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Planned Money.

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PLANNED MONEY

Economics and Finance

MONEY AND FOREIGN EXCHANGE

AFTER 1914

by GUSTAV CASSEL

ECONOMIC PROSPERITY IN THE BRITISH
EMPIRE

by STEPHEN LEACOCK

BACK TO PROSPERITY

by STEPHEN LEACOCK

POVERTY AND THE STATE

by GILBERT SLATER

THE GROWTH OF MODERN ENGLAND

by GILBERT SLATER

THE SERVILE STATE

by HILAIRE BELLOC

PLANNED MONEY

BY

BASIL P. BLACKETT

“Then pause not ; for the present time’s so sick,
That present medicine must be minister’d,
Or overthrow incurable ensues.”

SHAKESPEARE. *King John*, Act V, Scene 1.

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PREFACE

IN that readjustment of national life to a twentieth-century environment which is the great task of this generation, existing institutions and old established habits of thought will be called to account. Some which have outlived their utility will be scrapped. Others will justify their claim to survival only after undergoing profound modification to make them serviceable in modern conditions. National reconstruction must be comprehensive and must extend into every branch of human activity. To concentrate on some aspects and forget others is to create indefensible salients and to waste invaluable time and effort. On the other hand, any individual contribution to the study of reconstruction problems must be limited in its scope and must take as its province some particular subject on which any specialist knowledge the contributor may possess can most usefully be brought to bear in the service of the national cause.

Among the institutions and established habits of thought which require thoroughgoing reconsideration are our monetary system and our attitude towards the international gold standard. There is widespread misgiving as to the serviceability of orthodox currency theory and practice in present

circumstances, and attacks are being launched upon them and upon the responsible authorities from various angles. The authorities can, however, point out with justice that amid a host of criticisms there is a singular absence of any reasoned presentation of an alternative constructive programme drawn up with full knowledge and understanding of the many practical difficulties and making full allowance for the extraordinary risks attaching to interference with the delicate machinery of the financial markets.

I have in this book attempted to meet this reasonable challenge, and to make constructive suggestions for a revision of our national currency system as an integral part of a general programme of national reconstruction. The first chapters of the book are intended to emphasise the essential point that monetary reconstruction must not be approached as an isolated problem or divorced from its interrelations with the wider national task of readjustment. In the remaining chapters my aim has been to avoid technicalities and technical jargon so that the average man and woman may be able to think and judge for himself and herself on matters which are often supposed to be incomprehensible to the layman and left, not always with advantageous results, to the judgment of the reputed expert. It is right and proper that management should be left to the expert, but the layman should decide policy after listening to the expert's presentation of the case.

The professional economist will, I fear, feel that many subjects touched on should have had a whole chapter or a whole book devoted to their

examination and not a single sentence or paragraph, and that some important considerations are omitted altogether. This is unavoidable if the book is to be readable by the general public for whom it is primarily intended. I am more concerned at the possibility that, in trying to be brief and intelligible, I may have incurred the charge of being dogmatic. I have tried to be definite, but have hoped to avoid dogmatism, just because I am acutely conscious of the intricacies of the subject and the experimental character of the programme put forward and the complexity of the considerations which must be weighed by the responsible authorities before coming to vital decisions on matters of financial policy. At the same time the opportunities are great and the case for action is urgent, and I should be false to my own convictions if I did not insist on the need for courageously facing the issues and for bold action upon conclusions once reached.

I do not claim originality for any particular ideas in this book. The process of formation of my own opinion has been one of gradual assimilation and sifting of views expressed by others in books, in conversation, and in letters. I have read or scanned most of the innumerable pamphlets on money which have been a significant phenomenon of the last few years. I gladly acknowledge but cannot identify many debts to others who have thought and written on the subject. I shall be well content with similar anonymity if such of the ideas in this book as are of value pass freely into the national circulation, and help to give to our generation and to those to come a rational monetary system free from

some of those defects which have for so long tormented humanity.

No institution and no person other than myself is in any way committed by views here expressed. The responsibility belongs to me alone.

BASIL P. BLACKETT.

LONDON,
September, 1932.

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PART I

PLANNING

Introductory

PLANNED MONEY

CHAPTER I

PLANNING

“ having thus discerned how dire a thing
Is worshipped in that idol proudly named
‘The Wealth of Nations.’ ”

W. WORDSWORTH, *The Prelude*, XIII., 76.

IN the course of the last few years the Western world has gradually come to realise that there is something more in the Russian Five Year Plan than a manifestation of Bolshevist doctrine. It has begun to ask whether Russia—and Italy too—may not be right in their insistence on national planning, however wrong they may be in their aggressive repudiation of the overriding claims of freedom. In this country the idea of planning has passed rapidly beyond the stage of being suspect for its communist connotations and has become perfectly respectable. The word “Planning” which was hardly ever used a few years ago except in such phrases as “Town and Regional Planning” has come into common vogue in political circles without, however, attaching to itself any very precise signification.

What then does “Planning” mean? First and foremost it stands for a political philosophy which is

the antithesis of laissez-faire. The nineteenth century believed that in laissez-faire it had discovered an automatic and self-regulating economic system, which nothing but unwise governmental interference could prevent from promoting public well-being. "Within the framework of law and institutions, established by the public authorities of each country, of law to repress fraud, of currency to afford a medium of exchange, of order and security, the individual would work for the public advantage by pursuing his private profit. As no one need buy what he did not want nor give more for anything than he thought it worth, none could earn for himself without bringing profit to others. The strongest of all the motives to arduous work which is common to mankind, the desire for personal gain and fortune, was harnessed to the chariot of the public good. The individual, thus specialised and eager, could discover more exactly, and provide more skilfully, what others wanted than any planning authority with a wider range and a less stimulating motive." (Sir Arthur Salter in *Recovery*, p. 9.)

The twentieth century is now painfully discovering that this automatic self-regulating system was a myth, and that the marvellous material prosperity which the world enjoyed in the seventy-five years before 1914 was not due to the supposed merits of this system, but to a fortuitous combination of circumstances, essentially precarious and ephemeral, which has now passed away. It has taken a war unexampled in history for its destructiveness of material things and of human life, and a trade depression which has immobilised for want of

employment more human beings than were ever mobilised at any one time on all the battle fronts of the war, to drive home the lesson that some better method must be found and applied to the ordering of man's economic life than the unregulated competitiveness of human beings guided solely by their own self-interest, however enlightened. Planning may thus be defined as a necessary corrective of the major wastes and frustrations arising from the unregulated impact of one economic activity upon another ; or again as the conscious and deliberate provision by human forethought of means for regulating production in relation to demand : or again as conscious control by human agency of the processes of Production, Distribution and Consumption with a view to securing the maximum opportunities for satisfaction of the greatest possible quantity and variety of human wants ; or once again, if it is permissible at this stage to beg all the vital questions at issue, Planning may be defined as the conscious and deliberate co-operative effort of free men and women disciplined by an active social conscience to create for themselves and for their fellows the optimum material environment in which to realise their highest potentialities of spiritual development.

The very notion of planning is obnoxious to most minds, and meets with instinctive hostility from those who have been brought up in British traditions of personal and constitutional freedom. They are offended not only by its suggestion of regimentation from without, but also by the quality of arrogance implicit in the claim that it is possible

to guide and control events. There is indeed a mysterious process of growth in human affairs which cannot be planned.

“Wisdom lies

In masterful administration of the unforeseen.”

It is important above all to keep a sense of balance and proportion, and to preserve a fundamental humility in the face of outward circumstances. The statesman who observes and apprehends what is happening among the human beings around him is more likely to arrive at correct judgments and to translate judgment into wise action and to avoid unfruitful experiments than is the dreamer of dreams and the framer of paper plans for building an ambitious Utopia. “You must enter through the gate of humility and pass through the gate of knowledge before you can reach the gate of wisdom.”

Any planning of national reconstruction in this country must do full justice to the sound common sense of this traditional British scepticism. It must be dynamic planning, not a cut and dried programme devised for a static world ; but planning there must be, something more than piecemeal efforts at reform which continually leave out of sight what Hegel called “The Altogetherness of Everything.” Nothing has been more exasperating in recent political experience than the continued frustration of effort resulting from well-meant piecemeal action. Royal Commission after Royal Commission and Committee after Committee has seen its report pigeonholed, either because proper preparation had not been made to take the syn-

chronised steps in some other field which were essential if its recommendations were to be adopted, or because its terms of reference were too narrow to enable it to make really fruitful recommendations, or because in trying to be useful it went outside its reference without being allowed access to essential evidence on subjects not strictly within its narrow sphere. It has been not unknown for a Government to be pursuing two or more incompatible policies simultaneously, either unconsciously owing to excessive departmentalism or even consciously for want of decisive action by the Cabinet. For example, the Coalition Cabinet, between 1918 and 1922, adopted as its monetary policy the gradual return to the gold standard at the pre-war parity and at the same time fixed the wages of railwaymen "definitively" at a minimum of 100 per cent. over pre-war rates, and similarly it embarked on a housing policy, the finance of which necessarily broke down with the raising of the bank rate to 7 per cent., an unavoidable step in carrying out its declared monetary policy.

There has been a very real improvement in these respects with the advent of a National Government able to act with freedom in every sphere. Indeed, without using the word, this Government has done considerable planning and has laid the foundations for much more. Yet the National Government has not been able to avoid incurring its share in the national humiliation of the episode of the Waterloo Bridge impasse. The failure over nearly a decade to solve the problem of Waterloo Bridge and the failure over a generation and more to reach a satisfactory

solution of the problem of Charing Cross Bridge are apt illustrations in a smaller field of the necessity for broad and comprehensive planning. Neither problem will be adequately dealt with except as part of the bigger question of the re-planning of a large area of London both North and South of the Thames.

If the National Government is successfully to carry forward the task of national reconstruction to which it has set itself, it must frame for itself a political philosophy adequate to the needs of to-day. In adopting a policy of tariff protection for British industry and agriculture, the Government has broken with the whole of those principles of *laissez-faire* which proclaimed that "interference with the natural channels of trade" was outside the functions of government. Having adopted protective tariffs as an instrument of public policy, the Government cannot continue to base its taxation policy on the principle that it is not only improper for a Government to take any responsibility for the efficiency and remunerativeness of business but also dangerous to have regard to any such objective in considering taxation questions.

Real planning, then, should be conscious and deliberate and be publicly adopted as a declared policy. It requires, too, a readiness to question every existing institution and the foundations on which it rests. The new England must grow naturally out of the present and the past. Violent revolution is a surer and swifter way to chaos and a new Dark Age even than drifting, though drifting is likely enough to lead to violent revolution. Readiness to question every existing institution and to accept and abide

by the answers, as the scientist accepts the answers which Nature gives to his questions, does not imply that the foundations are necessarily or even probably insecure or that existing institutions ought to be abolished. It does imply that they ought not to be taken for granted.

Planning must be national in having regard to the national economic life as a whole. It cannot be individualistic. Nor in existing circumstances can planning be international. Here a fundamental difficulty arises. Britain cannot prosper in a distressed world. Problems of external trade and external contacts arise in acute forms at every stage of national reconstruction. Many of the causes of present distress can be removed only by international co-operation. Yet to wait till effective steps can be taken by international action would result in mere futility. Action, whether political or economic, must be taken within the area within which political conditions permit of its being effective. This dilemma between the claims of nationalism and of internationalism is responsible for a considerable part of the feeling of frustrated effort in the modern world. A new political philosophy is required in regard to international relationships no less than in home affairs.

