too, is heard of tightening one's belt and more of the triumphant advance of prosperity, which is cheering even if one has not yet personally experienced it. Now, all this is very baffling; yet if we avoid careless generalizations and give more precise meanings to the terms we use than is commonly done we may gain a little light.

The word 'inflation', which has been worked so hard during the past eighteen years or so, has been invested with meanings almost as diverse and unstable as the conditions which have given rise to its frequent use and abuse. It has been most generally applied to an increase in the issue of money, in the form either of (i) currency alone, (2) bank credit alone, or (3) currency and bank credit combined. This has been considered either (a) in relation to the gold holding, (b) in relation to the production of commodities, or (c) absolutely, the mere increase of money alone being so described. The word has also, though much more rarely, been applied to an increase in prices, and more rarely still has this been recognized as the cause of the increase in the issue of currency. With these preliminary observations, we will now proceed to give a definition of our own.

Inflation is that state of financial disequilibrium which is brought about by the increase of *notional* wealth at a greater rate than *real* wealth without the express object and effect of

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adding to the latter, and its influence is most injurious as well as most durable when that increase is concentrated in the hands of a small percentage of the population. The most common causes are: (i) increase in the value in terms of other commodities of any single commodity which is used as the fixed standard of value, e.g. gold; (2) the system which purports to provide for current national expenditure by the creation of future obligations (made more onerous by interest); and (3) profiteering in commodities and securities. This last, by forcing up prices and so diminishing the purchasing power of money compels an expansion of currency and credit. By profiteering we particularly mean the exploitation of a monopoly or quasi-monopoly by charging extortionately for indispensable commodities. The privileged position which makes this possible may be gained by a sole concessionaire or a commercial combine who have obtained control over one or more of such commodities, and by traders separately when some national emergency makes the demand far exceed the supply. While a scarcity may necessitate a rise in price, it can never in our view justify higher profits. It is nevertheless often produced artificially precisely because it affords such an excellent opportunity for the latter. Profiteering in stocks and shares is usually called speculation, but the first description applies with special force to those operations in which advantage is taken of some exclusive source of knowledge for private enrichment, an abuse of confidence which is a frequent cause of serious loss to those who wish only to invest their savings and would be content with a moderate but steady return. Among other causes of inflation are (4) the raising of rents; (5) the conversion of public loans in a way that adds to the capital of the debt; (6) the over-valuation of the capital assets of an industrial undertaking and over-estimate of its earning prospects, a favourite device of company promoters which is often connived at by the owners and directors of such con-

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cerns for their several private ends. (7) Increasing the cost of credit, in so far as it does not prevent its use, (8) the reduction of production without a corresponding reduction in deferred claims, and, most inflationary of all, the creation of (9) those claims on future production or service which are founded upon past production and service, after their fruits have been exhausted, that are encouraged and lauded by the name of thrift or savings. The most portentous example of all is afforded by the so-called public borrowing for the war whose true nature has been exposed in the chapters dealing with our war finance. But while the national honour is supposed to require the strict observance of those outrageous contracts, it is untouched by the neglect of the interests of the poor and the shabby treatment meted out to the survivors of those who served their country most single-mindedly in its extreme need.

It may be observed that an increase in the currency issue, which the great majority of our bankers, financiers and economists, as well as the politicians who are misled by them, have fastened upon as the outstanding example of inflation, finds no place here at all, and we will next explain its omission. We do not dispute for a moment that it belongs to the category of notional, not real wealth; but unless it were gratuitously distributed it would not be inflationary, and even if it were so distributed among the masses it would almost certainly create an immediate additional demand for those commodities which do constitute real wealth, and they would be readily forthcoming, we may be sure, in such a case. The only use of such distribution that would be inflationary would be the devotion of any part of it to savings, the very one which the authorities we have mentioned would applaud as sound. The wider the distribution were, the less, naturally, would be so applied, for, as we have been told, people generally save out of their abundance, not so much

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through self-denial. In the lectures which Professor Gustav Cassel delivered at Columbia University during 1928 and which were subsequently published under the title of *Post-War Monetary Stabilization*, he said: 'In all future times people will go back to the monetary revolution of our age, be astonished at all the amazing mistakes of monetary policy in this period, and take the greatest interest in the consequences of these mistakes and in the means by which it at last proved possible to return to normal conditions. Clearly it is the duty of the present generation to do its utmost to arrive at a clear analysis of what has happened to the world's currencies during the same period.⁵ We heartily agree with the last sentence, but shall be very much surprised if the result be to lead us back once again to what Professor Cassel conceives to be normal conditions. He says: 'The history of money recorded many cases of inflation before the world war, but the lessons of these cases seem to have been almost completely forgotten at that time. People actually failed to understand that an arbitrary increase in the supply of the means of payment could have any effect on the value of the currency, which was thought to be protected in some mysterious way by the gold reserves of the central bank. When such measures proved insufficient to keep a decent ratio of gold cover against notes, the authorities resorted to the device of diminishing the note circulation by replacing in the widest possible degree payments in notes by payments in the form of cheques. In several countries great importance was ascribed to such alterations in the composition of the means of payment actually in use and a willing co-operation in such a policy was proclaimed to be the first patriotic duty of the whole nation.⁵

The opinions which we hold differ materially not only from those which Professor Cassel here criticizes, but also from some of those which he himself entertains. We do not think any ratio to gold or any cover whatever is needed as a back-

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ing for the note issue. This supposed need seems to us to show an entire misconception of the true function of currency and it is one that has been long and widely held. Huskisson,¹ in the tract on the Depreciation of the Currency which he published in 1810, says: 'It is of the essence of money to possess intrinsic value. . . . The money or coin of a country is so much of its capital. Paper currency is no part of the capital of a country. It is so much circulating credit. A Bank note is not a commodity; it is only an engagement for the payment of a certain specified quantity of money.' Here one badly feels the need of a definition, and reference to one of our own to be found at the end of the last chapter will at any rate give any reader sufficiently interested to turn back to it the measure of the difference between our view and that of this erstwhile Chancellor of the Exchequer. Even our present currency note is, in form, a promise to pay the sum of one pound or ten shillings, as the case may be, made by the Chief Cashier of the Bank of England on behalf of the Governor and Company of that institution, and anybody who should claim its redemption would be handed in exchange another note of precisely the same kind, which would be all that he were legally entitled to. It is very unlikely, however, that any eccentric person has ever taken that step. As if by instinct, most people use these notes for the purchase of goods or the payment for services, keeping by them or paying into their banks any that they have no immediate need of; and how these objects would be assisted by the added right of effecting an intermediate exchange of the notes into gold is beyond our comprehension. Does its absence ever cause anybody except hoarders, who are not to be encouraged, the least inconvenience? If people really want gold they can buy it with this 'circulating credit', as Huskisson contemptuously calls it, as well as any other commodity. We have, of course,

¹ *Sec ante*, p. 217.

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a Currency Note Redemption Fund,¹ now forming part of the resources of the Issue Department, though we can hardly imagine any sane individual suggesting that the currency should be redeemed. True, the note issue may be contracted by the sale of some of the securities in the Fund and expanded again by buying them back, but we do not regard that relic of the past as indispensable.

In a letter which appeared in *The Times* of the 16th September 1919, Mr. F. C. Goodenough, the late Chairman of Barclay's Bank, said: 'A volume of currency which does not coincide with the productive power of the community raises prices and increases the cost of production, both of which affect adversely the foreign exchanges.' This is not very clear, as it does not say whether the lack of coincidence to which the effect is attributed is due to excess or deficiency, but it is interesting as relating the currency not to gold, of which the writer was a staunch supporter, nor even to the existing stock of commodities, but to the *productive power of the community* and there was certainly no ground for saying that the latter was less than would warrant the then existing volume of currency. As to the foreign exchanges, those based on paper sterling during the past four years have kept every bit as steady as those based on gold, comparing like with like, and sterling has kept far steadier than gold in relation to commodities. Mr. Goodenough, however, like most of his confreres, thought we ought to return to the old state of affairs as soon as possible. As a beginning, he suggested that 10 per cent of the currency note issue should be backed by gold, gradually increasing to 20 per cent by a fixed date, then 30 per cent and so on. 'Ultimately', he said, 'the whole issue could be put on a satisfactory basis.'² Our currency will thus gradually

¹ Principally consisting of paper securities issuing from the same source as the currency notes themselves!

² That is presumably a hundred per cent gold backing. Incredible as it

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again become an asset, as formerly, instead of a liability as now.' On the 8th October following Mr. (afterwards Sir) E. M. Harvey wrote to the same journal in support of these ideas. The increase in the issue of currency necessitated by the war has caused a prodigious amount of nonsense to be written and talked about 'inflation', as applied to the so-called 'abuse of the printing press'. It was argued *ad nauseam* that if we had faithfully observed the rules of the Gold Standard such expansion could not have occurred, but it is not seen by its protagonists that therein lies its condemnation. It very soon became evident that the effective prosecution of so serious a struggle required an expansion of industry and increase of employment far beyond that allowed by that obsolete standard. That is admitted even in the First Interim Report of the Cunliffe Committee which says: 'Plainly, given the necessity for the creation of bank credits in favour of the Government for the purposes of financing war expenditure, these issues could not be avoided. If they had not been made the banks would have been unable to obtain legal tender with which to meet cheques drawn for cash on their customers' accounts. The unlimited issue of currency notes in exchange for credits at the Bank of England is at once a consequence and an essential condition of the methods which the Government found it necessary to adopt in order to meet their war expenditure.' Yet that Committee, as well as the Committee on Financial Facilities under the chairmanship of Sir Richard Vassar-Smith, who reported towards the end of 1918, repeatedly referred to the expansion of the currency as if it were the root of all evil. The last-mentioned body said: 'The enormously increased purchasing power thus created has, in our opinion, been one of the main factors contributing to the rise in prices which has taken place.' In all the excitement

might have seemed, we have actually seen that ideal realized abroad, and with what results!

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there has been over inflation it is curious how its true causes have almost invariably been mistaken for effects, and its least important aspects have monopolized attention to the neglect of the most important of all. This, the war debt, has either been entirely ignored or glossed over as if it were inevitable. The unreality and vice of public borrowing for current public needs, which was specially exemplified at that time, has already been dealt with, but it is worth while here to contrast the inflationary effect of the great additional mass of deferred claims to which it gave rise with the expansion of the currency upon which such disproportionate attention was focused. *The so-called war debt then required considerably more than the whole fiduciary issue for the payment of a single year's interest, and even now that both have been reduced it needs nearly as much, while the capital burden has actually increased!* By far the greater part of this heavy annual tax on the whole community is paid to quite a small section of it, so tending to magnify the over-concentration of spending power.