There is an ostrich-like quality in much modern thinking on this subject. The world might indeed be materially far richer than it is if human beings could find the organising ability—and still more the mental, moral and spiritual strength—needed to take full advantage of the opportunities which modern science offers. It can never, in present conditions,

be as rich as would be theoretically possible under a system of universal free trade if all differences of race, creed, culture and historical environment were assumed not to exist, or to be capable of being ignored. As factors in production a homogeneous and standardised humanity might be the ideal instrument, though few would willingly change the present colourful world for such an ideal.

A workable philosophy of international relations must take the world as it is. If any one lesson stands out clearer than another from recent history, it is that of the economic interdependence of the world ; but it is apt to be forgotten that economic interdependence postulates the existence of a number of national economic units or groups which are thus interdependent. The world is not a single economic unit, but the aggregate of a number of units which are politically and economically independent as well as being interdependent. Economic progress is impossible if this fact is ignored and is not likely to be fostered if much time is spent in deploring it. Economic nationalism takes many forms and many of them are open to grave objection, not only because they impede world progress and make the world poorer in the material sense, but also because they defeat their own ends and impoverish the nations responsible for them. Nevertheless, he would be a bold man who maintained that it would be to the advantage of the world to-day to get rid of nationalism altogether or even of economic nationalism in every form. It is, moreover, futile to try and build on any such expectation. The best service which the particular nations of the world

can render to the cause of world recovery is energetically to take all steps within their power to put their own house in order, provided always that in so doing they act consistently on the principle that, if any proposed measure is such as to damage other nations, that is a very strong reason in their own self-interest for trying to find some other means of securing the desired internal advantage.

This pragmatic philosophy of international relations, if genuinely accepted, would go far to clarify modern thinking and practice on many subjects, and not least on money, which is the particular subject of this book. It has, moreover, a special value for Great Britain as a part of the British Commonwealth of Nations. The British Commonwealth is a very practical experiment in international organisation on a basis which gives full recognition to the independence, both economic and political, of the partner units, freely associated under a single sovereign. The harmonious and free co-operation within a single system of a number of States enjoying equal partnership in one great Commonwealth of Nations offers to the world a model of international co-operation capable of indefinite extension. The only rival world political and economic system which puts forward a comparable claim is that of the Union of Soviet Republics. The Russian model is of little use to a world to which freedom is an absolute value. Britain's historical position as the centre of a world-wide Empire makes it inevitable that in planning national reconstruction she should pay special regard to imperial contacts. The planning of an Empire Economic Family can never be far

away in the planning of Britain. It still remains true that the first step is to put her own house in order, but the existence of the Empire makes it even less possible for Britain than for other countries to dream of—or to wish for—economic isolation or self-sufficiency. An imperial outlook is thus a valuable corrective to any narrow British economic nationalism. If it adds complications in planning national reconstruction, it also helps to suggest ways through and round many difficulties. The immense scale of modern economic processes is not the least of the causes of the breakdown of nineteenth century methods and institutions. Man's powers of large-scale organisation and of harmonious co-operation threaten to prove themselves unequal to meeting the growing complexity of the machinery for regulating production, consumption and distribution. If these powers are further taxed by the need for economic planning which transcends national boundaries, the peculiar organisation of the British Empire provides special opportunities for mutual collaboration not open between nations which are politically disassociated, and goes some way to ease the difficulties of national planning for an area such as that of Britain, which cannot feed its population without world-wide trade, and is altogether too small to form an economic unit commensurate with the vast scale of modern commercial and industrial operations.

This is not to say that international planning must be entirely forgotten. Planning must cover every aspect of British social, political and economic life, and in particular the inter-relations between

each and every aspect, and advance in any one field must be kept closely in step with advance in every other field. International contacts and their inter-relations with domestic affairs cannot possibly be ignored. Just as the need for imperial planning is a useful corrective for undue economic nationalism, so also the very fact that international co-operation extends planning across existing political frontiers is of special value. The goal of international planning should be kept always in sight. Successful national and imperial planning is, however, the way of advance most likely to promote international planning. British achievements in planning cannot fail to react powerfully on other nations and at an early date to extend the area of planned economy far beyond the boundaries of this country and of the Empire.

CHAPTER II

THE NEED FOR PLANNING

“ Lord, what fools these mortals be !

* * * * *

And those things do best please me
That befall preposterously.”

SHAKESPEARE. *Midsummer Night's Dream*,
Act III., Scene 2.

“ What's here ? The portrait of a blinking idiot
Presenting me a schedule ! ”

SHAKESPEARE. *Merchant of Venice*,
Act II., Scene 9.

A DOCUMENT written by the author in March, 1931, begins thus :—

“ In the last twenty years we have allowed the numbers of our feeble-minded to double themselves. Why ?

“ Our agricultural industry is falling more and more into decay and we are doing nothing effective to check the rot. Why ?

“ We have failed miserably for ten years to deal intelligently with the problem of the Coal Industry. Why ?

“ We have allowed wages in the unsheltered industries generally to fall to dangerously low levels and have kept them up in the sheltered industries at figures which are admittedly so high in relation to unsheltered wages as to endanger the whole economic structure of the country. Why ?

"We have watched the purchasing power of our currency fluctuate wildly up and down and play havoc with our economic life and have been powerless to help ourselves. Why ?

"We are heavily burdened with rates and taxes, and not one of us believes we get value for our money. Why ?

"We gird at bureaucratic legislation and at legislation by reference and it goes on unchecked. Why ?

"Prime Ministers and even Leaders of the Opposition (and their ladies) get nervously worn out in the mere effort to grapple with their everyday business, and fatigued by the mass of detail they have neither time nor energy for thinking, and we do nothing to remedy this. Why ?

"We have left the House of Lords unreformed since the Parliament Act of 1911. Why ?

"With unusual foresight as to what the coming of the motor meant we established a Road Fund in 1910, but we still allow ribbon-building to proceed unhindered along our new motor roads. Why ?

"We still have all sorts of different voltages for our electric light and power services in adjacent parts of the same towns. Why ?

"In the Imperial sphere there is a desire shared by nearly all parties throughout the Empire to organise the Empire as an Economic Family, and yet we have the spectacle of the Imperial Conference of 1930. Why ?

"In the sphere of foreign affairs the nations sign the Kellogg Peace Pact and arm themselves to the teeth. Why ?

"There is probably a greater fund of goodwill to-day throughout the nation and a more generous desire to get the right things done than ever before, yet both in the political and in the economic sphere all of us find our efforts leading to general frustration of our will. Why ?"

The document which is being quoted went on as follows :—

“ Questions of this sort could be multiplied indefinitely. They are of varying importance and relate to all sorts of different aspects of our political and economic life. Yet one simple answer can be given to all of them.

“ Our political and economic machinery is breaking down.

“ The pessimists declare that mankind is no longer clever enough to manage the machine he has created. On all hands there is an increasing recognition that failure to manage the machine threatens national collapse and perhaps a world-wide disaster to present day Western civilisation, and the onset of a new *Götterdämmerung*. Yet side by side with this fear and despair there is a very British complacency which still clings to the old belief that somehow or other we shall muddle through, that British institutions are and always have been the best in the world, and that anyhow it is better to carry on and not to think too much about our troubles. If despair is cowardly, complacency is deadly.

“ We must deny resolutely the view that mankind cannot manage the machine which he has created, while affirming as indubitable that failure to realise that the machine is breaking down and to think out and carry out a plan of national re-organisation means a complete collapse for this country and probably for the whole of Western civilisation.

“ Alike in our politics and in our economics what is essentially lacking is orderly and co-ordinated planning.

“ Neither in politics nor in economics have any of the political parties grasped that the first and urgent necessity is planning ahead. The great fund of individual and corporate goodwill goes to waste, and all our

wills are frustrated for want of a large scale plan of national reorganisation. Particular projects, often of great potential value, are put forward without any effort being made to relate them to each other or to a national plan, and they either break down or function imperfectly through needless friction engendered by absence of ordered planning. Frequently where public opinion has become exasperated at its failure to get something done to remedy a defect which everyone recognises as intolerable, our distracted legislators with desperate unanimity unite to pass into law a compromise which is wanted by no one and merely increases the evil.

“Effective planning on the economic side and even the introduction of many desirable reforms in detail have become impossible without a drastic overhauling both of Parliament and the Central Government and of the machinery of Local Government. Political and Economic Planning are supplementary and complementary to each other, and must be carefully inter-related.

“We must insist on the need for economic and political institutions to match the new social adjustments which applied science has created, and for a new economic and political technique to enable us to find intelligent methods of surmounting new difficulties and complexities.”

The remainder of the document was a call for honest and unprejudiced study of what the foundations of a National Plan should be and how it should be built up, and for active work to convince the nation of the need for Planning—“not for acceptance of any preconceived ideas, but for thought and study, in furtherance of national well-being, along lines which are at once realist and idealist, and for a

faith, sturdy and undaunted by the buffets of daily disappointments, in those national ideals of freedom and public service which have shaped our past history."

Much has happened since this document was written. Financial collapse has overtaken the whole world. Governments everywhere have been preoccupied with the overwhelming problems of the moment. The need for national reconstruction has been far more widely recognised in this country, and unless, when the respite comes, a new wave of complacency overtakes the nation, the demand for a great overhauling of British political and economic machinery will be irresistible. To some extent, therefore, the necessity for awakening the nation to the dangers of drift has become less urgent. Acknowledged dissatisfaction with the mess into which man has brought himself and recognition that the mess is due to man himself and to the failure of his intelligence, not to the niggardliness of Nature, are creating the atmosphere in which, if some major political catastrophe does not divert their energies, Governments and peoples are most likely to use the respite to initiate measures of reform.

Yet the inertia of habit and custom and the sheer momentum of ordinary economic processes, the forces of resistance to which in the main Western civilisation will owe its escape from immediate disaster, are not sufficient to bring real recovery.

They are, indeed, in some measure antagonistic to successful reconstruction in that their bias must be in favour of piecemeal reform and against comprehensive planning for the longer future. Even to-day

there are impenitent individualists whose cry is for a return to unrestricted laissez-faire. To them it is answer enough to point out that the economic life of the world has become too complex, the scale too large, the marvellous stream of new invention too bewildering, the annihilation of distance and the speed of transport and communication have drawn the nations too closely together, to allow of any return to nineteenth century methods. And the social conscience of mankind has rightly revolted against the brutality of the economic adjustments on which, in the last analysis, the self-regulating machinery of the old system depended.

Those who are sincerely conscious of the new needs of the twentieth century require, and are entitled to receive, a fuller answer to their legitimate doubts and hesitations as to the claims of Planning. In the last chapter an attempt has been made to define "Planning" and to indicate the general nature of its scope and aim. What is needed now is to give greater precision and content to what might otherwise be dismissed as mere rhetoric. Some will demand a full and detailed Plan, complete with its Time and Progress Schedule. The aim of this book is less ambitious, nor could such a Plan be drawn up by a single individual. It would need the skilled collaboration of many minds, administrators, business men of varied experience, Trades Unionists, Lawyers, men and women skilled in Parliamentary and Municipal procedure, scientists, teachers; and to do the task well they would need to be, not lookers on, however expert, but actively engaged in the practical day to day carrying out of the duties

of their own profession or occupation. The Time Schedule would necessarily vary greatly for different portions of the Plan, which, besides trying to improve man's material environment, would have to call in the services of the medical and biological sciences to assist in making man himself physically and racially better fitted for his environment. Moreover, such a Plan, when finally drawn up, could be useful only as illustrating the principles on which national reconstruction should be based and providing a general picture or framework or pattern for the general guidance of the nation and its leaders, and as assisting them more easily to synchronise action in different fields and to visualise the interrelations of proposed measures in one field with the programme of advance along the whole line of endeavour. It could not be a final and definitive programme to be followed in all its details through the changing years. While, therefore, the framing of such a plan has its merits and would be worth doing well, a distinction should be drawn between forward Planning and the framing of a Plan. Planning must, as has been said, be dynamic. A Plan cannot avoid the appearance of being static.

The aim of this book is a restricted one. While insisting on the need for conscious forward planning and for acceptance by the nation of the philosophy which Planning implies, this book will examine some of the potentialities of Planning in the particular field of Money or Finance. Planned Money is vital to Planning, which is hardly conceivable under a monetary system in which the general level of prices is subject to violent fluctuations. And a

stable price level is impossible without Planning in other economic and political fields. Before, however, this special subject is approached, it is necessary to give more definite reasons for the assertion that Planning is a worthy aspirant to the place left vacant by the demise of laissez-faire. Granted, it will be urged, that a return to laissez-faire is ruled out, is Planning even possible without sacrifice of personal and constitutional freedom? Or again, is this Planning anything more than a freak name for State Socialism? or again, does not Planning involve an invasion of economic freedom, even if it is admitted that it is not open to the charge of encroaching on spiritual freedom, and will it not so shackle and trammel man's economic freedom that the result will be less production not more, less enterprise and initiative, a drying up of the incentives to progress, and final loss not gain in material well-being? In short, will Planning really pay?

The relations between Freedom and Planning are so important and the point at issue so vital that they deserve a separate volume for their treatment. A single chapter—the next—necessarily inadequate, is all that is permissible in this book.

There remains, meanwhile, one further aspect of the case for Planning which must be considered. It is sometimes objected that, while Planning may be able to substantiate its claim that it will provide an adequate substitute for laissez-faire in controlling Production in relation to Demand and in restoring the machinery of Distribution, its advocates are guilty of a *petitio principii* in assuming that the restoration of economic equilibrium will auto-

matically lead to the re-absorption into employment of the millions now unemployed. If this objection were valid, there would be no need to pay further attention to Planning. It would stand condemned in advance. Planning has strong reasons for claiming that it provides the requisite economic organisation for preventing the recurrence of conditions leading to the non-employment of a vast number of willing workers, not indeed automatically—Planning, unlike *laissez-faire*, does not believe in any automatic self-regulating system—but by conscious regulation of production and distribution in such a way as to permit of the maximum satisfaction of the demands—potentially unlimited—of the consumer.

It will be seen that the assumption is made that the demands of the consumer are potentially unlimited. This is the kernel of the matter. “In the sweat of thy brow shalt thou eat bread.” The struggle for existence has hitherto been the unchallengeable foundation of all human society and of all economic thought. Even to-day there are vast regions, in India and China for example, where starvation is never far from the thoughts of millions of peasants; but in Western Europe and North America the problem of daily subsistence is no longer fundamental. In actual fact in these countries and potentially in the rest of the world, supplies of food, clothing, houseroom, sufficient to keep the population alive and even to secure them a moderate standard of comfort, could be provided without calling for more than a few weeks’ work a year from each member of the community, or alter-

natively without calling on more than a comparatively small number of them to occupy themselves at all in the production and distribution of the things required for the community's daily consumption. While, however, basing its organisation on the universality of the struggle for existence, society everywhere has long since aimed at far higher standards of life and has assumed that the potential wants of human beings are for practical purposes unlimited. It would be interesting to know how large a proportion of the economic activities and of the work-hours of those in employment in Britain or the U.S.A. in 1929 was devoted to catering for the leisure hours of the community. If economic science is called upon to discard some of its pre-suppositions and to adopt a new outlook, it is surely justified in postulating that, given suitable opportunity, the average man and woman is willing to work hard in order to extend the range and the volume of satisfactions enjoyed. The emphasis must, however, be shifted from fear of starvation to some incentive to endeavour which is more immediately persuasive. The threatened breakdown of modern civilisation is in part due to the continued reliance of its economic and social machinery, which it has inherited and not yet adapted, upon the old incentive. To some extent the prevalence of unemployment is a reflection of the fact that society still relies on the motive of providing for mere subsistence to stimulate the individual to effort, whereas the mere provision of subsistence leaves large numbers of the population with more than ample leisure. The social conscience of the community meanwhile

gives tacit recognition at any rate in Great Britain to the insufficiency of that motive by refusing to allow the unemployed individual to starve and insisting on providing him, by some form of public assistance, with something more than the bare minimum of subsistence.

Here again the needs and the opportunities of the twentieth century have outgrown the philosophic outlook which it has inherited. Conscious forward planning must take fully into account the significance of this change in the economic motive of human activity. A sound political hypothesis must always be economical in its demands on human nature, but it is even more dangerous to underrate the level of humanity's aspirations than to overrate them. Planning does not aim at changing human nature though it does aim at giving opportunities for advance towards a higher and a fuller life. If the progress of applied science has indeed pushed the motives belonging to the harsh struggle for existence into the background, the possibilities of advance will be increased by an economic outlook which gives both recognition and opportunity for conscious development to springs of human action which are less sordid in their origin.

CHAPTER III

PLANNING AND FREEDOM

“ This last spot of earth, where Freedom now
Stands single in her only sanctuary.”

W. WORDSWORTH. *The Prelude*, XI, 400.

THE acute financial and economic depression from which the world is suffering to-day has affected man's spirits in all the leading countries of Western civilisation. For a parallel to the prevalent pessimism it is necessary to go back to the Roman Empire in the fourth and fifth centuries of the Christian era. The discouragement and oppression of spirit are the more profound because of the general recognition of the truth that the failure is due to man himself,

“ Inwardly oppressed
With sorrow, disappointment, vexing thoughts,
Confusion of the judgment, zeal decayed,
And lastly, utter loss of hope itself
And things to hope for.”

Courage which does not falter in the face of natural calamities is of less avail when it is realised that not nature, but human want of capacity, is the enemy at the gate. Individual human achievement has not been lacking. The last two generations have won ever greater triumphs over nature and throughout the material field, but the need for an

ever wider and bolder application of the principle of the division of labour seems to have outranged man's powers of large-scale organisation. The task man has set himself demands more than the control and adaptation of the forces of nature. He has to learn so to control his own human nature and so to work together with the human nature of his fellows as to fit them and himself into an organised society which is capable of taking full advantage of the new opportunities which nature offers, without losing in the process all that makes life worth living.

Mr. Bernard Shaw has summed up the dilemma between Freedom and Planning in a few challenging aphorisms. "Almost all British constitutional safeguards are safeguards against being governed." "Communism is a tremendous extension of government and consequently a great encroachment on liberty." "Mussolini understood that what was keeping the people slaves was their determination to be what they called free." "No real business that had to do positive work could achieve anything on the British Parliamentary system."

Is the dilemma absolute? Is national reconstruction impossible without sacrifice of the essentials of personal and political freedom? Can conscious forward planning of our economic life be reconciled with the overriding claims of freedom? Is it true that what we need is more government and less liberty? If indeed national reorganisation has to be bought at the price of losing our freedom, there will be many who will feel that it were better for humanity to descend once again into the abyss of barbarism in order to struggle back painfully at

some later epoch to a civilisation capable of satisfying both its material desires and its spiritual aspirations. Is there no other choice? It is clear that the first need is for an unprejudiced examination of what is meant by freedom. Use has already been made of the phrases personal freedom; constitutional freedom; economic freedom; and spiritual freedom. It will be observed that, though Planning must include in its aim the reconstruction of political and social life, it is primarily in the sphere of economic life, in the sphere of material things, that conscious forward planning is demanded. That economic reconstruction will profoundly affect existing political institutions and will involve readjustments of constitutional machinery and technique is not open to question. It does not follow that constitutional freedom will be endangered. Fear that the means may restrict freedom is not enough to justify refusal of the objective. The British constitution has always accommodated itself to changing conditions. Further development is always to be welcomed if it takes the form of a natural evolution along lines consistent with British traditions. If Planning is a reaction against *laissez-faire*, *laissez-faire* itself represented a reaction against some of the doctrines of the Mercantile era, and Britain's free institutions were won long before Adam Smith. There is, therefore, no *à priori* reason for regarding freedom of thought, freedom of speech, freedom of conscience, or free institutions, as incompatible with conscious forward planning of our economic life.

Economic freedom must always be tempered by

the conditions of its environment. In any organised society, human beings must submit to some restraint upon their right to do as they please if they and the community to which they belong are to enjoy the material advantages which flow from the division of labour. Economic freedom cannot be an end in itself, but is a means for securing an environment which presents the widest possible opportunities for the exercise of the highest faculties of human nature. Subject to this proviso, economic freedom will be greatest under that form of economic organisation which provides men and women with the highest standards of material well-being attainable by the use of the powers of scientific production and mutual endeavour which they are at any given time able to command. The forms which economic freedom takes will vary widely from country to country and from generation to generation, according to the level of culture and to historical and geographical surroundings. Looked at from the material standpoint, economic freedom postulates the presence of human incentives sufficiently strong to induce the average member of the organised community to take pains and give of his best. On the spiritual side it postulates the absence of such infringements or inroads upon his personality and individuality as will seem to him to deny his fundamental humanity.

Except perhaps in Soviet Russia, no economic system has attempted to refuse to the would-be consumer the right to determine for himself which of his competing wants he will satisfy within the range of choice open to him. It is the consumer's choice which settles the relative prices of the goods

and services offered for sale by the producer and the middleman. The consumer's purchasing power has in general been made dependent on his capacity to contribute to the community's output of goods and services and on the community's demand for those particular goods and services. The quantity and quality of production is determined ultimately by the strength of the consumer's demand at particular levels of relative prices.

The extent to which the Soviet System denies freedom of choice to the consumer may possibly be exaggerated in the accounts of Russia which reach Western ears. Such denial is perhaps intended to be a temporary measure during the period of capital re-equipment of the country. In so far, however, as the communist ideal is a mechanised State which will produce according to Plan the maximum output of consumable goods and distribute them with the maximum efficiency, the State is logically driven to interfere with the freedom of the consumer's choice. It tends to regard each member of the community, not as a consumer, but as a part of the mechanism of production requiring a given quantity of fuel, oil, etc., to keep him going as a producer. In pursuance of a plan drawn up in advance it fixes by decree the quantity and quality of production of all kinds, and cannot afford to leave it in the power of the human consumer to cause variations in demand by exercising a free choice among his competing wants. Instead, therefore, of leaving it to the demands of the consumer to determine relative prices and thereby to dictate to the producer what shall be produced, the Communist System starts

by determining what shall be produced ; and in fixing relative prices with reference to this pre-determined plan of production it goes a long way towards dictating to the consumer what he shall and still more what he shall not consume.