We will now see what grounds there were for the wild assertions that currency notes were issued in excess of needs, and were the cause of the rise in prices. Replying to one of the periodical questions on the subject in the House of Commons on the 10th April 1918, Mr. Bonar Law said: 'Currency notes are only issued in response to actual public demands for circulation. There is no fixed maximum to the amount that may be issued, nor would it be possible in present circumstances to impose such a maximum without serious disturbance to credit conditions. The situation is being carefully watched by the Government and it is certainly not intended that the expansion should be allowed to continue indefinitely, but I am not prepared to commit myself to the opinion that it will be possible to check the automatic increase that is now taking place while war conditions continue.'¹ Replying to a

¹ Why only 'in present circumstances . . . while war conditions con-

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similar question in the same place, on the 31st March 1919, Mr. Austen Chamberlain said: 'The amount of currency notes issued is not determined by the Treasury, but by the demand of the public for currency as expressed in the amount drawn by the banks in the form of currency notes from their balances at the Bank of England. This demand in its turn depends largely on the rate of expenditure, both public and private. It is these factors and not any arbitrary act of Government which primarily fix the limit of the issues.⁵ Again, on the 30th April following, the same gentleman referred to the matter in his budget speech in these terms: 'It must be remembered that never at any period during the war or since has there been anything in the nature of a forced issue. Currency notes have only been issued in response to the public demand for currency. If there were anything like a forced issue it could be stopped to-day, not only without disadvantage but with positive advantage to all concerned. But what would be the effect of such action under present circumstances? The refusal of the Treasury to issue any more currency notes would not lessen the demand of the manufacturer on his banker for legal tender for payment of wages, and the banker would be forced to meet that demand so long as his customer had a balance to his credit. After exhausting his own stock of notes he would go to the Bank of England. The Bank of England, unable to obtain currency notes, would have to meet the demand by the issue of their own notes or of sovereigns withdrawn from the reserve in the Banking Department. In order to protect that reserve from immediate exhaustion a violent rise in money rates and drastic curtailment of credit would have to take place. This would not only have a most serious effect on the prices of securities, on wages and on the rates charged on Government borrowing, but also

tinue? Why should it not always be issued 'in response to actual public demands for circulation'? See *ante*, pp. 112-3 and *post*, p. 245.

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on the revival of trade and industry at a critical moment when the revival of trade and industry is the most important object we have in hand¹. . . . A new level of world prices must be established before we can say with anything like exactness what amount of currency is required.'² These pronouncements show quite plainly that the issue of currency waits upon the demands of trade and does not affect, but is affected by, the price-level. The fact no doubt is that the outcry against inflation falsely ascribed to an undue expansion of the monetary issue was the more readily listened to by many as being a most welcome and convenient way of diverting attention from the ravenous profiteering which went on worse than ever after the termination of the war.

In the book we have already quoted from, Professor Cassel says: 'If we start from the elementary idea that the value of the monetary unit is always determined by the total supply of the means of payment representing this unit, we are able to present the general theory of inflation in a very simple form. Inflation begins with an arbitrary increase in the supply of the means of payment.' Again, he says: 'The only thing we can know with certainty is that when the community is supplied with additional purchasing power not justified by an increase in the volume of trade to be transacted the result will be a rise in prices.'⁵ But how is the volume of trade to be transacted to be ascertained, and does not an increase in that itself usually, though perversely, lead to a rise in prices? Does not much depend upon the way in which money is distributed and used? We know, for one thing, that it may be simply held by the banks if there is no demand for it, though in the latter case the increase is not at all likely to be made. Why should it

¹ This is a pretty bad indictment of the Gold Standard, but it is true (see *ante*, pp. 220-1), though we were then only nominally on it. Even the pegging of the sterling-dollar exchange had been brought to an end when this speech was delivered.

² It must of necessity always fluctuate.

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be if it is not wanted? It appears to us that Dr. Mlynarski hits the nail on the head when he says, 'It is too often forgotten that the credit of a Central Bank, based on gold, is a means of *financing production and not consumption*. If the increase of production, stimulated by the inflow of credit, outruns the increase in the purchasing power of the ultimate consumer the equilibrium of production and consumption will be upset to the disadvantage of the producer. Supply then exceeds demand, prices begin to fall, and trade stagnation sets in. Under these circumstances neither a large increase in the production of gold nor a faster inflow of gold into the Central Bank can be used as a *direct* means of alleviating the situation.' It is seen by this excellent presentation of the case that an increase in the supply of the means of payment (whether backed by gold or not), may have the very opposite effect to that suggested by Professor Cassel.

Professor Cassel says of the war period 'a nominal purchasing power was created without any corresponding increase in the quantity of goods that could be bought'. It is interesting to see yet another upholder of the Gold Standard arguing, though quite inconsistently, as if currency and credit should be related to goods and not to gold. Such expansion very commonly occurred under the Gold Standard itself before the war, and as a matter of fact did not happen quite as Professor Cassel seems to think during its progress, for there was then undeniably an enormous increase in the quantity of goods which, although not ordinarily useful, were vitally necessary for the prosecution of the national purpose at that time. When Professor Cassel states that, in whatever way the means of payment were increased without a corresponding increase in the basis of the currency, which was then to be sure formally gold, there was inflation according to his definition of that term, he states a truism; but when he goes on to describe its effects and cure one sees more forcibly than

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ever the absurdity of using gold at all. If we had really adhered to the Gold Standard we should inevitably have lost the war. Here we were with the labour, the machinery and the raw materials for the commodities which were then most urgently needed. Fresh raw materials from abroad could only be bought with gold, our command of which soon proved insufficient, or by the pledging and selling of our holdings of foreign securities/which were unhesitatingly and quite properly used for that purpose. We were much earlier left without any gold for internal payments. But, having secured the raw materials, were we to stand still at home because we had not sufficient gold to finance the manufacture in England of the munitions of war, notwithstanding that we had the requisite labour and machinery? We were not quite so mad as that. What we in fact did was not only to expand but to alter the basis of our currency from the irrational gold to the rational commodity one, that excellent form of currency which we have once more, let us hope finally, returned to; though it is to this day loathed by most of our bankers and economists. *Eppur si muove!* As has been pointed out, there was an increase in the quantity of goods which would in any case have required an increase in the currency, but the necessity for this was magnified by the raising of prices, which was the true cause of inflation. Moreover, as Professor Cassel has himself recognized, a far greater number of people than usual were then employed for good pay.

The acute distress which was caused to the German people when their currency as well as many other of their institutions were in a state of chaos and dissolution as a consequence of defeat was indeed pitiable enough, but it has had such a terrifying effect on those among us who cherish orthodox views in regard to finance as to destroy their sense of proportion and cloud their judgments for many years afterwards. Professor Cassel says: 'The definite annihilation of the old

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German currency should for all time stand as a great warning against the first steps along the dangerous road of inflation.' Let us now, then, examine the German nightmare. Towards the end of 1918, the German people, deceived and betrayed by their former rulers, were left with a country that had been denuded of supplies and with no immediate prospect of being able to renew them. Selfish privileged individuals, doubtless warned in good time of the impending crash, had laid their hands on every exportable kind of wealth and fled abroad with it, while a large proportion of what remained had to be delivered up to the victorious Allies. Thus not only were the traditional bases of a sound currency removed but there was hardly any kind of a base left whereon reconstruction could proceed, though the real situation was for some time obscured by the wild operations of the speculators. Notwithstanding the able conduct of the retreat, every day hordes of hungry soldiers, demoralized by defeat, came fleeing home before the enemy. Those who took over the abandoned helm, never having been allowed to gain any training or experience in the arts of government, were overwhelmed with urgent problems of unparalleled difficulty. They were without the means of enforcing public order or immediately supplying the necessities whose lack was one of the causes of its overthrow. The most pressing need was the conclusion of peace, and, while they were engaged in the negotiations which led up to the signature of the Treaty of Versailles on the 28th June 1919, they were at the same time anxiously debating the future constitution of their country, which was framed in the teeth of much opposition and proclaimed at Weimar on the 11th August following.

Meanwhile the profiteer, who regards the distresses of individuals and whole nations alike as merely opportunities for enriching himself, was working like a demon to exploit the situation. The prices of such necessities as were at all obtain-

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able, already high enough, accordingly began to mount still higher. As such of the people who were at work soon found it impossible to keep body and soul together on the wages they were receiving, they naturally demanded and obtained more. Having, in addition to the ravages of the war itself, suffered heavy losses of population and resources by the treaty which she was obliged to accept, Germany was kept in a state of perpetual disturbance by a series of plebiscites for the settlement of her various frontiers, by intrigues for the setting up of an independent Rhineland, by the continual extension of the French occupation, to Frankfort, Homburg, Hanau and Darmstadt in April 1920, to Dusseldorf, Duisburg, Ruhrort, Muhlheim and Oberhausen in May 1921, and finally over the whole territory of the Ruhr in January 1923, to be continued till July 1925. These events, encouraging conspiracy, murder and revolt in her midst, rapidly destroyed what little confidence remained and made government almost impossible. It is hardly to be wondered at that production should have flagged in circumstances such as these, especially when the total amount of reparations to be exacted was left undetermined so that it might be increased proportionately to the return of any degree of prosperity. Further rises in prices compelled further increases in wages, the process daily gained in velocity, and of course the currency had to keep pace with it. The whole thing was an *ignis fatuus*, for it made no difference to a man whose wages were fifty marks a week and his barest cost of existence was the same when both went up to fifty million marks or whatever the fantastic figure might be, but the pursuit was a cruel one because the *ignis fatuus* and the profiteer were ever ahead of the exploited individual whose sufferings were further intensified by the speculators in the exchange. The catastrophe which finally engulfed the old German currency had been postponed, only to be made more calamitous when it came in 1924, by those

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who had greedily bought depreciated marks in the fond belief that they would sooner or later recover their original value. The confusion may be imagined when, in addition to the multiplication of the national currency, almost every town from the largest to the smallest issued notes of its own. It should, however, be remembered that it was not a deliberate inflation of the currency which forced up prices, but the forcing up of prices and the heartless exploitations of profiteers of all kinds, added to the other factors mentioned above, which brought about inflation.

That is what happened in Germany; and it is palpably ridiculous, when not consciously dishonest, to hold up the natural result of her accumulated disasters and disorders as a warning of what must necessarily follow from the supersession of gold by the issue of a paper currency regulated to meet the expanding needs of industry and consumption under utterly different conditions. While large numbers of unfortunates lost everything during those tragic years in Germany, plenty of fortunes were nevertheless made then and there, as everywhere, not only in spite of but because of such calamities, and, although the masses suffered terribly at that time, they were afterwards no worse off, relatively speaking, than they had been before. There had been, it is true, a great redistribution but it was by no means an equalizing one; it resulted rather in the transfer of accumulations from one section of the people to another. In one respect, indeed, the people as a whole did benefit, inasmuch as the internal national debt had gone the way of the currency, and for that reason the country might have prospered as never before if it had not been for the load of reparations. That is sufficiently borne out by the very remarkable industrial progress it made during the years 1925-8, when money was being re-lent almost as fast as it was being taken away from the nation. Germany was never naturally a rich country, though she had been

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made so by the great qualities of her people, and the war deprived her of some of the most valuable of her material resources, as well as a heavy percentage of her population, partly through war casualties and partly through cession of territory. Yet her foreign trade balance had again become favourable by the end of 1925 and the volume of her exported manufactures steadily increased till about 1928, when the output considerably exceeding the pre-bellum figures.

The chrysomaniacs who are for ever agitating for what they are pleased to call stabilization on a gold basis overlook the fact that the real enemy to stability, and that which does more harm to genuine commerce than any other single factor is that insatiable greed for unearned increment which perpetually seeks gratification in profiteering or speculation. While they talk of the undesirability of interfering with the natural functioning of supply and demand (as if such deals could properly be so described!), they nevertheless want the Legislature to intervene once more to re-anchor this country to an exploded system, notwithstanding that the least prosperous countries at the present time are precisely those which are writhing under it. They would not favour any legislation which aimed at stopping the iniquitous gambling in raw materials, manufactures, businesses, stocks and shares, indirectly also in human labour, which has too long been tolerated and protected on similarly false grounds. Have we not recently witnessed a silver ramp? Accumulated war profits have provided unscrupulous people with huge additional funds for these most mischievous dealings.