This desire to dictate to the consumer is one of the main reasons why the Soviet System appears to the onlooker to be the arch enemy of freedom in all its forms ; and it has in fact undisguisedly to base both its politics and its economics on compulsion from above and on concentration of power in a small oligarchy, if not in a single dictator. Such dictation of the consumer's choice is not an indispensable feature of Planning. Reasonable standardisation of some articles of ordinary consumption is certainly desirable and has been effected with considerable success in the U.S.A., and even more in Germany, without any challenge to freedom. Some similar standardisation in this country, and some limit to that excessive stimulation of demand for the satisfaction of mere whims which arises from unbridled competition among those who cater for them, should be welcomed. The economic waste in producing and marketing a hundred varieties of trouser buttons is as damaging in its degree as is the more obvious waste of having six hundred different types of locomotives on a single railway. Economic freedom is not challenged by such commonsense reforms. The broad principle remains. The economic aim of a free community and of Planning in a free community must always be to give the consumer the widest possible opportunities for satisfying as many of his wants as possible.

In Great Britain, then, Planning must leave the consumer's choice free. It will leave prices to be determined by demand and will not seek to regulate the relative prices of particular commodities. On the other hand, the keynote of Planning in the monetary field is the maintenance of stability in the price level, and this should involve some smoothing out of those fluctuations of the consumer's purchasing power which are a potent cause of disequilibrium between production and consumption under the existing *régime*. If, however, the consumer's choice is left unfettered, Planning necessarily implies some new machinery for relating production to demand, some conscious regulation of production to supplement the present unregulated efforts of a host of producers to estimate as best they can, in competition with each other, just what the demands of the consumer are and just when they will become effective.

The breakdown of the existing economic system appears most obviously in the failure of its machinery of distribution. That machinery has of late years been increasingly unsuccessful both in carrying the products of industry and agriculture smoothly to the consumer's door, and in translating the distributor's information regarding the consumer's demand into language intelligible to the producer for purposes of determining the volume, time and quality of his production. The application of science to production and the rationalisation of industries have gone ahead of any corresponding improvement of methods of distribution. Inasmuch as it has been upon the monetary system that special

reliance has been placed to convey to the producer the consumer's messages as to the nature, time and volume of his demand, Planning must pay special attention to the part played by money in distribution.

All this clearly requires a regulating or planning body in possession of statistical information and means of measuring current economic and social happenings far more complete and accurate than are at present available. This country has much to learn from abroad, for example from Germany, the U.S.A. and some of the British Dominions, in the technique of gathering and applying statistical data. One of the most immediate preliminary steps towards national reconstruction ought to be a thorough overhaul of existing statistical methods and machinery. The need for this must be becoming increasingly felt by the Tariff Advisory Committee which already presents some of the characteristic features of a National Planning Commission. It is impossible to approach questions such as a Tariff on Iron and Steel, or on Pig Products, without becoming involved in the problems of efficient organisation of industry and rationalised marketing methods. The setting up of the Tariff Advisory Committee provides a good illustration of the fact that the National Government has already moved far in the direction of Planning, without as yet publicly adopting the philosophy of Planning or making clear to itself or to the country the full implications of what it is doing. The fact that this Committee is advisory and not executive is specially important for purposes of the present discussion, since it suggests strongly that it is possible to adopt Planning and set up a National

Planning Commission without superseding either the Cabinet or Parliament and without dragooning the producer. From the course of events flowing from the adoption of a protective tariff, a fruitful general principle of Planning can be drawn. In the relations between Government and producer, whether engaged in agricultural or manufacturing or extractive industry, each particular industry must be dealt with as a whole, and must organise itself for mutual co-operation and not appear as a medley of competitive atoms. Similarly Industry as a whole, Agriculture as a whole, Retail Trade as a whole, must meet the Government and the National Planning Commission as organised functional bodies capable not merely of receiving orders from the Government but of being entrusted by the Government with wide powers of co-operative action.

It begins to appear possible that Mr. Bernard Shaw is wrong in saying that what we need is more government, not less. The sense of frustrated effort which is prevalent to-day pervades Government as well as industry. What is needed is not a large increase in the activities of a governmental machine which is already over-burdened, but the development of functional bodies carefully organised and interrelated, covering all the major economic activities of the nation, and the devolution to these bodies by the Government of powers, responsibilities and duties for which present political and economic machinery provides either inadequately or not at all. The ideal of Planning in a free State is a community of free men and women, self-disciplined by an active social conscience, and organised for mutual service

with the help of legislation devised by themselves. Organised as functional bodies enjoying large powers of self-government within their industry and entrusted with serious responsibilities to the community, the producers should be able to regulate production in relation to demand with an effectiveness unknown in present conditions. Distribution and marketing could be rationalised on similar lines.

Just as in its attitude towards Steel and Pig Products, the Government would naturally insist on efficient production at minimum costs, with due regard to the interests of the employees, as a condition of the grant of a charter of self-government. The idea of combination to raise prices against the consumer has already lost favour with the best leaders of industry. Industrialists would have no difficulty in accepting the principle that, in return for the grant of rights which would generally include at least partial monopoly within defined limits and some power of discipline over minorities inside their industry, the community is fully entitled to be safeguarded against exploitation. There would no doubt be variations in the form of organisation adopted by the functional bodies of the different chartered industries. There is no special need for uniformity, although for the important work of managing their inter-relationships with each other equality of status would be valuable. The essential point is that they must represent the result of a real and compelling desire of the different interests within the industry to work together harmoniously for the good of the industry and for service to the community. This certainly makes big demands on

human nature and involves motives higher than competitive desire for individual profit, but so far from encroaching on the fundamentals of freedom, whether spiritual or economic, it enhances freedom

“ having gained
A more judicious knowledge of the worth
And dignity of individual man.”

Outside the province of industrial organisation, Planning will necessitate the careful correlation of a host of other human activities which have their place in the economic life of the nation. Housing, Town Planning, Transport, Unemployment Insurance (or better the National Employment Policy), Medical and Health Services, Education, all require to be surveyed and brought into accord with the new social and economic structure. There is no need to enter into detailed discussion here of the task of Planning in these connections. Profound as some of the changes which are to be expected may prove, encroachments upon the essentials of freedom are not in question. Planning as here conceived is a policy poles asunder from State Socialism with nationalised industries, nationalised land, a State medical service, and a thorough-going regimentation of every phase of the citizen's life. Planning has no desire to enshrine equalitarian doctrines or to eliminate from business the motive of personal reward. Once the major activities or industries are co-operatively organised, there will be a large field even for the most hardened individualist in other useful occupations. Just as a pragmatic philosophy of international relations must accept and make the

best of a number of independent national units proud of their uniqueness, so national planning builds upon the individual citizen's independent personality and humanity. National planning relies on the individual's readiness to work in mutual harmony with others and to give expression to his social conscience, not solely on his competitive instincts as *laissez-faire* does, not on dragooning from above or from without as does Communism, not on smothering the individual under an all-embracing State administration, as does (or did) British Socialism.

National reconstruction on the basis of conscious forward planning must be a process of gradual development, though its urgency will not permit of long delay in beginning the task or of a great lengthening out of the period of its realisation. Experience alone can prove how far present-day preconceptions as to what are the essentials of freedom will require to be modified in the process. Enough has, however, been said to show that Planning is not incompatible with personal, constitutional and economic freedom and contains no threat to spiritual freedom. In the unplanned, haphazard and disorganised economic structure of to-day, men and women are baulked of freedom in all its aspects. If by conscious forward planning they can escape present frustrations, they will be rightly judged to be more truly free.

PART II

MONEY

CHAPTER IV

UNPLANNED MONEY

Like to a stepdame or a dowager
Long withering out a young man's revenue.
SHAKESPEARE. *Midsommer Night's Dream*,
Act I., Scene 1.

IN no sphere is human loss of control of the machinery of civilisation more glaring than in that of Finance. Modern life depends on world-wide interchanges of goods and services. These in turn depend on confidence and credit. The sheet-anchor of credit is the sanctity of contract. Practically every contractual obligation is expressed in terms of money. Even before the illuminating experiences of the last eighteen years, the fact that the purchasing power of money was liable to considerable variation was well recognised by economists and sometimes taken into practical account by shrewd men of business. Nevertheless it is a fact which even to-day the parties to a money contract habitually forget or ignore for ordinary everyday purposes. They have, indeed, no option if they are to carry on business at all. Yet the recent fall in prices has involved an increase so overwhelming in the burden of all money debts that in varying degree all over the world modification of money contracts begins to be looked on as a justifiable or even necessary corollary of the inequity of continued pay-

ment on account of principal and interest in terms of money of which the purchasing power has been enormously enhanced. The nation as a whole and all classes in it suffer grievously from this general fall in prices. Take first the case of a farmer who raised £1,000 in 1924 by mortgaging his farm and spent the money on improvements which would, he calculated, provide for the interest of £50 a year and leave him a handsome surplus. He engaged himself to pay 84 cwts. of wheat by way of interest each year, and his capital commitment represented 1,680 cwts. He now finds himself compelled to find 168 cwts. of wheat a year, and if his mortgage had to be repaid to-day it would represent the value of 3,360 cwts. Expressed in terms of other agricultural products, his obligations have undergone a similar or greater uncovenanted multiplication. The Irishman whose pig was "the gentleman that pays the rent," needs three pigs to render the same service to-day and probably does not possess them.

The manufacturer has had a like experience; a mortgage or debenture issue raised in 1924 requires for its service the equivalent of a much larger quantity of the goods he produces than in 1924. In many cases, indeed, the business is not now earning enough, owing to the fall in prices and in demand, to pay fixed charges, and the creditors are the real owners of the business. It is a common jest in many centres that there are only five solvent cotton or shipping concerns in the town, or whatever the special local industry may be, viz., the Midland Bank, the Westminster Bank, Lloyds Bank, the National Provincial Bank, Barclays Bank.

With the producer, agricultural and industrial, staggering under the weight of indebtedness legitimately and often meritoriously incurred, Government, central and local, finds itself in a like predicament. The total dead-weight debt of this country on March 31st, 1924, was £7,641,046,952; the corresponding total on March 31st, 1932, was £7,433,942,880. The Board of Trade index number of wholesale prices on the first date was 165·4 (taking 1913 as 100), and on the second date 104·6. In terms of wholesale commodities, therefore, in spite of a nominal reduction of over £200,000,000, the debt had gone up in eight years by 53½ per cent., or, translated into sterling at 1924 prices, from £7,641,046,952 to £11,755,011,016. Much the same results appear if the charges for interest and management only in the same two years, 1923/4 and 1931/2, are taken. The figures are £307,309,000 in 1923/4, and £289,492,000 in 1931/2. At 1924 prices this represents an increase from £307,309,000 to £457,763,000, or 49 per cent. In order to meet this the Government has inevitably been driven to levy taxation at higher rates and thereby to burden still further the harassed producer, who has to hand over a larger proportion of his reduced annual production to the creditors of the Government.