To what extent their attachment to gold is due to unreasoning fanaticism, incurable conservatism, the hope of successful gambles in the metal or on the exchanges, or to the cabals of the cosmopolitan owners of the mines and dealers in bullion for whom it has produced so rich a harvest, it is impossible to determine, but an impartial and clear-headed

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examination of the monetary question shows convincingly enough that not only is any such basis unnecessary, but that it is positively harmful. Are we again to have the already over-concentration of claims further aggravated by increasing the value of vested interests, and the service and commodity value of debts, depressing the purchasing power of by far the greater part of the community, and then again to blame the unhappy Government that has to face the inevitable *dibacle* in strikes and financial embarrassment? Surely that trick or blunder cannot be perpetrated twice in a single decade! The bankers who lend their support to such a demand must really not be surprised if it exposes them to the suspicion of being either incompetent or interested parties, for one or other of these conclusions is inevitable. Those who have large accumulations of the metal or are interested in producing or dealing in it are naturally in favour of devaluation of the monetary unit, such as the United States has adopted, as an alternative to the restoration of gold at the old parity. They know that the latter has ceased to be possible and why they desire the modification referred to is surely obvious enough, for it would permanently secure to them the advantage of its present inflated value which is due to purely artificial causes and would at once disappear with its universal abandonment. It is that eminently desirable event which they have above all to fear. It is the essential feature of the standard which is the worst, namely giving it a privileged position among commodities by fixing its value in terms of the currency. No commodity whatever should be so privileged, and in that case the only possible basis for money is the General Commodity Standard which is also the only fair and beneficent one.

All

The Government's Policy in regard to Capital after the War

On the 20th February 1919, Mr. Baldwin, then Joint Financial Secretary to the Treasury, made in response to enquiries the following announcement: 'The Reconstruction Committees on Currency and on Financial Affairs have advised that it is not possible under existing financial conditions to dispense altogether with the control of capital issues, and my right hon. Friend has come to the conclusion that it is necessary, at any rate for the present, to continue this control in a modified form. It is imperative during the reconstruction period to preserve for undertakings which are essential for the speedy restoration of commerce and industry, and the development of public utility services, an adequate share of the capital which is available for investment and to prevent any avoidable drain on the foreign exchanges. A Regulation under the Defence of the Realm Act will accordingly be made forthwith, prohibiting fresh issues, except under licence. The enlargement of the purpose for which it will be proper to allow fresh issues may be expected to result in a great increase in the number of applicants, and it has been represented to me that in the interests of applicants there should be machinery for allowing them to state their cases orally before the Committee, if they desire to do so, before any decision adverse to the application is arrived at. My right hon. Friend has therefore decided to reconstitute and extend the Capital Issues Committee. The

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new terms of reference are as follows: "To consider and advise upon applications received by the Treasury for licences under the Defence of the Realm Regulations for fresh issues of capital, with a view to preserving capital during the reconstruction period for essential undertakings in the United Kingdom, and to preventing any avoidable drain upon foreign exchange by the export of capital, except where it is shown to the satisfaction of the Treasury that special circumstances exist".'

From the time the policy had been first initiated, in 1915, the Emergency Regulations of the London Stock Exchange and the stock exchanges throughout the country had prohibited dealings in stocks and shares that had been issued without the consent of the Treasury; but, as the latter were not actually illegal, a great many had taken place outside these institutions to the prejudice of their members. Partly by way of compensation to them, the new Regulation 30 F. (D.O.R.A.), which came into force on the 24th February 1919, made such outside dealings for the future illegal, but, further than that, it was given retrospective force. This gave rise to a mild panic among those who suddenly found themselves thus converted into law-breakers and their holdings apparently deprived of value. The agitation caused and the large amount involved obliged the Government to reconsider the position. Upon motion for the Adjournment of the House on the 27th, Mr. Bonar Law gave a very fair explanation of the Government's difficulties, admitted that the effect of the new regulation was apparently more restrictive than the custom which had prevailed during the war, but said that that was exactly the reverse of its intention! He said he had the authority of the Chancellor of the Exchequer for stating that he intended to issue an Order removing its retrospective effect, which in the meantime would not be enforced, and begged the House to accept that concession without desiring

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any further alteration in the Regulations, as they had been made in the best interests of the trade of the country. No doubt that also was the *intention* of those who framed them, but there seemed to be a very general opinion that they were more likely to prove harmful. In the meantime the Treasury were overwhelmed with applications, much confusion, delay and discontent resulting. Finally, on the 24th March, Mr. Austen Chamberlain made the following statement to the House: 'I have given very careful consideration to the various representations that have been made to me in regard to Defence of the Realm Regulation 30 F. providing for the control of capital issues, and I have now, after consultation with Members of this House who have shown a special interest in the question, and with my City advisers, come to the conclusion that, in view of the general movement towards the removal of restrictions upon trade and industry, I am no longer justified in attempting to maintain Government control over the distribution of capital for domestic purposes. . . . As regards issues by British companies for capital purposes abroad, and issues by or on behalf of persons resident abroad, the position is to some extent altered by the recent decision to set free the foreign exchanges, but until the full effects of that decision have become apparent, and as long as the domestic demands for new capital, both for trade and industry and for national purposes are so pressing, I do not think it would be safe to remove the restrictions upon investments outside the United Kingdom. The new Regulations will therefore provide that no such issues shall be permitted except under licence.⁵

Thus was begun a policy whose internal effects were soon brought home to the Government, but which has done and continues to do as much as anything else to cripple our foreign trade, not only setting an example of that pernicious economic nationalism which everybody is slowly beginning

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to recognize as one of the worst evils of the day, both economically and politically, but even compelling others to follow in our wake. For, just let us consider its implications and effects. Since all harvests have to be financed in advance, so therefore must a large part of the general needs of all countries which are in a comparatively early stage of development, above all those whose products are mainly food and raw materials. Has not a large proportion of our wealth been gained in other lands by men who have seen that by turning sterile tracts of scrub or thicket into arable and pasture lands, furnishing the former with the right kind of seed and the latter with sturdy breeds of cattle and sheep, the wilderness may be turned into a land of plenty? Have they not shown that deserts may be made to blossom if barrages are constructed and pumping machinery installed for their irrigation? Have they not brought rare timbers from the depths of tropical forests and rich ores from the depths of alien earth for the uses of civilization and their own profit? Have not all these things required to be brought within the reach of ports by railways; have not such ports and railways had to be constructed and equipped for the transport and convenient loading of our ships with these varied cargoes, to the advantage of all our manufacturing industries, our shipping, our banks and insurance companies, our acceptance and discount houses? All very obvious doubtless. Yet, listen to this. In reply to a question in the House of Commons on the 10th April 1919, Mr. Austen Chamberlain said: 'The expression "capital purposes outside the United Kingdom" includes the purchase of land and other fixed assets situated abroad and the acquisition either within the United Kingdom or elsewhere of instruments of production or other income-producing assets for use abroad. In this connection, my noble Friend will no doubt remember that the Committee has been instructed, in considering the applications made to them, to

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take into account the extent to which the proceeds will be expended within the United Kingdom and the assistance which the issue may be expected to give to British trade.⁵

In fairness to the Government, it should be remembered that, before framing these inept policies, they turned to those who, because of their eminence in the City, they mistakenly thought were best qualified to advise them in such matters; and the bankers, who were principally consulted, should realize that this is the original source of the criticism under which they have ever since smarted. No doubt they gave what they honestly believed to be sound advice, but the training suited to fit them for their own trade, in which special care has to be taken to avoid risks, is by no means the best to develop the qualities required for the formulation of a policy that so far transcends its limits. Whereas it may be sound in certain circumstances for a single business unit like a bank to decline, as being too great, a risk in connection with the undertaking of another in which it is interested solely as a possible source of pecuniary profit to itself, the position of the Government is entirely different. The latter might well be justified in spending public money with the view of providing useful employment for the idle, and the result would no doubt be commensurate with the wisdom of the scheme devised. But even in the extremely unlikely event of its being entirely unproductive the loss could not possibly be greater than if no such effort had been made. Indeed the effect on the men of occupation alone must have some value. It is this which the bankers, with their eye on the till, are unable to see and it must be a poor sort of statesmanship which is unable to detect the narrowness of such an outlook. It is therefore unfortunate both for the bankers and for the country that they should have been so frequently appealed to. They were strongly represented on the Committee on Financial Facilities, presided over by Sir Richard Vassar-Smith, which was appointed

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on the 26th November 1917 by the Chancellor of the Exchequer jointly with the Minister of Reconstruction, and its report gives the impression of a group of men whose minds were permeated with and narrowly bound by the doctrines of the Gold Standard, with its artificial equilibria and so-called 'wholesome restraint on *over-trading*'. They held seventeen meetings, but they only examined eleven witnesses before recording their conclusions on these weighty matters. They said: 'Although the provision of financial assistance is undoubtedly an important factor in the reconversion of trade and industry, we do not think it is by any means the primary factor. The remedy for the wastage of capital during the war lies mainly in increased production and genuine saving.' Increased production, of course, but it has got to be financed and the work will be held up if you bungle that! By 'capital' it is evident that they were thinking of two entirely different things, for 'increased production' must refer to commodities whereas 'genuine saving'⁵ clearly refers to the accumulation of claims. When so many things were urgently needed in great quantities at the same time they would no doubt in many cases have to be waited for, and it might conceivably require the intervention of the Government for a brief period to ensure that certain pressing needs were met first. There was otherwise surely no longer any reason why people should intentionally do without in order to add still further to the gigantic accumulation of deferred claims which already existed, as for example in the various descriptions of war 'indebtedness'! There was very good reason indeed for getting rid of this, and we have already seen how the half-hearted attempts to do so were frustrated.

The Committee whose conclusions we are at present considering compared the existing bank deposits, then approaching £2,000,000,000, with those of £1,070,000,000 at the 31st December 1913 as 'an indication of the very great expansion

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of credit which has taken place⁵ without mentioning as an offset the 'very great increase of production' which accompanied it and which they had referred to in another connection, their measure being exclusively the golden one. They said 'the enormously increased purchasing power thus created has, in our opinion, been one of the main factors contributing to the rise in prices which has taken place', notwithstanding the repeated declarations of the Chancellor of the Exchequer that currency had only been issued as and when it was demanded, for value, showing that it was the effect and not the cause of the rise in prices. One of their unanimous recommendations was that 'some restriction must be imposed, at as early a date as possible, upon the creation of additional credit by the restoration of an effective gold standard', at the very moment when this country had become for the first time a large international debtor and the needs of the world were greater and more pressing than they had ever been before, offering us a wonderful opportunity to regain the position in its markets which we had perforce lost during the war! The restoration of the Gold Standard would not merely have placed a restriction on the creation of additional credit, but would have been severely deflationary when both the volume and velocity of business transactions were to be augmented. At such a moment, when a financial system of the greatest flexibility was a prime and indispensable necessity, we were recommended to reshackle ourselves with the metal which the expansion due to war industry had obliged us to cast off!

The Government, then, so advised, were afraid that issues by British companies for 'capital purposes outside the United Kingdom, including the purchase of land and other fixed assets situated abroad and the acquisition, either within the United Kingdom or elsewhere, of instruments of production or other income-producing assets for use abroad' would be

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injurious to our home industries by depriving them of capital, and would make the exchanges further adverse to us. The restriction of such issues would certainly tend to prevent us from engaging in many of those activities of our forbears which we have enumerated, but were they injurious to us and did they put the exchanges against us in the past? If not, why should they suddenly be expected to have such effects? When a British company is formed to build a railway, say, in Argentina, does it not spend its money on orders placed in this country for rolling stock, rails and railway material of all kinds? Does it not give employment to British engineers, managers, foremen, etc.? It may pay away considerable amounts for supplies and in wages in Argentina, but will it not ultimately earn a revenue there? Even if it invests in land or other fixed assets, as it must do for a railway, it presumably does it with a view to profit; and what becomes of the sterling credit with which the local credit for the purposes mentioned has been purchased? Must it not eventually be used to pay for British goods and services, if it is to be used at all? Let us not forget that it is advantageous to ourselves, as well as to others, to buy certain foreign products and employ foreign labour, otherwise we should not do it; and every pound that we pay for milreis, pesos, or whatever currencies we may need for the purpose, must in turn be spent in our own country. More than that, the dealings of that nature that we have hitherto engaged in have not only led to the immediate enrichment of all parties to such bargains, but have in addition resulted in the acquisition or creation of a vast quantity of real wealth and the accumulation of a vast number of claims to wealth by us in other countries. Sir George Paish has estimated that at the end of 1913 the capital value of British investments abroad amounted to no less than £4,000,000,000, of which £1,780,000,000 was in the British Dominions and possessions oversea;

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£754,000,000 in the United States, £764,000,000 in other American countries and something less than £200,000,000 in European countries. In railways we had £1,521,000,000; in Foreign Dominion or Colonial Government securities £959,000,000; in mines £273,000,000; in land investment and finance companies £244,000,000; in municipal loans £147,000,000; in commercial and industrial securities £145,000,000. The ownership of all this external wealth, the fruit of that export of capital which our Government suddenly thought it advisable to obstruct, was, as we have seen, of incalculable value to us during the war, and in peace it has secured to us the largest share in the world's commerce. Is it not strange that the nations which so jealousy competed for international trade, casting envious eyes on that obtained by others, when there was really plenty of scope for all, should since have severely limited their own opportunities? The truth of the matter is that our Government and their advisers made the same mistake that the Americans did, though with far less excuse, in confusing the infinite variety of the world's wealth, whose free exchange has been so beneficial, with the one commodity gold, which has probably done far more harm than good. There is and has always been a good deal of misunderstanding of the nature of foreign loans and investments, both here and elsewhere, as was evidenced by President Coolidge's reference to the Anglo-American war debt in which he spoke of Great Britain having hired the money whose return he demanded in gold.

The so-called export of capital, which received a certain amount of ill-advised criticism before the Colwyn Committee and still more before the Macmillan Committee, is altogether a very misleading phrase, since it suggests the export of money, and it is evident that it is generally so thought of. If, however, we realize that domestic savings are nothing more than an accumulation of claims to domestic products and services, we

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shall at once appreciate the fact that the former are of no use to people in other lands except for the purchase and export of the latter. A foreign company, or a company formed by an English group to operate abroad, might raise capital in this country; a foreigner might borrow English money or persuade an Englishman to invest in his business abroad. In each of these cases alike it would only be the proceeds of the money in the form of commodities that could usefully be exported, and the effect as far as the country were concerned would be exactly the same as if the producer, manufacturer or merchant were himself to give credit: that is, agree to postponed payment for the goods exported, the only actual difference would be in the sponsoring of the credit. Even gold might properly be included among such commodities, and in so far as it came from mines not owned by ourselves it would in the first place have had to be purchased by the export of our own products. The use of gold in trade and commerce is merely an intermediate form of barter, and credit not based on any single commodity might very well be termed a direct medium for selective barter. It would therefore be a good thing if people were to regard foreign loans as concessions of immediate rights to our goods and services for a deferred consideration of similar nature rather than as an export of capital, the very kind of transactions which have led to our pre-eminence in the domain of international commerce.

In addition to the foregoing we had other resources for increasing our foreign investments; namely the surplus which remained in our favour from the sum of the dividends and interest produced by those undertakings which have grown out of previous investments of the kind we have mentioned and the earnings of our shipping, banking, insurance and other activities abroad, after payment for our foreign imports and the various services rendered to us by foreigners. It was a surplus that could not be brought home. If we had made the

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mistake of thinking of it in terms of gold and had demanded payment in that medium, as the Americans did for the balance owing to them after the war, we should speedily have brought our external trade to a standstill and caused a general deadlock with all its resultant evils, very much as they did. Thus it will be seen that it is quite a mistake to regard foreign lending as involving drafts on a limited amount of capital for export abroad to the detriment of our home industries. On the contrary, it may be partly of specially created credit and partly of accumulated earnings abroad, to be utilized in favour of our home industries. During one of the meetings of the Colwyn Committee, Sir Charles Addis asked Professor Kirkaldy whether he could explain the discrepancy between the Board of Trade figure of £97,000,000 for our investments abroad in the year 1923 and the actual issues on the London market which amounted to £136,000,000. The answer given was that 'it would be very difficult to analyse the items and find out what the figures were'; but the explanation is most likely to be found in the omission in the one case and the inclusion in the other of some of the different kinds of investment distinguishable as above. Our external balance, which was largely and increasingly in our favour before the war, has since suffered a sad decline. Without wishing in the least to minimize the gravity of this fact, we may nevertheless observe that as long as we have an accumulation of previously earned dividends and interest that have been capitalized and invested abroad, our balance cannot truly be described as adverse. We could not carry on for long if it were, and one of the best ways to avoid that danger is to return to the saner methods of the past, among which we do not include the Gold Standard, as far as the choice is still open to us. The situation has already been sufficiently complicated by the controls, leading to a diversity of other evils, which the follies of the creditor countries have forced their debtors to adopt.

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The identical Government who had placed an embargo on capital issues for foreign enterprise and would likewise have restricted those for purely internal purposes had it not been for the opposition the attempt aroused, at the same time initiated a policy of a directly opposite character by the Overseas Trade (Credit and Insurance) Act of 1920 and the Trade Facilities Act of 1921, with their subsequent amendments. Briefly, the first was designed to assist exports to the new and restored nations whose disorganization and impoverishment by the war naturally made credit conditions difficult. Under the Export Credits scheme, which grew out of it, the Government began by making advances up to 80 per cent of the cost of the goods exported, then substituted for this the guaranteeing of drafts covering shipments, and afterwards, in the light of experience, made further modifications in the methods and extended the sphere of assistance. By the second, the Treasury were empowered to guarantee the principal and interest of loans for capital purposes in Great Britain, while the Act of 1924 also provided for Treasury contributions to loans for public utility developments in the British Empire overseas. These were most refreshing indications of boldness and originality which might have had far more important results if they had been applied with faith and courage. But the bankers, big industrialists, company promoters and the moneyed interest generally regarded all such aids with the greatest suspicion and dislike, as poaching on their own preserves, always fearing that they would lead to more Government supervision of, as well as competition with, their own activities. They therefore did all they could to discredit them, to belittle their usefulness and encourage the view that they were only temporary expedients, a sort of eleemosynary shifts which it was desirable to be rid of as soon as possible. In this they were very successful, as one might expect in a country where those of their kind receive so much consideration and **are**

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listened to, particularly by the Government, with so much deference.

Sir Otto Niemeyer told the Macmillan Committee that he never was a firm adherent of Trade Facilities even in the days when he was connected with it. He regarded it, to use his own words, as a mere palliative to afford temporary relief to unemployment by guaranteeing a few firms 'and those probably the weaker ones, because the strong firm does not want to come for Trade Facilities. In fact, when we had them in 1922, many people did not want to come for them, because they thought it was a kind of slur on them. I remember the feeling quite well. People had to be persuaded to come there.

'Chairman: Pauperization?—Yes, they said "We are not like those fellows who have to come for Trade Facilities. We can raise our money ourselves." Now a temporary palliative is no real remedy.⁵ It was all very fine to adopt this superior attitude, but the Bank of England, of which Sir Otto was a director, had been obliged to launch its own schemes, the Bankers' Industrial Development Company and the Securities Management Trust, for helping some of the biggest concerns out of the muddle they had got into through their omission to build up reserves out of the great profits they had made during the war. Had they not foreseen that these would be specially required for the reorganization and re-equipment of their factories for the very different production of peacetime? Indeed, they had continually resisted taxation on this very plea, which had been listened to with the greatest sympathy by successive Chancellors of the Exchequer. In his budget speech of the 4th April 1916, Mr. McKenna said: 'A great firm, carrying on a large business far in excess of its usual operations, cannot do so in most cases without accepting great responsibilities and running grave risks. Further, we must not overlook the fact that after the war many of our traders will have to compete with neutral rivals who have

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been able, through war prices, to build up immense reserves of capital which have not been subject to taxation. These are considerations which, in the ultimate interests of the country, must not be left out of account. Still, there is another side, which equally must not be left out of view. Great profits are being made now, in many cases for a second year since the war.⁵ On the 18th May following he said: 'There is very great force in the argument used by those who are opposed to an increase in the Excess Profits Tax. I can assure the House that I have been very reluctant to increase the rate of charge from 50 to 60 per cent. The force of the argument lies in this great fact, which we cannot ignore, that a very large part of the income of the successful employer and the successful firm in one year becomes the capital of the next, and that when you take from the successful employer the excess profits, you are taking it from the man who has proved himself the most capable of using it in the development of national industry. I am always impressed in my own mind with that argument and I hope my hon. Friends below the Gangway, who do not see in 60 per cent excess profits a sufficient charge, will remember that, if they destroy capital in the hands of those who can best use it, in the long run they will prove the worst friends of labour. I believe we are now taking the maximum amount that the trade and industry of the country can be called upon to bear.'