It is often argued that the rentier, the receiver of dividends or interest on Government debt and on other fixed interest securities, obtains an uncovenanted benefit corresponding to the uncovenanted increase in the commodity value of the charge on the debtor. If this were so, the case in equity for a revision of the original money contract

would be overwhelming. In fact, the position is not so simple. The fall in prices has brought considerable advantage to the receiver of interest, in so far as he continues to receive his interest ; but if he is in the habit of living on that interest and spending it on retail purchases, the fact that retail prices have fallen very much less than wholesale prices limits his direct gain to the extra amount of retail goods and services which his interest enables him to purchase. Further, this direct gain in purchasing power is offset to a large extent by a host of indirect losses. He is probably paying more of his interest away in taxation. He is fortunate if some of his fixed interest securities are not in default. For the fall in prices and the trade depression are world-wide and have brought with them inequalities, not only between individuals and classes within each nation, but also between nation and nation. There are interesting differences and shades of opinion in different countries in the national attitude towards default and in the extent to which national honour is felt to be engaged. The fall in prices has unfortunately greatly weakened this sense of honour. In countries which depend mainly on selling their natural products the economic consequences of falling prices have been calamitous. Sheer inability to meet contractual obligations has sometimes made default unavoidable. Even in this country numerous instances can be cited of unpaid debenture interest.

There may be a comparatively small body of rentiers, mostly of the class of retired pensioners or widows with very small incomes, and a certain number of charitable trusts holding nothing but

British Government stocks, who have escaped these indirect losses. Generally speaking, the so-called rentier class holds a proportion of ordinary or preference shares as well as Government stocks and debentures, and in this respect as well as in that portion of their income which is earned, they have shared in full measure the misfortunes of their fellows.

It is true that so far as concerns the internal debt of the British Government, that is, that portion of it which is held within the United Kingdom, the raising by taxation of a sum approximating to £300,000,000 a year and the disbursement of that sum in interest and dividends on Government securities amount merely to a redistribution of the annual earnings of the nation as a whole. There is a certain economic waste involved in paying the salaries and expenses of the people engaged in collecting the required taxation and of those who are occupied in managing the debt and paying out the interest, but apart from these charges the internal debt involves no direct diminution of the national income. It is in the social and economic effects of redistributing the national income on so tremendous a scale that the real damage is done ; and the extent of the damage is immensely increased when the fall in prices is itself bringing about a wholesale redistribution of income to the disadvantage of the producer and is increasing the proportion borne by the interest charge to the total national income.

The deeper the consequences of the recent catastrophic fall in prices are analysed, the more evident are their evils. Every individual and every

class suffers severely, and if the sufferings are unevenly distributed, that is but an aggravation of the national sore. The instability of prices brings instability into every phase of economic life. Strikes, lock-outs, gigantic unemployment, lower standards of living, disequilibrium between sheltered and unsheltered wages, between retail and wholesale prices, between the prices of primary and secondary products, industrial depression, agricultural depression, increased taxation, reduced production—all these are the direct consequences of the fall in prices and the absence of a stable measure of value.

It would be unfruitful here to examine how far monetary policy has caused or contributed to the fall in prices. It is enough for present purposes to point out that monetary policy has failed to prevent the disaster, and that our monetary system, whether as villain or as victim, has provided the machinery which in its operation has translated the causes of the disaster, whether political, social, economic or monetary, into the form of a catastrophic fall in prices.

Is twentieth century Britain content to make continued use of a monetary system which has so conspicuously failed her in the past and is admittedly liable in the future to present her again and again with the disastrous sequence of boom, slump, boom, slump?

This question is quite distinct from that of finding the right remedy for the immediate situation, but something must first be said on the latter subject, since the first step in the direction of an improved monetary system must be the restoration of equilibrium between costs of production and the prices

which the consumer will pay. Broadly speaking, two courses are theoretically open. The first which has been officially rejected by the National Government is to concentrate on bringing down costs and charges to a level at which they will again reach equilibrium with present prices. The second course is to work for (or wait for) such a rise in prices as will bring them into accord with existing costs. For the purpose of providing a starting point for a new and better monetary system it is theoretically immaterial at what level prices stand, provided that there is real equilibrium between prices and costs and that debts have been written down to a figure consonant with that level. And once equilibrium has been effectively regained at any particular level of prices, the country will be just as well off and prosperous at that level as it could be at any other, whether higher or lower. It is the process of readjustment from one level to another which brings with it all kinds of inequalities of sacrifice between one individual and another and one class and another, shakes confidence, and subjects the social and economic fabric of society to shocks and strains of a damaging and dangerous kind.

If prices do not rise, the prospect of a long drawn-out period of wage cuts, swollen figures of unemployment, and the gradual substitution of the reluctant debenture holders and creditors for the present owners (that is the shareholders) of most of the business concerns in the country, is not one to be lightly faced, following as it would upon the years of distress already endured. The prospect is so unpleasant that it may be taken as certain that, if

the hope of relief through gradually rising prices has to be given up, drastic and far-reaching measures would have to be adopted to force the pace. A policy, which attempted to uphold the full sanctity of money contracts and to continue payment in full of the interest and principal of the National Debt and which, at the same time, involved continuous pressure upon industrial profits and upon the money wages of the artisan, could not last long enough to permit of the restoration of economic equilibrium.

It is true that the fall in prices has increased real wages for those who are in work and continue to draw the same money wages as before ; but it is difficult to get the workman to see that real wages, not money wages, are what matter to him. The social inequity of making the profits of enterprise bear the whole burden, while leaving rents and interest payments unreduced is also glaring. Moreover, the process implies the continuance of deflationary action of a kind which recent experience shows to be of doubtful efficacy. A vicious spiral of deflation tends to be set up which prevents the closing of the gap between prices and costs, because the pressure to reduce costs further depresses prices and causes a progressive decline in the volume of business instead of achieving its aim of an increased turnover at lower prices.

Doubts about the efficacy of further deflation of this nature are reinforced by an important psychological factor. It is often stated that the present troubles of Great Britain are a sign that the nation has been living beyond its income and has been trying to maintain higher standards than it can

afford. The national instinct revolts against this conclusion and has sound reasons for its revolt. It is true enough that failure to manage the machinery of modern civilisation has resulted in waste in all directions and that the national dividend is in consequence far below what it might be if the national resources were better organised. There is also much wasteful expenditure which ought to be pruned away. On the other hand, the nation ought to be able to afford standards of life far higher than it enjoys to-day, and is balked of that enjoyment, not because its resources are insufficient, but because it fails to utilise them rightly. When they are told that the way to recovery is to lower their standards and to economise, the people of this country are unconvinced. They rightly see that what is wanted is not economy in the sense of refraining from useful expenditure, but economy in the sense of wise organisation of national resources. A process of gradual deflation means a progressive lowering of standards. It appears to imply resigned acceptance of the results of bad organisation and has a defeatist atmosphere about it which deepens that general depression of spirits which it is most important to exorcise. If, therefore, readjustment to present prices is to be accepted as inevitable, the British people would far rather have it come about swiftly than by gradual attrition and long drawn-out tribulation, all the more if they understand that drastic scaling down does not mean an attack on existing standards of life, but simply a writing down of money values to bring them into accord with existing facts.

If it be argued that the successful conversion of the

5 per cent. War Loan has gone some way to rectify the position, it is pertinent to observe that the £30,000,000* a year saved in interest is a trifling sum in comparison with the increase of over £4,000,000,000 in the capital charge of the debt valued in terms of commodities at 1924 prices, and amounts to only a fraction of the increase of £150,000,000 per annum in the interest charge in terms of 1924 prices. Moreover, this conversion scheme affects only a portion of the National Debt ; there are large portions of it which are protected by long-term contracts against any further conversion, and rents and other money contracts apart from the National Debt are left untouched.

This objection remains valid even after full allowance is made for the effects of conversion in bringing down the cost of new long-term borrowing and in enabling many existing industrial debenture issues to be paid off and the money re-borrowed at lower rates of interest. It should also be noted that from one aspect the conversion scheme is a move in the direction of raising prices, and some of the credit for the success of the scheme belongs to the policy of cheap money deliberately adopted by the Bank of England, that is, to one of the steps taken with a view to facilitating a rise of prices, and still more to the even more definite, if at first hesitant, steps taken by the Federal Reserve Board of the U.S.A. towards the conscious creation of additional purchasing power. In these circumstances, with the example before them of what has been done in Australia and elsewhere in scaling down interest

* About £47,500,000 in terms of 1924 prices.

rates and other money charges *pari passu* with the reduction of profits and wages, the people of this country would surely insist on the adoption of similar measures here.

The drastic scaling down of all money contracts with a view to rapid restoration of equilibrium on the new and reduced level of prices was seriously considered by the Macmillan Committee in the spring of 1931 under the designation of "A National Treaty." So long as British sterling was tied to the gold standard, this country was powerless to take any initiative in the direction of raising sterling prices, and the National Treaty appeared to offer the only alternative to mere drifting. But for the onrush of the financial and political crisis and the abandonment of the gold standard in September, 1931, it is probable that the idea of a National Treaty would have played a prominent part in the history of 1931 and 1932. It can hardly be doubted that, even to-day, if it is once conceded that readjustment to present price levels is unavoidable, the best course is to try and carry a National Treaty through forthwith. On this hypothesis the great fall in prices is an accomplished fact, and the dangers foreseen should be averted and the inequalities smoothed out as well as may be, by conscious and deliberate action, taken by mutual consent, to complete the necessary readjustment as quickly as possible. Delay increases the inequalities and the sufferings and weakens the constitution of the patient. The operation proposed is a delicate and severe one, and if long postponed might prove fatal.

There are, however, cogent objections. The

remedy is dangerously radical, and for some time at least would leave the social and economic structure of the nation in a very weak state. It has some of the demerits of gradual deflation and might at first drive down prices as well as costs. It would raise many new problems upon the solution of which its success would depend, some of them quite unforeseeable. It means a scaling down of all money wages, of the interest and principal of debts, of rents, of customary charges of all sorts, and it would be quite impossible in the time available to avoid creating many individual hard cases. Moreover, even if it be granted that it could be successfully carried through in this country, there remains to be solved the problem of debts due to people in this country from abroad and of parallel or simultaneous action in other countries—for example, in India. It would be futile to expect that the principal and interest of the internal debt of the British Government and of British municipalities and of the debentures of public companies could be scaled down, and that the Indian Government's sterling obligations could be left untouched. It would be felt to be quite intolerable that a holder of Indian Government stock should have his income in full as before, while a holder of British Government stock incurred a 20 per cent. or 25 per cent. cut. It would be even more impossible to maintain that the Indian debtor should be forced to go on bearing the burden of making payment in a money which had appreciated so greatly in terms of commodities that the British debtor had had to be relieved by legislation from doing likewise.

Moreover, the position in India is even worse than

in this country. The fall in prices of primary products in India and Burma has made the burden both of the external and of the internal indebtedness quite unbearable over any long period of time. In the absence of a rise in prices, an all-round scaling down of money contracts in India and Burma is absolutely unavoidable. Yet to anyone familiar with Indian conditions the thought of attempting to apply the principles of a national treaty to India is ludicrous. It simply could not be done. Indeed, it is hard to resist the conclusion that, whatever might be the case here or in some other Western countries, social and political collapse in India is the ineluctable alternative to higher prices.

Nor is India alone in this predicament. The course of events would vary in different countries, but many countries within and outside the British Empire would have difficulties to meet scarcely less formidable than India. Australia and New Zealand have tried to meet their difficulties by lowering the exchange value of their local currencies. Just as Great Britain has tempered the fall in sterling prices by abandoning the gold standard, so have they tried to avoid suffering part of the fall in sterling prices by reducing the value of Australian and New Zealand pounds in terms of British sterling. This action, however, brings no relief in the burden of their indebtedness in terms of British sterling to British lenders. It is the level of prices in the currency of the lenders that is all significant. In the absence of a rise in sterling prices, a comprehensive arrangement with their external creditors may well prove the only way of avoiding default.