How was it, then, that so many of the industries run by those wonderfully able and successful people, a large part of whose income in one year became the capital of the next and who were the most capable of using it for the development of national industry, were found in a bankrupt condition (that is the industries, *not the men who ran them*) on the return of peace? What had become of all the profits, which everybody knows were colossal, and all the allowances, which included 'deductions from the profits before taxation for the extinction

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of a pre-war loss, also on account of the postponement or suspension owing to the war of renewals or repairs and, in certain special cases, on account of the obsolescence or exceptional depreciation of value, owing to the war, of buildings, plant and the like employed in the business?⁵ Why, almost every imaginable contingency seems to have been allowed for by the taxing authorities and to have been overlooked by the prodigiously able men upon whom, according to Mr. McKenna, the country was dependent for its prosperity! It was the very industries that had profited most by the war that were found to be in the most parlous condition after its termination, and shipping for one was not too proud to come for Trade Facilities! *The fact of course was that too many of these very able and very clever men had kept the kernel for themselves and left the husk for others.*

As to assisting undertakings of public authorities, Sir Otto Niemeyer said he thought it was better done, if at all, by public borrowing, but his objection to multiplying public loans was that, by putting up interest rates, it made credit dearer. That is one of our own objections; but, as far as the assistance rendered to traders by the Trade Facilities Acts was concerned, the money \\\ as borrowed by the companies, firms or individuals themselves, the Government only guaranteeing them so that it was obtained more easily and cheaply. As Lord Macmillan elicited from Sir Richard Hopkins, it merely amounted to the interposition of Government credit with the valuable result of obtaining money at 5½ per cent when good industrial debentures were on an 8 per cent basis! When industry is paralysed and unemployment caused by fearful greedy people clinging to their accumulations and demanding such extortionate rates of interest, it is surely about time for the State to step in. To talk of Trade Facilities as being a form of pauperization, as something beneath the dignity of industry to profit by, when, among other things,

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they enabled the London Underground Railways to obtain £12,500,000 for important improvements and extensions, was absolutely outrageous. If they were sometimes misused, it was a case for their more careful and more intelligent administration, not for their abolition. After a long period of financial torpor, it would seem that our Conservative, Coalition or National Government, whichever they may prefer to call themselves, are beginning to wake up to the fact that an immense stimulus to industry may be given by the proper utilization of public credit.¹ But, whereas only another three months of destructive war would have cost this country at least £600,000,000, which would have been provided without hesitation, it has taken them years to rise to the pitch of merely guaranteeing a twentieth of that amount, to be spread over a far longer period, for the electrification of railways! If such a measure was sound in 1935, why was it not so five years before, and in what respect does it differ from those Trade Facilities for which their respected advisers had not a good word to say? Does this change of policy imply an admission of previous error, is it just one more concession to particular interests, or is it considered merely as good propaganda for the coming General Election? We trust it may rather signify the belated application to the Government themselves of that reforming process so delightfully termed rationalization, of which they long ago recognized that our industries stood in urgent need. Let us hope that it may be the bankers' turn next!

¹ Written before November 1935.

XIII

Some Misconceptions as to the Nature of Capital

In his evidence before the Colwyn Committee on the 3rd July 1924, Mr. McKenna said, in reference to a memorandum that he handed in: 'On the question of permanent capital, I have had, of course, to condense; it would take a book to deal with the subject properly. I would like to begin by stating my conception of money in relation to capital. Although one ordinarily speaks of money as capital, and even in what I have written here it is unavoidable that I should for brevity refer to money as capital, I do not regard money in any sense as capital. Money is the agent for the creation or the destruction of capital, but it is not capital itself. If I have money and I spend it on production, it is an agent for the creation of capital; if I have money and I spend it on consumption, it is an agent for the destruction of capital, but it is not capital itself; and it is quite obvious that it could not be so. Money is only the resultant, if I may so call it, of a credit and debit account. Whoever has money may be said to have credit against which somebody else has a debit. If I have £100 in a bank, I think of myself as having £100 of money; but all that I have is a debt from the bank to me of so much money. The bank is a mere intermediary, however; somebody else owes the bank that £100,¹ so if I were to call my £100 capital, the person who owes the bank £100 would possess a

¹ This does not follow, for the larger part of the advance may be due to an expansion of credit by the lending bank.

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minus capital, which cannot be.'¹ He went on to say that the quantity of capital is not so important as the use of capital, that money repaid to a holder of debt will probably be re-invested. 'On the other hand money raised in taxes will be partly raised from money which would have been spent in consumption and therefore to that extent the capital available for trade or commerce will be increased. The amount of that increase diminishes as taxation rises because as taxation rises less is taken from consumption and more is taken from production until finally you get to a point at which all taxation is taken from production and none from consumption.'²

Financiers and industrialists are far too prone to regard both taxation and wages in the light only of burdens upon industry, forgetting the services rendered for them and overlooking the benefit to trade of the spending of them. Also, as Mr. McKenna does here, to over-emphasize the importance of production, for which capital is required, as compared with consumption for which wages are required. But industry cannot flourish unless the second keeps fairly steady pace with the first. Was Mr. McKenna right when he observed that money spent on consumption was an agent for the destruction of capital? The answer obviously depends upon what we are to understand by the term capital. Jevons says: 'We are told with perfect truth that capital consists of wealth employed to facilitate production; but when economists proceed to enumerate the articles of wealth constituting capital, they obscure the subject.' He then says: 'Capital, as I regard it, consists merely in the aggregate of those commodities which are required for sustaining labourers of any kind or

¹ Had Mr. McKenna never heard of loan capital?

² This is very fallacious; but, if taxation is so injurious, consider the enormous amount that is necessary to provide the interest on the war loans. Mr. McKenna fails to distinguish between a mere transfer of capital and its extinction.

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class engaged in work,'¹ but, while this includes much that is not ordinarily thought of as capital, it leaves out of account all the increasingly elaborate mechanical apparatus for production which is daily supplanting human labour. Further on, he makes the rather cryptic assertion that 'Capital simply allows us to expend labour in advance'. Some definitions include the forces and gifts of nature, the acquired skill of individuals, and so forth. Cunningham, in *The Growth of English Industry and Commerce*, speaks of *sinking* capital in the land!² But, as Mr. McKenna truly said, it would take a book to deal with the subject and we must not become involved in an academic discussion here. It is to be observed, however, that whenever the means for advancing the welfare of the nation are under consideration, whether it be in works on political economy, in parliamentary debates, in committees of enquiry or in the Press, nearly all seem to be agreed in urging the necessity for saving as indispensable to provide capital for industry. It is quite evident that this was in Mr. McKenna's own mind when he expressed his reluctance, as Chancellor of the Exchequer, to increase the rate of Excess Profits Duty, saying that a large part of the income of the successful employer in one year becomes the capital of the next.

Now, what is it that is actually saved? Not labour certainly, because if it is not used at once it is lost altogether. Not land, because of that the quantity is unalterable. Nor are goods, plant, machinery, buildings or anything of that sort referred to. No, these savings are really only claims, not to anything in actual existence, but to future production or services, and how do they arise? They come to some extent from earnings

¹ This is certainly not what the Capital Issues Committee were concerned with.

² Was he thinking of Mr. Pepys fearfully interring his gold in his garden at Brampton?

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but mainly from surplus profits, the larger the profits the larger naturally the surplus, and it was, as we have before remarked, the full use of the exceptional opportunities to make these at that time that caused the inflation of the war period. Our *financial* capital, then, the subject of the whole business of the banking world, consists of credit created by the Bank of England and expanded within a certain rough ratio by the joint-stock banks, based upon the accumulation of deferred claims so originating. It is with this that the Capital Issues Committee had to deal, and it is the policy they were appointed to assist that we have been criticizing. There is such an extraordinary confusion of thought in regard to these matters that notwithstanding the enormous addition to the mass of such unsubstantial claims created by profiteering during the war, which the special levies considered by the Committees on Increases of Wealth (War) and on National Debt and Taxation were intended to reduce, there was evidently an impression among our bankers that they were insufficient, for the Committees on Currency and Foreign Exchanges and on Financial Facilities, which they dominated, both urged the necessity for *economy and saving*. These processes, by reducing consumption, postpone the exercise of claims and lead to their accumulation, providing the first and lesser of the above-mentioned sources of our financial capital.

'Increased production, cessation of Government borrowing [*though not on principle*] and decreased expenditure both by the Government and by each individual member of the nation are the first essentials to recovery,' say the Cunliffe Committee in their Final Report, paragraph 3, and: 'The shortage of real capital must be made good by genuine savings. It cannot be met by fresh purchasing power in the form of bank advances to the Government or to manufacturers, under Government guarantee or otherwise [*none of your*

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Trade Facilities!'] and any resort to such expedients [*if you want to damn a method call it an expedient!*] can only aggravate the evil and retard, possibly for generations, the recovery of the country from the losses sustained during the war,' say they in their Interim Report, paragraph 17. As Mr. McKenna truly says, every credit implies a debit, and of course the converse. These losses, crystallized in war loan, became credits in favour of our profiteers. Let us mark well that *real capital* might be provided by abstaining from consumption and by *genuine savings* of whatever additions individual profiteers chose to make to their prices for goods supplied to the State or the community, but not by credit created in any way by the State to assist the production, exchange and distribution of commodities in the common interest, though the *genuine savings* first mentioned might be hired by the State for the purpose last mentioned in such an emergency as a war! Coming from such distinguished authorities, these must be economic theories worth pondering, one would think; but we adjure our readers not to accept them as irrefragable dogmas that it would be perilous even to question. The virtue of abstinence may be admitted when it frees materials and energies for more urgent needs, those of war for instance, but may be very much doubted when it implies the withholding of custom from industry at a time when it is unable to find a sufficient outlet for its products, with no other object than to finance the production of still more!¹ That there is any more substance in capital provided by profiteering than in that created by the State also seems to us to require demonstration, especially when the former redounds to the advantage only of a section, while the latter benefits the whole community.² Lastly, we are by no means prepared to admit that the creation of credit ought to be considered as the prerogative of the Bank of England *in its private capacity* and in

¹ In other words, starve industry to feed it. ² See *ante*, p. 83.

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a lesser degree of the joint-stock banks, but never of the State.

The similar recommendations of these two committees were accepted and repeated by those above mentioned and by those on National Expenditure and on Finance and Industry. Those who framed them were probably labouring under the delusion which prompted John Stuart Mill to say, in his *Principles of Political Economy*: 'Capital is the product of saving: that is, of abstinence from present consumption,⁵ and of the queer doctrine, which he quotes, of the Law of Increasing Returns. 'This law,' he tells us, 'that the power of the instruments which produce wealth may be indefinitely increased by using their products as the means of further production is stated to be among the four elementary propositions of political economy which are the result of "observation or consciousness".' Merciful heavens! If that is where the science leads us we had better leave it alone. Is nothing ever to be consumed? What on earth is production for if we are perpetually to drill ourselves in abstinence? Here we have the explanation for the *over-production*, unemployment and poverty of which the world has by now probably had all the experience it wants. Where do we find the injunction to destroy the fruits of over-production and to subsidise non-production? Perhaps these are new doctrines, the latest contributions to political economy from the New World!

Mill, it will be noticed, was thinking of material assets and commodities, which in business are generally described as plant, machinery, stocks, etc., not capital, which is always expressed in terms of money; and when Mr. McKenna said that money spent on consumption was an agent for the destruction of capital he could only have been thinking of a limited mass of money which, if not so dissipated, would be available for the purchase of the machinery of production. That may apply in the case of individuals, but it is entirely inapplicable to the internal activities of the whole com-

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munity, and it was these that were under consideration when Mr. McKenna uttered that dictum. In this he was misled by a very common fallacy, which may be further illustrated by the two following quotations. Speaking on the Second Reading of the Finance Bill on the 25th June 1914, Mr. Bonar Law said: 'There is only one other consideration which I should like to put before the House. What would be the position of this country to-day if we were suddenly faced by a great war? Has the Chancellor of the Exchequer ever thought of that? . . . Where should we get taxation which would raise the revenue that is necessary? Even the Prime Minister—I am speaking from memory, but I think that I am accurate—told us that when he was Chancellor of the Exchequer an income-tax of is. in time of peace was something very much to be deprecated. It is from the income-tax that everyone used to expect to get the necessary money in time of war. Where would you get it now?' In Committee on the same bill on the 15th July following, Mr. G. Faber said: 'If a great war came, with a National Debt of £650,000,000 we should be in a very awkward position indeed. We should perhaps have to raise £500,000,000 and with our credit knocked about, with the Sinking Fund impaired, with taxes at war level [!] we should be in such a tight place that no financier in the country would like to have to face it.'⁵ When the time came ten times as much as Mr. Faber suggested was actually raised in this country besides twice as much externally, and it was not obtained from income-tax, alas! Just as in peace time we were warned not to tax income too heavily as it would be needed as a reserve in case of war, so when war came we were warned that it would be needed to supply capital for industry when peace was restored.

The hardy resistance to taxation on the part of our rich industrialists, traders and speculators combined with the anxiety of our Government not to deplete what they believed

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to be the limited financial resources of the country obliged the latter to manufacture the money themselves as we have seen. They did not realize they were doing this, they thought they were only borrowing it from those who had not the money to lend! But they thereby provided us with a practical illustration of the truth of a contention that we might otherwise have found impossible of any general acceptance, namely that there is no limit to the amount of financial capital that the State can create, and that it is certainly not generally advantageous to leave that function to its subjects. Moreover, instead of being afraid of spending, we should realize that financial capital only becomes effective through spending. In Sir Inglis Palgrave's *Dictionary of Political Economy* various examples are given of the continual spending of so-called fixed capital which is necessary. 'When examined into thus, it is interesting to trace how little of what is ordinarily termed "fixed" capital is really permanent. The apparent permanence of "capital" is occasionally spoken of as something which may always be depended upon, something which endures for ever. Because payment of interest on the "debt" of a nation or the "stock" of a company is continued from year to year, it is assumed that the wealth represented by the original outlay continues in existence and that the "capital" remains—capital described as the saved product of past labour. The capital considered either in the concrete as (mainly) the accumulated stock of instruments auxiliary to labour or, more abstractedly, as the power of directing labour to the attainment of greater but remote utilities through the control over the produce of labour possessed by the owners of accumulated wealth, is only maintained by a perpetual process of reproduction.' This too must be accompanied by perpetual spending, not only for such purposes but for individual consumption as well. As we have already observed, savings for capital purposes also have to be spent to be effec-

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tive, but they are less beneficial by reason of the lag. *Though there is no necessity whatever for industry to suffer through the cessation of saving, it is quite impossible for it to continue without spending.*

The effective capital of a country consists only in its real wealth and its realizable claims upon other countries. The renewal of the former and its conversion to human uses requires activity and cannot be assisted by any kind of abstinence. The capital of an individual may also consist of claims upon his fellow countrymen, but if he squanders such claims they merely pass to another, affecting the relative positions of the parties themselves without making any difference to the country as a whole, except to the extent that the change leads to greater or less useful activity. If A has £10,000 and B has £5000, no matter whether it be in the form of real or notional wealth, and certain transactions between them result in a reversal of their positions, so that A comes to be left with only £5000 while B has increased his capital to £10,000, it will neither impoverish nor enrich the country they are citizens of, or domiciled in, unless the said transactions have further resulted in the destruction of a previously existing material asset or the creation of a new one. The latter would either impoverish or enrich the country accordingly, but it would make no difference to it which of the parties were the loser or the gainer. It is well to emphasize this truth, for, evident as it may seem when stated, many people, including some of our statesmen, legislators and other conspicuous public men apparently fail to see it. In his address as chairman, delivered at the thirty-ninth ordinary general meeting of the shareholders of Barclay's Bank Ltd. on the 18th January 1934, Mr. F. C. Goodenough said, *inter alia*: 'Turning to the position in the United States of America, the financial crisis there, which was imminent a year ago, developed with great rapidity. Its shock has been terrific and its consequences in the future will have a far-reaching effect.'

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The immediate cost of the crisis cannot be exactly calculated. Quite apart from the individual losses there remains the financial cost to the country as a whole, arising out of the steps which it was considered necessary to take, in the interests of the country, to avoid a catastrophe. Some indication of the cost will appear from the very serious deficit estimated to amount to \$9,000,000,000 on the Federal budget for the two years ending June 1935. This deficit, it is anticipated, will have to be met by loans. The loans will increase the gross Federal debt to about \$32,000,000,000 which compares with about \$22,500,000,000 in June 1933 and \$17,000,000,000 in June 1929, and will add considerably to the sum which will have to be raised by taxation for the service of the debt.'

Instead of attempting to measure the severity of the crisis by considering *the financial* cost to the country as a whole, as Mr. Goodenough does, we should surely do more wisely to reflect upon the *material* cost of the bad financial system which originally provoked it and had nothing better to offer for its relief than loans requiring increased taxation for the service of the additional debt they created. Since nothing on earth can make good losses suffered through the paralysis of human activity in the past, the real loss here referred to would be just the same if by some magic the deficit could be entirely wiped out. As to the future, the mere transference of money within the confines of a country can only enrich or impoverish it according to whether it stimulates by better distribution or depresses by increasing concentration. It has not infrequently been said in regard to the prosperity of the United States during the period preceding the crash of 1928 that the country had been living beyond its means. That, however, is impossible in the case of a nation, unless it has been incurring a progressive *external* debt, for if it neither possessed nor imported the means it obviously could not live on them. The same has been said in regard to ourselves because of certain

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internal adjustments that have been made, inadequately enough, through the medium of pensions and other forms of social amelioration. Apart from the question whether it lives wisely or too well, which would lead us rather into an investigation of the expenditure of the rich, a country can afford all it can produce or obtain in exchange for its productions, though many of its citizens may be prevented from satisfying their wants owing to the deprivation of purchasing power caused by the heaping up of claims in the hands of a minority.

Here is another of innumerable possible examples of how strangely our public men (in this case a former Chancellor of the Exchequer) misunderstand the true nature of national capital. In Committee of Ways and Means on the 29th April 1931, Sir Robert Home said: 'This year, for example, the estimate for Estate Duties is put at £90,000,000. That is *capital*, and it is quite proper to use it for the reduction of debt, but only £52,000,000 is being devoted to the reduction of debt, so that this year alone £40,000,000 of the country's capital is being used for our ordinary current liabilities. More than that, if we look back over a period of years we shall find that while we have raised £508,000,000 from Estate Duties in the last eight years the nominal amount of our debt has come down by only £172,000,000. More than £200,000,000 of capital has been applied in that short space of time in meeting ordinary current liabilities. If any business in this country were conducted on that basis it would not last very long. The fact that we are a rich country, with piled-up resources, no doubt enables us to meet these obligations over a longer period than could other countries—for example Australia, a young country with few resources; but the day of reckoning will come, and Nemesis awaits this attack upon the capital resources of this country; it destroys the very funds which are necessary for the purpose of supplying the industrial population of our country with employment.' Here Sir

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Robert Home makes the common mistake of comparing transactions affecting the *internal* economy of one entity, the State, with those presumably affecting the *external* economy of another entity, a private business. Why should not a business last very long because of the transfer of money from one of its departments to another, where it was more needed, instead of restoring it to a third department of the same concern from which it may originally have been taken? Would it not be more likely to come to grief if, through neglecting* to make such transfers, it kept a considerable part of its staff, which it was obliged to lodge, feed and clothe, in complete idleness? What, in the above quotation, he calls capital is really only income; what he calls piled-up resources are merely claims whose extinction would not reduce the total wealth of the entity in the least, but would be more likely, by the resulting dissemination of spending power, to increase employment among its industrial population. Again, in the House of Commons on the 1st May 1934 Mr. Neville Chamberlain, replying to Rear-Admiral Sir M. Sueter, said that the total amount of estate and succession duties paid in the last twenty years (1914-5 to 1933-4 inclusive) was £1,142,000,000 (about one-seventh of our share of the cost of four and half years of war!).

'Captain Balfour: How long does he intend to use this capital as annual national income?

'Mr. Chamberlain: It has not all been used as income, some of it has gone to the reduction of debt.'

Do these gentlemen really believe that the imposition of high death duties, whatever may be said for or against them on other grounds, leads to the exhaustion of *national* capital? Do they really think that by reason of this increment to the national exchequer during this period the nation has become poorer by £1,142,000,000? If so, it would be worth their while to study the question a little more deeply. A great many

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old families have lost their broad acres but the broad acres themselves, we may rest assured, have continued to exist; the claims of a good many defunct plutocrats have been diverted from their descendants, but if the redistribution thus brought about has made the country no richer it certainly has not made it a penny the poorer, unless the effect of the transfer has been more crippling than encouraging to beneficent enterprise. If it has had this effect it is bad policy; if it has had the opposite effect it is good policy, and those are the sole considerations which should influence the Chancellor of the Exchequer.

When one realizes the true nature of wealth one sees also the groundlessness of the fear that any revolution in the form of our government, whatever else may be said either for or against it, could drive capital out of the country or destroy it to any important extent. By reason of its immobility or its bulk, its perishability or the uncertainty of the demand for it, and various other considerations needless to detail, it is virtually impossible to remove much of the real wealth of one country to another, quite impossible by panic-stricken individuals in disobedience of the general desire of the people and the organized government of a country like Great Britain. The precious metals and jewels may to some extent be carried away, but they would not entail any very serious loss. It is the general acceptability of gold which has made it practically the only form of real wealth which can be moved in any considerable amounts from place to place by profiteers or panic-stricken fugitives, without heavy loss; and instead of this being an advantage, as is often alleged, it is one of the gravest disadvantages of using it for monetary purposes. The great evils which are undoubtedly caused by people perpetually moving their capital in the form of gold from one national refuge to another would soon be stopped by the abandonment of its use for monetary purposes. Very often it would

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have been more profitable to put an embargo on the *import* than on the export of gold, but the finance ministers of our time are hardly likely to appreciate the truth of that. As regards what we have called notional wealth one could only transfer British stocks, shares, equitable estates, etc. to the extent that others could be found to purchase them, and, as has been pointed out, it is a matter of indifference to a country what particular individual owns an asset within its jurisdiction. Great as is the British ownership of foreign assets, even these are still very small by comparison with the wealth actually subject to our Government. British-owned foreign securities to bearer might be smuggled out of the country, though it would not be easy, but it is very questionable whether those subject to registration could be transferred contrary to law. There is, however, no nation less subject to sudden alarms than the British, none more patriotic or public-spirited, and if there are also those among us who prefer their own private interest to every other, where would they go for greater security?

Political parties who are opposed to any fundamental change in our Government may try to frighten the public by predicting a great flight of capital as a result of such a programme, but sensible people will not be greatly affected by tactics of that kind, they will rather regard it as the desperate resource of those who have no valid counter-argument. Any loss that might be sustained in that way would be far more than counterbalanced by a wise development and application of our internal riches. When one considers how vastly the productive power of man has been augmented by the aid of machinery one sees how quickly such wealth as could be carried away could be restored, just as one can imagine what a colossal amount has been lost by keeping countless millions of the world in idleness for the past seventeen years. No partial alleviation should be allowed to divert attention from the

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unsoundness of the system which has caused such a calamity. It would hardly indeed be possible to find a better example of muddled thinking than that the alleviation which has been obtained in this country through the abandonment of the Gold Standard should actually have been used as an argument in favour of its restoration! When the Government congratulates itself on its return to sane finance and points to the improved conditions that have followed from it, how many of their supporters realize that the last budget would at once have been seriously unbalanced by the conversion of its paper pounds into gold? In the Middle Ages a rich man's wealth principally consisted in great landed estates and a horde of retainers. The loss entailed by keeping so many out of useful production when man power was of vastly greater importance than it is nowadays was bad enough. That many of them should be constantly engaged in waging war, destroying property and ravaging crops was worse, but even then there was no brake on production comparable with that caused by the accumulation and hoarding of claims which characterizes modern life, and would long ago have become unbearable were it not for the compensating productive power of machinery. One not infrequently hears of national bankruptcy, and, as infelicitous metaphors and false analogies too commonly lead to bad reasoning, it may be well to point out that such a condition as national bankruptcy is an impossibility. The result of bankruptcy is that a receiver is appointed to collect the remaining assets of the defaulter and distribute them among his creditors according to their legal priorities, leaving him under certain disabilities until he is granted his discharge. Such a thing never does and never can happen to a nation at the hands of its own subjects, though it is sometimes spoken of as a danger by political partisans who wish to frighten the public away from certain reforms. False arguments are always a sign of weakness of one kind or

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another. Fortunately it is beyond our power to reduce a nation to bankruptcy, but by denuding it of its forests without re-planting, wastefully using up its stores of minerals, neglecting to develop its capacity to produce real wealth, destroying its beauties and weakening its people we may indeed seriously reduce its capital.