It is not surprising in these circumstances that, following the Macmillan Committee and with the endorsement of the representatives of all the Governments of the British Empire represented at Ottawa, the National Government of Great Britain has publicly adopted the view that a rise in prices is essential to the restoration of economic equilibrium. Some progress has been registered in carrying out the policy of raising the sterling price level. The introduction of a protective tariff, in spite of some of the arguments used in support of it, the conversion scheme, the deliberate cheapening of the rates for short-term money since January by the Bank of England's discount rate policy and by its action in increasing by purchase on the open market its holding of Government securities, and the policy of the Government in allowing sterling exchange rates to fall to less than 75 per cent. of the former gold parity—all these have contributed their share in causing sterling prices to stand at a higher figure than would otherwise have been reached. Their combined effect has, however, been no more than to keep sterling prices from falling much below the level of September, 1931. The movements of the Board of Trade index number of wholesale prices have been as follows :—

September, 1931 . . .	99·2
November, 1931 . . .	106·4 highest point
July, 1932 . . .	97·7 lowest point
August, 1932 . . .	99·5

The corresponding movements of gold prices as indicated by the American index number of dollar

prices and the French index number of franc prices have been as follows :—

	U.S.A. (Bureau of Labour)	France
September, 1931 .	102·0	96·0
November, 1931 .	100·6	90·8
July, 1932 .	92·4	87·3
August, 1932 .	—	84·3

The divorce of British sterling from gold has thus saved sterling prices from undergoing the further heavy fall in gold prices since September, 1931, but has so far done nothing to bring about that considerable rise in prices back to somewhere near the levels of 1928 and 1929 which the Macmillan Committee already regarded as essential as early as May, 1931, when Britain was still on the gold standard and the Board of Trade index number stood at 105·7.

While the spokesmen of the National Government have subscribed to the doctrine that a rise of prices is necessary to salvation, and have been responsible for the steps enumerated above which have checked the further fall of sterling prices, the National Government and the financial authorities, through whom it works, have been extremely cautious in giving positive expression in action to their declared faith. All the measures mentioned are of a negative kind, and no one of them has been deliberately designed or publicly announced as a move towards raising prices. Statements of policy regarding the future of sterling and its relations to gold have been extraordinarily guarded, and even to-day the public is in the dark as to what the Government's intentions

are in the matter of a return to the gold standard. It is known that the Government does not desire at the moment that there should be a rise in the gold exchange value of sterling, that the Exchange Equalisation Account is to be used simply to smooth out temporary fluctuations in the rate of exchange, that the Government is not bound by the declaration of the Board of the Bank of International Settlements that the gold standard remains the only available international monetary standard, and finally that the Government looks forward to the eventual return of this country to the gold standard, but only if various conditions not fully specified have first been fulfilled.

Nowhere is there to be found any indication of a positive policy of action to raise sterling prices or even of any intention on the Government's part to frame such a policy. On the contrary the Government has stated its view that monetary action alone cannot restore economic equilibrium, that action to raise prices must be taken internationally and cannot safely be attempted by this country alone, or even by British initiative, and generally that positive action of any kind is undesirable pending the meeting of the projected World Monetary Conference.

There are many strong reasons why the Government should be cautious and even hesitant. Financial markets everywhere are always sensitive and at the present juncture exceptionally sensitive. They are quickly disturbed even by casual utterances of individuals not holding responsible positions. There is a great volume of money lent on short term which

surges this way and that from one financial centre to another at the slightest rumour. There are day-to-day financial situations in the City of London requiring the most delicate handling. There are big politico-financial questions such as the German and other standstill arrangements, Reparation, Inter-Allied Debts, Allied Debts to the Government of the U.S.A. All these have to be weighed in the scales when British monetary policy, and particularly when any public announcement of British monetary policy, is under consideration.

The case for caution can hardly be overstated, and it would carry complete conviction if it were not for two counter-arguments of great force. The first is that the situation is desperate. In the absence of a positive policy hand-to-mouth expedients have to be resorted to, and decisions taken hastily at the last moment to deal with particular situations as they arise. This is most apparent in the international field. For example, the decision to make a further loan internationally guaranteed to Austria is avowedly nothing but a temporary and very doubtful expedient, possibly inconsistent with this country's interests, to enable Austria to carry on in the vague hope, based on no clear vision of the future, that some change in the general world position may intervene before the proceeds of the loan are exhausted. Even if action taken in such emergencies prove to be right, the absence of a definite policy of action subjects the nerves of the nations to continued shocks, which may at any moment be intolerable, as one vital decision after another is postponed to the eleventh hour and arrived at only

when dire necessity galvanizes the Government into action. The second counter-argument is connected with the first. The absence of a positive policy is largely due to the belief that nothing practically useful can be achieved without international agreement. The hope of such agreement within the possible limits of available time is admittedly slender. Meanwhile, the many countries whose currencies are closely bound up with the fate of British sterling are left in ignorance of British policy, and without special assistance such as might conceivably be given in meeting their own acute difficulties. India's extreme need in the trough of the fall in prices has already been mentioned.

The attitude of the British financial authorities sometimes suggests an insufficient realisation of the responsibilities and duties which they owe not only to India, but also to other countries within and beyond the boundaries of the British Empire, in dealing with the question of British sterling prices and rates of exchange with other foreign countries. Moreover, as creditors of most of these countries, British citizens, and through them the British Government, are vitally interested in their financial welfare. It seems to many people who have taken thought on the subject that the Government underrates the strength of sterling's position in the world. Examination of the relative movements of sterling and gold prices since September, 1931, makes it evident that sterling prices have a profound influence on gold prices in spite of the divorce of sterling from gold. If, then, measures taken to raise sterling prices may be expected to cause a

further fall in gold prices in so far as the rise in sterling prices is masked by a fall in gold prices, it is equally true that a rise in sterling prices which is accompanied by a real increase in the volume of British business will quickly react on gold prices and bring about a corresponding rise of gold prices due to the increase of demand. This happy result would be still more assured if the increased volume of business was not confined to Britain, but was extended to India, Australia, Scandinavia, Argentina, and other countries whose currencies are specially dependent on British sterling. If this line of argument is correct, the British Government, so far from waiting for international action, has both the power and the duty to take the initiative boldly and decisively. It has further justification for so doing in that, so far from resisting any sympathetic rise in gold prices, countries on the gold standard would heartily welcome it. As already mentioned, the U.S. Federal Reserve Board has itself taken the initiative in trying to raise dollar prices.

There is every reason to believe that British monetary policy has been following correct lines, and that so far as it goes it deserves the commendation bestowed upon it at Ottawa. It is possible that cheap money by itself, especially if negative action here is reinforced by a bolder policy of currency and credit expansion in the U.S.A. now that it is free from preoccupations as to the drain of gold to France, may just suffice to turn the tide and induce a considerable rise of prices soon enough to bring about some sort of recovery. The chances are on the whole against this happening, but they are not

quite negligible. The question of the longer future remains. It will be seen that there is no act of commission by the British financial authorities in recent months to which any special exception is taken. It is their acts of omission which provoke questions and in special degree their refusal to take the initiative which the strong position of sterling in world finance seems to put within Britain's power. The case summarily stated here for a positive British monetary policy will be more fully developed in later chapters.

It has been convenient to devote some space at this stage to British currency problems of the moment both because they illustrate the evils to which our present unplanned money exposes the country and because the hesitation between an international and a national currency policy, which impedes positive action to raise prices now, points naturally forward to the conflict between an international monetary standard and a more restricted national or group system which has to be resolved if this country is to enjoy the advantages of Planned Money. The next chapter will accordingly be devoted to the International Monetary Standard.

CHAPTER V

THE INTERNATIONAL GOLD STANDARD

“ I am too high-born to be propertied,
To be a secondary at control,
Or useful serving man, and instrument
To any sovereign state throughout the world.”
SHAKESPEARE. *King John*, Act V., Scene 2.

THERE are devious ways and blind spots in human reasoning powers and habits which frequently lead to bizarre results. Supporters of the present Government have at times been hard put to it to explain to intelligent audiences how it comes about that in August, 1931, a National Government was essential in order to prevent this country from going off the gold standard and that in and since September, 1931, the National Government has conferred great advantages on the British nation by going off and remaining off the gold standard. Their Labour opponents have, however, profited nothing by this apparent inconsistency since they missed their opportunity at the critical moment, just before the Labour Government fell, of pointing out, as they might have done with considerable show of argument, that the gold standard was not worth saving, if indeed it could be saved, at the price involved.

The doctrine of the sanctity of money contracts is essential to the maintenance of confidence and

credit on which the economic machinery of the modern world rests. This doctrine cannot, however, win wholehearted intellectual and moral assent so long as money itself is subject to large and irrational fluctuations in purchasing power. If attention is concentrated on the money contract, and changes in the purchasing power of money are ignored, the only irrefutably logical standpoint in relation to the gold standard is that of Mr. Havenga in South Africa. His attitude is that South Africa and people in South Africa have entered into contractual obligations of various kinds to pay sums of money on demand or on their due dates, and the money contract is expressed in South African pounds defined by law as the equivalent of a specified weight in gold of a specified fineness. Any failure to honour these obligations in money of the specified gold value is, he maintains, a breach of contract. This attitude takes no account of the major assumption underlying all these money contracts, the assumption that gold is a stable measure of value. The social inequity to the debtor class and to the producer generally, and in particular to the primary producer who is the special sufferer, is ignored. The letter of his contract calls for payment in gold of a specified weight and fineness, and the fact that the commodity value of his debt has trebled or quadrupled in terms of gold is, from this standpoint, irrelevant. It is open to question whether it was quite consistent with this Simon Pure doctrine to impose restrictions on the freedom of exchange, but this may pass as an unavoidable expedient for meeting a compelling temporary necessity.

In this country and in many others the authorities have been content to take a less ferocious view of the meaning of the doctrine of the sanctity of money contracts. They have regarded it as a sufficient discharge of a sterling obligation that payment should be tendered in sterling. The fact that the commodity value—the purchasing power—of sterling has fluctuated widely over a comparatively short period does not, according to this view, make any difference whatever in the obligation to honour the letter of a money contract in full. It is held, however, that there has been no breach of contract in permitting, or submitting to, a change in the gold value of sterling, even though the change required an Act of Parliament to make it valid. It is difficult to accept this attitude as entirely logical, and this is further admitted in the fairly widely held belief that there was nothing dishonourable in being driven off the gold standard after making all reasonable efforts to maintain it as this country did, whereas deliberately to abandon that standard simply because it seemed an advantageous step to take would have been indefensible.

For purposes of the present argument, it does not matter whether the necessity for abandoning the gold standard in September, 1931, was the result of past sins of commission or of omission by the authorities financial or political of Great Britain. In the circumstances with which they were confronted the Government and the Bank of England would clearly not have been justified in demanding further sacrifices of the people of this country in order to maintain sterling on a parity with gold. The

technical legality of their action is of course not in question, since it was legalised by Act of Parliament. The Bank of France, however, and other central banks which had considerable deposits at the Bank of England, could hardly be expected to regard what had happened as being entirely in accord with the doctrine of the sanctity of money contracts. In terms of francs, the London deposits of the Bank of France had been seriously diminished in value by an Act of the Parliament of the country of the debtor without consultation with the creditor. The central banks of some countries other than France felt even more seriously aggrieved seeing that the Bank of England had taken a leading part in bringing about the general restoration of the gold standard a few years before and in encouraging the deposit at the Bank of England of part of their central reserves held against their national note issues. From their point of view the breach of the sanctity of money contract involved in this country's abandonment of the gold standard established by law seemed evident.