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In the foregoing pages we have endeavoured to show how considerably our system of public finance increased the pecuniary needs of the war, multiplying the internal debt elevenfold and saddling the country with a burden of interest which was at first nearly twice as great as the total national revenue shown in the last pre-bellum budget. Defects which in the previous period of peace were hardly discernible were made manifest when ordinary business came to be superseded by operations conducted by the Government on a scale so vastly greater than had ever been seen before. Yet there is but little evidence that either our statesmen or our financiers have even begun to learn, much less to apply, the invaluable lessons that are to be drawn therefrom. If they had they would not only have perceived the disastrous consequences of supplying the needs of the nation in the manner here particularly criticized but would also have recognized the obsolescence of the Gold Standard and the extreme folly of continuing the indiscriminating ban on foreign lending after the war had come to an end.

It is to be borne in mind that, although the persistent rise in the price level which resulted from the Government's methods of obtaining the supplies and materials of war was inevitably followed by increases in wages, the latter always lagged behind the former and never extended to the millions of men enlisted in the fighting forces. On the other hand, the

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claims created by the Government's 'borrowing' policy, unjust, uneconomic and unnecessary as they were in the first instance, were always being artificially inflated by increasingly favourable terms of conversion, ever higher rates of interest and the important advantages given to subject creditors of the State in the matter of death duties. As, moreover, the so-called war loans were issued at a time when the pound sterling was suffering a steady decline in gold value owing to our virtual abandonment of that standard, though this was concealed by the continuation of our formal adherence to it which was made possible by the pegging of the sterling-dollar exchange, our effectual return to the Gold Standard in 1925 still further aggravated the weight of our internal debt after it had already been added to, not only by the terms of almost every successive original issue but also by the early post-bellum conversion and funding operations. Thus had this charge, colossal and unwarrantable enough as it was before, been twice quite gratuitously augmented even after the conclusion of peace. As this was to the advantage of the relatively small numbers of holders and to the prejudice of by far the greater part of the people it naturally resulted in the further impoverishment of the latter. The economy thereby enforced upon them, and even enjoined by the Government, reacted unfavourably upon industry, leading to unemployment, a still further restriction of diffused spending power, a lower yield of taxation and an increase of public burdens, all those evils in short that have characterized the post-bellum period.

Nobody was more outspoken in his indignation against the unblushing profiteering that went on while the nation was involved in a mortal struggle than Mr. Bonar Law, who himself held office from the formation of the Coalition in 1915, and he was fully aware at least of the present gravity of the evil. As he admitted, the Government were at fault for allowing such profits to be made, and, to his credit be it spoken,

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he acknowledged his share of the blame for the failure to foresee and prevent such abuses. Still more unfortunate, however, was the fact that neither he nor his colleagues realized that the evil of public borrowing was even greater, in that its sole effect was to encourage, enlarge and perpetuate those private levies on the nation by providing a cumulative fund for their preservation, to the injury of ultimate trade revival instead of being a future source of assistance to it as both he and they anticipated. War loan was inflation of the worst possible kind, the creation of a lasting, terribly burdensome and purely redundant fund. It could not afford additional capital for industry when the war was over because if it were sold it would absorb as much as it realized, and if it were used as collateral it would merely add still further to the mass of useless credit when the bankers themselves were declaring that the volume of Treasury bills and currency, which latter they usually hold to be the better basis for credit, was already excessive.

In such a state of affairs the gain of the few is by no means proportionate to the loss of the many, because, unless there is a corresponding increase in the effective demand for production, the greater the amount of credit that is available the more difficult it becomes to find profitable employment for it, and the whole country is therefore impoverished. No condition could be more favourable to the development of the gambling spirit, a disturbing influence which tends to further disequilibrium, and those individuals who had not scrupled to enrich themselves by the war were not likely to be restrained by any sense of public duty or of obligation to others in time of peace. Instead of being the able men, rebuilders of the nation, whom Mr. McKenna extolled, a large proportion of them were, at any rate in the more humane sense of the term, without education and quite untrained in the responsibilities and wise use of wealth, a preparation which is seldom

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enough found even among those who have inherited it. Those therefore who found themselves for the first time in their lives able to live in affluence and still have a considerable surplus were not likely to embark again on the troubles and uncertainties of regular trade when there was so much excitement and possible profit to be gained from speculation in stocks and shares, currencies and commodities, merely by correspondence and the exchange of cheques. At that time, too, such was the eagerness to find a short way to wealth, they had before them the example of many respectable old-established firms inflating their capitals and turning their businesses into companies, or selling out lock, stock and barrel, to engage in these novel activities. It was, as Mr. Bonar Law said, no use blaming individuals for following the dictates of ordinary human nature. Industrial companies and firms principally exist for the making of profits, and the making of money generally increases the passion for it. But it is the duty of the Government to see that such pursuits are not followed in a way that is grossly unfair to certain classes and inimical to the Commonwealth as a whole.

During the progress of the war the suffering it caused was, at least from the economic point of view, counterbalanced by exceptional productive activity and less than the usual distress among the poorer classes because of full employment at the better wages which then had to be paid. It was this increased industry which had required the increase in the currency issue, and it should have been patent to anybody that a contraction of the latter would compel a slowing down of the former. There was certainly no occasion for this when so many neglected home wants needed supplying, and the reversal of our former credit position in the United States made it necessary not merely to revive but to enlarge our export trade as well. It was as certainly not a time to take from the poor any slight accession of purchasing power that

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the increase in wages might have brought them. In moving the Address in the House of Commons on the 11th February 1919, Sir Rhys Williams said: 'After four years of war the whole world is a buyer and the whole world is in want. Unemployment should be unknown'; and, in the debate which followed, Mr. Lloyd George said: 'I do not believe that there is any fear of unemployment if we behave rationally and wisely.'⁵ Why, of course not. Would it not reflect very strangely on our civilization, if after more than four years of feverish energy expended in destruction, when a vast amount of ordinary constructive work had had to be neglected, we should be unable to find employment for our decimated manhood? But we did not behave 'rationally and wisely', and the consequence was that all the old spectres reappeared, unemployment, strikes, financial embarrassments and industrial paralysis. It has been the purpose of this book to indicate the root cause of these misfortunes, which we are convinced is of a financial nature; and, to enable our readers the better to form an opinion of the validity of our argument, we have given actual quotations of the material parts, being careful not to tear them from their context, of official pronouncements, parliamentary speeches, evidence given before Select Committees and Royal Commissions and other utterances of those who offer themselves or are generally regarded as authorities on such matters. Quotations might very easily have been multiplied, but we have tried not to exceed the limits of necessity and we trust we have not exhausted the reader's patience.

While our statesmen were busy trying to discover the maximum amount of reparations that might be extracted from the defeated powers, our bankers were urging the necessity for reducing the currency issue and putting it on what they called a sound basis by the restoration of the Gold Standard, and our economists were theorizing about trade

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cycles, with their rhythmic booms and slumps, as if they were an integral part of the order of Nature, providing a kind of music of the spheres to which we must perforce attune ourselves. Since neither statesmen nor bankers saw that **the** transfers of huge sums to the creditor nations for war debts and reparations were utterly incompatible with the working of the Gold Standard, we must not be surprised that they should have failed to appreciate the necessity of resuming loans to the raw-material and food-producing countries **to** finance the provision of machinery for their development. These, it may have seemed to them, were merely goods while bankers are money merchants. Whatever happens to trade, money must on no account be lost, for it is of course **that** which sustains us! As regards reparations and war debts, **what** could not be collected might be lent for a season, but as soon as the respite debtor began to show any signs of recovery pressure was again applied, and on every occasion it produced a crisis. The same process was repeated many times over, always producing, *mutatis mutandis*, the same results, but nothing was ever learnt from these unexpected phenomena.

When Sir Henry Strakosch was asked by the Chairman of the Macmillan Committee whether he held out any hope of practical results following from the deliberations of the Gold Delegation appointed by the League of Nations, he said: 'Well, mainly for diplomatic reasons, our terms of reference are not very wide. We are to advise on the causes of undue fluctuation in the purchasing power of gold. We are **not to** suggest any remedies. That formula had to be chosen so as not to offend some of the countries—especially the French—who rather resented that the Financial Committee of **the** League should poach on the Central Banks' preserves, so **they** said. So the Committee of the League of Nations will probably not make recommendations but merely diagnose **the** case.' It was like the Pope objecting to an oecumenical **council**

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pronouncing on matters of faith! The subject was afterwards approached in a befitting spirit of humility by a whilom Chancellor of the Exchequer. In Committee of Ways and Means on the 20th April 1932, Sir Robert Home said: 'Whether we like it or not we are now in the situation of having a managed currency, and that the management is going to assume a determined character has been made plain by the pronouncement of the Chancellor of the Exchequer that he intends to ask from the House authority to borrow £150,000,000 for the purpose of equalizing the exchange. These questions of currency always seem very remote from the ordinary life of the people, who have not had to consider them for more than 100 years, and yet the question of currency sits down at every table that is spread with a meal in every cottage or castle throughout the country. It very intimately concerns us in the House of Commons. Aristotle said long ago that money exists not by nature but by law. It is the law that gives it efficacy. It is the law that says what is legal tender. It is in this House that we make the law. We were the people who decided about our return to the Gold Standard. We were the people who gave authority for the amount of the fiduciary issue that should be put out by the Bank of England. We were the people who only a few weeks ago gave authority for £15,000,000 to be added to the fiduciary note issue. In fact we are, God help us, the people who have to manage this currency under the advice and through the means of the Chancellor of the Exchequer, using as his instrument the Bank of England. I hope therefore that I need make no apology for my intrusion on this subject. For our duty's sake we cannot regard these as matters which are to be looked upon as impenetrable mysteries into which no sacrilegious nose may be poked. We have in our responsibility to our constituents to consider how this currency ought to be managed and upon what principles. I say that I do not feel that

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I need apologize for my intrusion into these matters, but I do apologize for the ignorance which will be found in every sentence of my remarks.' One cannot help feeling that Sir Robert Home's speech might have been appropriately punctuated in some other places by the imprecation he used.