From the standpoint of the nationals of Great Britain the abandonment of the gold standard appears to maintain and defend, not to derogate from, the sanctity of money contract. As already pointed out, the alternative, if time had allowed, was to attempt the very difficult and doubtful operation of scaling down all money contracts by some kind of national treaty. The result of departure from the gold standard was for the time at least to cause some rise in the level of sterling prices, thereby bringing a certain amount of relief to the sufferers from the previous fall. Social equity,

therefore, and industrial productivity have been served at the same time without departure from the letter of the law regarding money contracts. And if sterling prices have since fallen back to a level below that of September, 1931, the industrialist and the debtor class generally have at least been protected by the abandonment of the gold standard from the much more severe fall in gold prices.

The fact is that the logical implications of the theory of the international gold standard postulate that gold shall be a stable measure of value, and since it is not, common sense and economic fact necessitate some concession to human nature in applying the theory to particular local currencies. If a local currency is to be successfully maintained at a fixed parity with gold, the responsible authorities must be prepared to see the purchasing power of their currencies undergo whatever variations may occur in the purchasing power of gold. These variations are almost entirely outside the control of any authority in any particular country, unless, as was generally true of London before the War, the financial centre of that country is so predominant in the financial markets of the world that the purchasing power of the local currency and the purchasing power of gold are practically synonymous, or, in other words, the local currency is also for practical purposes the international currency of the world. This was exactly the position of British sterling from the time of the Franco-Prussian war in 1870/1 to 1914.

Even during this period many of the factors influencing the purchasing power of gold were

outside the control of London, owing to the decisive part played by the annual production of new gold from the mines. It was not due to any action, conscious or unconscious, taken by London that the world was subjected to the long drawn out fall in prices and appreciation of gold for upwards of twenty years from 1873 onwards, culminating towards the end of the 1890's in conditions which from the strictly monetary standpoint afford the best parallel to those of to-day. That fall was brought about mainly through the physical shortage of monetary gold. Similarly, the rise in prices from 1896 to 1914 is explained almost entirely by the progressively increasing output of gold from the Rand.

At the time when Great Britain was forced off the gold standard in September, 1931, influences were at work even more arbitrary and irrational in their effects on particular local currencies than the relative plenty or scarcity of newly mined gold. Instead of there being one single financial centre of the world, London, acting as the world's banker and keeping the current balances of the rest of the world, there were at least two—London and New York. In addition, Paris had come to be in possession of very large floating balances held outside France which were liable to be moved about from one foreign money centre to another in a manner that was quite incalculable, the movements being not only influenced in part by non-financial considerations connected with the French politics, but also largely beyond the control of the French financial authorities. Both the demand for and the supply of

facilities for temporary employment of short-term funds at attractive rates of interest had been greatly extended in the period since the War. In the result, London and New York, in their capacity as the world's bankers, were liable to be called upon almost overnight to part with enormous sums held on demand or at short notice simply because for some reason or other their clients had decided to change their banker, and to transfer tens or even hundreds of millions of pounds from London to New York or *vice versa*. With reasonable stability of prices they could count on being able to recall sums lent out abroad in time to meet such demands. With her debtors unable to pay promptly, as the result of the fall in prices brought about by the failure of the gold standard to function smoothly, London in September, 1931, had to suspend specie payments, the knowledge that her debtors could not pay being the direct cause of the sudden demand.

This power to choose between two international centres and to change bankers is a new development since the War, and when it is combined with instability of prices is absolutely fatal to the successful working of any international gold standard. Its effects on particular local currencies might possibly be minimised by the establishment, for example in the Bank for International Settlements at Basle, of some machinery in the nature of a world reserve centre, similar in character to the machinery of the American Federal Reserve system by which the corresponding difficulty of movements of funds within the U.S.A. was overcome. Alternatively a really comprehensive agreement between London

and New York might meet the difficulty. In either case successful working would, however, be dependent on gold prices being kept free from violent fluctuations.

It has been worth while to enter at some length into the circumstances of Great Britain's departure from the gold standard in order to pave the way for a more general examination of the questions of currency and exchange in relation to the subject of the monetary system of the future. Some generalisations will serve to simplify such an examination. Money is not wealth, though it may be treasure, especially if it is in the form of precious metal. Money is a means of facilitating exchanges of goods and services. A local or national currency exists for the purpose of facilitating exchanges of goods and services within the nation. An international currency standard exists to facilitate international exchanges. Currency in all its forms is simply a title giving the holder a power to purchase goods and services, with the proviso that if the currency be of gold or silver the holder is in possession not only of purchasing power but also of a given quantity of a particular metal which he may conceivably value for its own sake as a commodity.

Before the invention of money, trade was carried on by barter, and money was introduced solely because it facilitated trade. Historically gold and silver have always been the basic form of money. The fact that gold and silver are also commodities valuable in themselves has throughout history introduced a troublesome complication into their utility as money. For being commodities the demand for

and supply of which varies, and varies also for reasons separate from their use as money, they have never been able to provide an invariable measure of value, in the way that, for example, a yard or a gallon or a pound avoirdupois are invariable measures in their own spheres, outside the region of Einstein's relativity. Indeed, the complications introduced into a world of monetary economy by the use of gold and silver as measures of value may be said to be analogous to the complications to which human life would be subjected, if it tried to use standard measures such as the yard and the gallon in a world so ordered that the laws of relativity had to be taken into account for ordinary everyday purposes. It thus comes about that the world of barter was free from one very serious defect, the variability of its standard of value, which has troubled humanity ever since it began to use money.

In a world of barter there could be no such phenomenon as a fluctuation up or down of the general level of prices. Relative prices were then as now subject to variation among themselves. A cow was worth a larger or smaller quantity of wheat, a plough exchanged for a larger or smaller quantity of boots, according as the seasons varied or more generally according as the amount of human effort expended in producing and marketing different articles was greater or less. It is only because of the complications introduced by money that the modern world finds itself continually puzzled and too often tortured by fluctuations in the relations between a given quantity of its measure of value, money, and

the amount of human satisfaction represented by a given aggregate of all the kinds of goods and services which it is accustomed to bring to market. For this is what fluctuations in the general level of prices mean. The Board of Trade Index Number of Wholesale Prices or any similar Index Number is an approximate measure of the relation between a given quantity of sterling and a mixed consignment of the main commodities which enter into British commerce, the quantities and qualities of each commodity included in the calculation being chosen with reference to their relative importance in the nation's economic life. The fact that this Index Number has varied from 100 in 1913 up to 307·3 in 1920, down again to 158·8 in 1922, and then gradually down to 136·5 in 1929 and finally with a precipitate fall to 99·2 in September, 1931, means simply this, that the measure of value has been hopelessly unstable. There have been changes in the relative values of the different articles entering into the index number and minor changes in the amount of human effort represented by the aggregate, but broadly speaking the human effort involved and the human satisfaction which it measures have remained practically the same throughout, and it is the purchasing power of the money measure which has varied widely.

Whenever they occur, such variations in the purchasing power of money bring with them a train of undesirable consequences. They involve, as already pointed out, an arbitrary redistribution of income as between individuals and classes, and, if the variations are rapid and sudden, social and

political equilibrium is dangerously impaired. A slow upward movement of prices is on the whole the least disturbing form of price variation, but even this nearly always ends in an unjustifiable boom and is followed by a period of depression of trade and consequent loss to every class in the community. The evils of a violent fall in prices such as is being lived through at present have already been depicted.

If adherence to an international gold standard mitigated the evils of price changes, there would be no need to question its advantages. Recent experience shows, however, that in certain circumstances the fact that the standard is international tends to aggravate suffering. Not only does it mean that prices when they fall fall all over the world, so that the suffering is world-wide, but it also makes it very difficult if not impossible for any one nation or even a group of nations to take any effective remedial action. World-wide international co-operation becomes all but essential just at the moment when the particular local manifestations of the universal trouble occupy the whole attention of the Government in each country and make international action specially difficult.

It is only natural in these circumstances that the question should be actively canvassed whether an international monetary standard is worth the sacrifices involved. The ideal monetary standard ought to combine stability of the price level with stability of exchange between one country and another, thus securing the maximum possible volume of unimpeded interchanges of goods and services both internally between the citizens of each

country and externally between one country and another. Of late years stability of the price level has been sacrificed to stability of the external exchanges. This is true of the period from 1870 to 1914 as well as of the post-war period. It has come to be regarded as normal and unavoidable that the internal price level should fluctuate widely, and it has been accepted as axiomatic that there should be fixity of exchange rates in ordinary circumstances, and the absence of such fixity has been looked upon as evidence of temporary and undesirable disturbance. The par of exchange is a phrase with which the business world has long been familiar. No one ever talks or thinks about the par of prices or parity of the price level.

Is there any good reason why these conditions should be regarded as natural and normal? When it is remembered that kings and governments have throughout the ages insisted with jealous care on their prerogative of issuing money and controlling currency within their jurisdiction, it is somewhat strange to find modern States accepting as axiomatic a limitation of their sovereignty in the sphere of money so far-reaching in its effects on their own powers and on the daily lives of their citizens as is involved in their agreeing to conform in all circumstances to a standard of value over which they have no control. They have perhaps been to some extent reconciled to this surrender of sovereignty by the belief that no one was in control of the standard and that it operated with the impartiality of a law of nature. To some extent, too, their citizens have felt that like David they would rather fall into the hands

of God than into the hands of men, and did not want their standard of value to be at the mercy of an arbitrary ruler or of a fallible Cabinet or Legislature. To an even larger extent the acquiescence of both rulers and subjects has arisen from profound and almost universal ignorance of the real meaning and working of a monetary standard. They have clung pertinaciously to the belief that gold was really stable and have treated it as stable in all their monetary dealings, and have accepted avidly all kinds of explanations of their economic sufferings rather than the true one that their money was not a stable measure of value.

There are undeniable advantages in gold as an international medium of exchange, though not necessarily as an international measure of value. The claims of the bimetallists regarding silver are examined below. What is astonishing is the extraordinary hold which what is called the gold mentality has obtained, especially among the high authorities of the world's Central Banks. The gold standard has become a religion for some of the Boards of Central Banks in Continental Europe, believed in with an emotional fervour which makes them incapable of an unprejudiced and objective examination of possible alternatives. An explanation of this attitude must be sought for in the reasonable fear of Central Bankers that they may be charged with the duty of keeping prices stable without being given or without its being possible that they should be given adequate powers to carry out this duty. If so, it would surely be wiser on their part to admit the shortcomings of the gold standard as hitherto operated, while arguing

that the successful management of prices calls for delegation to Central Banks of powers so extensive as to be politically undesirable or unthinkable. There is great force in the view that the monetary system by itself is not a strong enough instrument for controlling price movements. To deny the obvious truth that monetary policy is a major factor in determining the level of prices is to insult the intelligence of an exasperated public by what is bound to look like obscurantist fanaticism in support of the gold standard.