As the late Sir Basil Blackett said, since 1931 the Government 'has proceeded quite rightly to forget the Gold Standard in practice to give the nation the blessings of a managed currency, though denying both its desire and its ability to undertake the task of management', and Professor Cassel has recently acknowledged that it has been possible to learn much from experience that shows preconceived programmes and political platforms in the past to have been largely wrong. He has truly remarked that the sterling bloc is a natural growth, in no way based on theory, and the frequent assertion that a paper standard could not work has been proved false. But he shrewdly says of us 'they have abandoned the Gold Standard, but they have not yet entirely abandoned their gold mentality'. Not only have the bankers, on whose advice the Government has relied so obstinately, shown an astonishing obtuseness in regard to credit and currency in the past, but they have with few exceptions remained impervious alike to argument and experience. That the views held by those who are prominent in public affairs, or reputed to be experts, should be so uncertain, confused and contradictory may cause some surprise, and it will be all to the good if it encourages those who are diffident of their ability to judge of such matters to take a greater interest in them and assume a more watchful and critical attitude in regard to them. They will then soon discover how remarkably few of those who are daily absorbed in politics, finance or industry have any clear grasp of the first principles of their business. Although man's superiority is supposed to consist in the gift of the ratiocinative faculty, it is a curious fact that those few who use it to ascertain the true

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nature and effect of the transactions they constantly engage in are regarded as mere theorists, while those who walk in darkness and depend upon instinct alone to guide them are accounted practical men of the world! One of the representatives of the National Union of Manufacturers, Mr. Edward Berkeley, told the Macmillan Committee: 'I do not think myself if you were to seat 100 manufacturers round a table two per cent of them would really understand the financial problem that was before them ... or the economic problem!' That would equally apply to the majority of statesmen and financiers themselves; so the man-in-the-street need not be excessively distrustful of his own capabilities or accept the opinion of any of these as oracular.

The maxim '*Nihil est tarn inaequale quam aequalitas ipsa*' is doubtless as true to-day as when it was first written, and there are probably very few who would regard absolute equality in the economic sphere, or even the approximate correlation of wealth to worth, as either attainable or desirable. There is, however, a world of difference between such a condition and the extreme inequalities we see about us; superfluity on the one side and dire need on the other, the excessive rewards of some and the utterly inadequate rewards of others. The idea that the partial correction of these injustices would discourage effort or deprive us of the best services of the ablest of our fellows is of course quite without foundation, and were it not frequently put forward as a serious objection it would be superfluous to refute it. It is not unnatural that such fears should be propagated by over-paid mediocrities and those who are secure in the enjoyment of wealth without having to do anything for it, but any such change would almost certainly have the opposite effect. Not only is useful service encouraged by condign reward, but there is fortunately always a considerable proportion of the people who are more concerned to make the best use of their

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abilities for the advantage of the whole rather than to amass riches for themselves alone. As Sir George Jessel once remarked, 'Some of the greatest inventions which have been of the most benefit to mankind have been invented by persons who have given their inventions freely to the world.' He might have added that very many of the others have brought wealth to men of the most commonplace abilities who have cunningly taken advantage of the exigent necessities of the investor.

As very few people can have any clear conception of the very serious setback in this respect which took place during the war period, it will be well to give some official figures which throw light on the matter. In one of the memoranda which they prepared for the information of the War Wealth Committee, the Board of Inland Revenue estimated our total post-war wealth as amounting to £13,046 millions, of which £9098 millions (i.e. almost 70 per cent) belonged to those who possessed fortunes exceeding £5000, while only £3948 millions (i.e. little more than 30 per cent) was attributed to the vastly greater number who possessed £5000 or less. Of a total estimated increase during the war of £4180 millions, £2846 millions (i.e. more than 68 per cent) was attributed to the first-mentioned class, who numbered no more than 340,000 persons, and £1334 millions (i.e. less than 32 per cent) to the last. The following figures will help to show how the previous disequilibrium was intensified by war profiteering.

<i>Individual Fortunes</i>	<i>War Accretions</i>	<i>Post-war Total</i>
£	£	£
5— 10,000	288,000,000	1,054,000,000
10— 25,000	549,000,000	1,909,000,000
25— 50,000	432,000,000	1,500,000,000
50— 100,000	401,000,000	1,241,000,000
100— 250,000	469,000,000	1,400,000,000

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<i>Individual Fortunes</i>	<i>War Accretions</i>	<i>Post-war Total</i>
£	£	£
250— 500,000	314,000,000	884,000,000
500— 750,000	129,000,000	351,000,000
750— 1,000,000	64,000,000	169,000,000
1,000,000 and more	200,000,000	590,000,000
	2,846,000,000	9,098,000,000
5000 or less	1,334,000,000	3,948,000,000
	£4,180,000,000	£13,046,000,000

Another illustration of the maldistribution of wealth was given by the reply of the Chancellor of the Exchequer to a question in the House of Commons on the 29th March 1926, in which he said that, for the twelve months ended 31st December 1925, death duties were paid on 67,918 estates of values not exceeding £1000, whose total net value was £29,804,000, giving an average of a little less than £440 each; on 31,576 estates ranging between £1000 and £10,000 and totalling £115,826,000 net, which gives an average of a little more than £3650 each; on 6022 of a value exceeding £10,000 but not exceeding £100,000, totalling £179,166,000 and averaging a little less than £30,000 each; on 418 of a value greater than £100,000 but not exceeding £1,000,000, totalling £109,216,000 and averaging a little more than £260,000 each; and on 13 which exceeded £1,000,000 each in value totalling £27,123,000 and giving an average of £2,086,384. Of the total aggregate value of £461,135,000, only £29,804,000, that: less than 6.5 per cent, belonged to 67,918 people, whereas £431,331,000, or 93.5 per cent, belonged to 38,029 people. The addition to the first category of all those whose estates were so small in value as to exempt them from the duties would, of course, make the disparity very considerably greater. As to the holdings of war loan,

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Mr. Young replying to a question in the House of Commons on the 4th July 1921 said: 'It is estimated that the contribution of the small investor to the total debt, of approximately £7,573,000,000, is about £596,000,000.' That is a little less than 8 per cent, and how many millions held none at all! Since people are never likely to overstate the amount of their wealth in their declarations for the purposes of taxation and, since evasion is far more difficult for the poor to practise than for the rich, we submit that these figures afford unchallengeable confirmation of the argument for whose support they are quoted, and surely they reveal a startling condition of inequality! What mattered most was not so much the amount of the so-called public debt that had been created as the displacement of credit it caused, for it is evident that if the claims inherent in the former had been equally distributed there would have been no aggravation of the previous disequilibrium. If further inflation were to be avoided, there were only two ways of restoring a better balance, that is either by cancellation of a part of the excess on the one side or by the transfer of a moiety thereof to redress the deficiency on the other.

For an economic disturbance of such violence as inevitably resulted from the enormous profits made during the war, and their crystallization in the war loans, the only possible remedy was something very different from and very much older than the Gold Standard; it was nothing less than the Solonian *seisachtheia*, which somewhat similar conditions caused the great Athenian lawgiver to bring forward some two and a half millennia ago. But a measure of that kind was hardly likely to commend itself to the slaves of financial bigotry, to the well-entrenched plutocracy, or least of all, to the newly rich themselves. They, however, were the people who were appealed to, and we may judge of their capacity or impartiality by the quality of their argument, full as it is seen to be of

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misunderstanding and, what is worse, of pitiable equivocations and evasions. It is refreshing to be able to quote the chairman of one of the Big Five in support of our main contention, though he spoke of the desirable change which has only begun as if it were nearing completion. In the course of the address which he delivered to the shareholders of Lloyds Bank at their seventy-sixth ordinary general meeting on 2nd February 1934, Mr. J. Beaumont Pease said: 'In social matters, too, by a gradual but vast redistribution of wealth by means of heavy taxation, and of great sacrifices on all sides, we have without the aid of any revolutionary means procured a higher standard of comfort, clothing, cleanliness and education than has ever before been enjoyed by the general mass of the people, while the hardships and terror of unemployment, serious though this still is, have been mitigated to an extent unknown in other countries.' But what we have to realize is that these changes, commenced before the war and here admitted to be of great benefit to the country as a whole, were seriously retarded by the policies we have been criticizing and still wait upon their correction.

Mr. Bonar Law once said that £1,000,000,000 represented the labour of 10,000,000 men for a whole year. Conversely, four years' labour of 2,500,000 men may be taken to represent £1,000,000,000 (the Macmillan Committee put it at twice as much) and we may gather from that the outrageous wastefulness in a material sense alone of allowing men by the million to remain unemployed for seventeen years! There is not much consolation to be drawn from figures showing that there has been an addition to those employed if at the same time the numbers unemployed are as great or nearly as great as before; nor from the assurance, for what it is worth, that the latter have not been continuously idle for all the years that we have been faced with this most important problem. Such explanations rather betray an incapacity to deal with it, and they

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come from a party which, but for two brief intervals, has either wholly manned or largely participated in the Government ever since the end of the war! Putting heavier burdens on the underpaid employed to provide the barest subsistence for the unemployed, beguiling the latter with 'relief' works of doubtful utility, in their very nature temporary as in their description heartbreaking, transplanting men to other areas and training them for unaccustomed tasks, when a wiser development of the national estate and a sounder social policy, by the creation of valuable new assets and the dissemination of purchasing power would provide opportunities for all. Was there ever a greater exhibition of incompetence or sterility of ideas? If decent work at reasonable pay is to be had men very soon learn to adapt themselves to such changes as are bound to take place, as was seen during the war period and after, when industry was twice revolutionized in a very short space of time. Talk of a *normal* level of unemployment which we now sometimes hear should not be tolerated.

We have been repeatedly told that conditions in other countries were even worse than in this; but, even if the comparison were not invalidated by their very different circumstances, we might ask how often the bad is to be justified by reference to the worse. Are we to accept our miseries as unavoidable, or to wait for other nations to show us the way out of them? Is it not indeed reasonable to suppose that the bad conditions elsewhere may to some extent have ensued from the policies of the country upon whose currency so many other currencies are based, which still owns by far the largest amount of external assets and does the largest international trade? That is the more probable since those policies undeniably injured our external trade. We must not be satisfied with the plea that *well-tried methods* have enabled us to recover a little from the deep depression into which in fact they led us, when what recovery we have made has been

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through their partial abandonment (e.g. the Gold Standard), especially when this fact is not entirely realized and those who make the plea are not quite sure whether we should not even readopt what we were forced to discard with such beneficial results. While the latter are no more than might reasonably have been expected from the snapping of the gold link and would unquestionably vanish with its restoration, the improvement might be confirmed and stimulated by a declaration of its final relinquishment in favour of the present General Commodity Standard. Beyond that, the demobilization of claims and the fuller use of public credit, for which it is neither necessary nor right that any subject individual or group should be paid, for the constructive purposes of peace, might open a new era of hope and achievement such as the world has never yet known. We trust this will not be dismissed as the mere dream of impracticable idealism, but that a due consideration of the arguments and illustrations used may lead to the conviction that it is the only really practical way of making any substantial advance in national prosperity.

*So distribution should undo excess
And each man have enough.*

—Lear IV, i.

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* It has been essential to the purpose of this book to make a distinction between *real* and *notional* wealth. By the first is meant all those things which minister *directly* to the necessities, the comfort, the enjoyment and the general well-being of mankind. By the second is meant all those things, especially money and deferred claims, which are of value only as giving the owner a right or title to the first. Gold and silver regarded as commodities would belong to the first, as media of payment to the second of these categories.