The world has grown so accustomed to the idea of an international money standard that it is difficult to realise that in the nineteenth and twentieth century eras of self-conscious nationalism such an international standard is an unexpected phenomenon and in many ways an unnatural arrangement, an accidental survival from an earlier epoch of history. Internal commerce and the well-being of those dependent on it are far more important in the economic life of a nation than external trade, even where the proportionate figures of external trade are unusually large as in this country or Belgium. What might be called the natural currency arrangement for an independent sovereign State would be a local currency, owing its internal purchasing value to management by or on behalf of the State, and so managed and controlled as to retain approximately the same purchasing power from year to year and from decade to decade, external trade being provided for by appropriate machinery which did not disturb internal stability. The idea is as old as Plato, who in the *Laws* (Book V., p. 742) writes as

follows : " The citizens will require a currency for the purpose of everyday exchange : this is practically indispensable for workers of all kinds, and for such purposes as payment of wages. To meet these requirements, the citizens will possess a currency which will pass for value among themselves but will not be accepted outside their own boundaries. But a stock of some currency common to the Hellenic world generally will at all times be kept by the State. . . . If a private citizen has occasion to go abroad, he will make application to the Government and go, and on his return, if he has any foreign currency left over, he will hand it over to the State, receiving in exchange the equivalent in local currency." A nation which was the happy possessor of such a currency system would be immune from the disorders which arise from a fluctuating level of general prices. It would have no troubles such as changes in the real value of a particular money wage, and undesigned redistribution of the national income as between individual and individual and class and class owing to changes in the commodity value of long-term debts or of other money payments fixed for a period of years, such as rents. Industrial plans could be laid down years ahead and followed through without the disturbances caused by a violent fall in prices. The agricultural producer above all would gain from the confidence that monetary changes outside his control could not intervene to cause him incalculable losses arising from an all-round modification to his disadvantage of the relation between the prices of primary and secondary products. Seasonal varia-

tions due to good and bad harvests and changes owing to other non-monetary causes would still remain, and so would variations in the relative prices of different manufactured goods, but violent rises and falls of the general price level would be eliminated.

All nations have attempted in various ways to secure some of these objectives by non-monetary measures. For example, both France and Germany are at the present time keeping up the internal price of wheat in the interests of their farmers by tariffs and prohibitions aimed at protecting the price of wheat against the fall in the general price level. Indeed, it is not far short of the truth to say that the whole modern system of protective tariffs throughout the world owes its origin to the attempt to combine national economic policies with the existence of an international monetary standard which was not a stable measure of value. It is one of the ironies of history that the world-wide movement which from 1872 to 1914 gradually brought every important country except China on to the international gold standard was the direct cause of the world-wide swing towards high protective tariffs during the same period.

A world in which each nation has a local currency and a local measure of value, not directly related to any international measure of value and fluctuating in terms of every other local currency simply in accordance with supply and demand, strikes the average individual to-day as a rather unpleasant and uncomfortable place in which to live and work and trade. He had some experience of such a world

in the years immediately following the War and did not like it. In the light of that experience people everywhere demanded a return to the gold standard with the least possible delay. In this country there were those who were strongly critical of the action of the Government in putting sterling back on the gold standard at the old gold par, but opinion was practically unanimous in favour of restoring the gold standard at some fixed parity. It is only since the renewed divorce in September, 1931, between gold and sterling and in the light of the experience of the international conditions which brought about that divorce that the validity of the arguments in favour of an international standard has begun to be seriously questioned in Great Britain. Objective understanding of currency questions is, however, still rare, and outside Great Britain and some parts of the British Empire, with the important exception of Scandinavia, the old gold mentality holds almost universal sway.

The world's currency experience of the early 1920's is far from affording convincing proof of the superiority of an international standard, and is in many ways a misleading guide. During that period the nations and their Governments were at the mercy of political and economic storms in which it was impossible for them to recover any sort of effective control over their currencies, with which the War had already played havoc. This is a totally different picture from the one presented for consideration above, where each nation is imagined as possessing effective control over its own currency and so regulating its issue as to maintain its pur-

chasing power stable over a long period. Granted that it is possible so to maintain stability of the purchasing power of a local currency, the major disabilities of the post-war period do not arise. For it was the violent fluctuations in internal purchasing power much more than the absence of stability in the foreign exchanges which were felt to be unbearable. Moreover, if the internal purchasing power of a number of local currencies were in fact being kept stable, it would follow almost automatically that their external exchange value in terms of each other would normally be subject to minor long-time variations only, and would in practice remain approximately stable for purposes of all short- or medium-term transactions.

In the present state of the world any wide international agreement on the subject of an international monetary standard can obviously be arrived at only with extreme difficulty. It is obvious also that, short of an incredible revolution in the mentality of the Central Bank authorities, no agreement is possible which involves the acceptance of the principle that the international standard of value should be so managed as to get rid of all but minor fluctuations in purchasing power. The World Economic Conference at Genoa in 1922 did indeed lay down the doctrine that, after return to the gold standard, which it advocated as the first step in financial rehabilitation, gold should be so managed (by co-operation between central banks and otherwise) as to prevent undue fluctuations in prices. The Central Banks have never, since that date, shown any willingness to admit or work for the realisation

of this objective. Their failure to act up to the Genoa resolution is the origin of the subsequent misfortunes of the gold standard. Yet their reluctance has been natural enough. Successful management of an international gold standard with a view to keeping gold prices stable throughout the world is possibly outside practical politics in a world consisting of a number of independent sovereign States, each of which in greater or less degree is committed to a policy of economic nationalism. If so, it follows that the objective of giving stability to internal price levels is incompatible in existing world conditions with the restoration at an early date of an international gold standard. The Central Banks of the world are not without reasonable excuse in declining the collective duty of stabilising world gold prices. The prospects of their agreement to do so now are slight. If, therefore, the objective of stable internal prices is to be attained at all, the time has come to inquire whether it cannot be reached along the lines of a series of local currency systems, not directly linked to an international gold standard.

The next question to be studied is accordingly the feasibility of stabilising internal price levels on the basis of independent local currencies. Before this question is further examined it is, however, desirable to clear out of the way the claims of the bimetalists, who put forward the view that the world's currency troubles would be solved if instead of gold the international standard were made up of a combination of gold and silver.

CHAPTER VI

BIMETALLISM

“Thou sheer, immaculate, and silver fountain,
From whence this stream through muddy passages
Hath held his current, and defil'd himself!”

SHAKESPEARE. *Richard II.*, Act V., Scene 3.

“With one fool's head I came to woo :
But I go away with two.”

SHAKESPEARE. *Merchant of Venice*,
Act II., Scene 9.

ENGLAND'S adoption of a monometallic gold standard was accidental, not designed. A much needed rehabilitation of the coinage was carried out under the reign of William III., Isaac Newton being then in charge of the Royal Mint. In the sequel it appeared that silver had been under-valued and gold over-valued. The fixing of the guinea at 21s. in 1717 was the decisive step. From then on throughout the eighteenth century it was profitable for people in this country to make payments abroad in silver rather than in gold, and for foreigners to make payments to this country in gold rather than in silver. The *de facto* gold standard thus set up was finally established *de jure* on the return to specie payments after the Napoleonic Wars. Gold became the only metal which could be taken to the Mint for coinage in unlimited quantities. Only gold coins were un-

limited legal tender for purpose of payments in the United Kingdom. The silver coins became mere tokens passing for small change purposes at a value above their intrinsic value and legal tender for a limited amount only.

British trade and commerce prospered amazingly during the nineteenth century, and this prosperity was widely believed both at home and abroad to be largely attributable to the supposed merits of the gold standard. It was indeed true that Britain gained real advantages from the fact that, owing to the predominant part which she played in international trade and finance, British sterling had become the main international money of the world. This pre-eminence would, however, in all probability have been equally marked if the British standard of value had been bimetallic. However, the reputation of the gold standard was made and as opportunity arose other nations passed over from the bimetallic to the monometallic system. The most important event in this connection was the decision of Germany in 1871 to adopt the gold standard, taking advantage of the receipt of a considerable sum in gold from the payment by France of the indemnity of £200,000,000 imposed on her after the Franco-Prussian War. With Great Britain and Germany on the gold standard, France, the U.S.A., India, and gradually almost all the nations of the world except China closed their mints to the free coinage of silver. They felt that they had little choice since so long as they accepted payments from abroad in silver they were liable to find the whole of their holdings of gold drawn away from them.

The ratio between silver and gold had varied considerably through the ages, even though both metals were regularly accepted as money and as measures of value. Their joint recognition as treasure tended, however, to keep the ratio fairly constant for long periods together. Actually, from 1820 to 1872 the maximum limits of variation were between 58 pence and $62\frac{3}{4}$ pence per oz. The gradual adoption of a monometallic gold standard had immediate and unfavourable reactions on silver. Its gold (sterling) price fell from $60\frac{5}{16}$ pence per oz. in 1872 to $52\frac{1}{4}$ pence per oz. in 1880. Between 1880 and 1914 silver reached a minimum price of $21\frac{1}{8}$ pence per oz. in 1902, and the maximum thereafter was $33\frac{1}{8}$ pence per oz. in 1906.

It is not proposed here to examine at length the case for and against what is called the rehabilitation of silver.* The main case put forward by the bimetallists is twofold. It is urged first that the great fall in the gold value of silver has led to the impoverishment of the silver-using countries of the East, particularly India, where the immemorial habit of the peasants has been to keep their small savings in silver, and, above all, China, which alone of the great countries of the world has remained on the silver standard. In the second place, it is claimed that the restoration of silver to its old position as a partner with gold, having a fixed ratio to gold and supplementing gold in the world's standard of value and metallic medium of circulation, would not only

* A convenient short summary will be found in Professor T. E. Gregory's pamphlet, *The Silver Situation—Problems and Possibilities*.—Manchester University Press, 1932.

enable the whole world, including China, to come on to a single international monetary standard, but would so increase the metallic basis of currency as to give the world a monetary standard far less liable than gold by itself to severe and violent fluctuations in purchasing power.

The demand for special measures, whether by international agreement or otherwise, to bring about a rise in the price of silver, without restoring to silver its position of full partnership with gold as an international medium of exchange and an international standard of value, has nothing to do with bimetallism. In essence, the proposal is not distinguishable from any other proposal for raising or stabilising the world price of a particular commodity. Attempts have been made at various times to valorise tin, copper, sugar, rubber, coffee, etc., with varying results, on the whole unsatisfactory. Except in so far as it is used as a measure of value, which is not, be it noted, its function when used for subsidiary coinage as in the British shilling or even the Indian rupee, silver is simply a commodity subject to the same law of supply and demand as other commodities. There may be sufficient reasons at given moments for singling out particular commodities for valorisation. There may be reasons for singling out silver at this moment. The question of the desirability of valorising silver now is merely a particular aspect of the effects of the great fall in prices generally, including the price of silver, by which silver has been very badly hit. It has nothing to do with bimetallism.

It may be conceded at once that the experiences

of the 1880's and 1890's when the bimetallic controversy first came to a head, supplemented by the further unhappy experiences of to-day, go far to substantiate the view that the world made a mistake in substituting a monometallic gold standard for the previous bimetallic standard. It cannot be seriously contested that the long-drawn-out fall of prices and the general trade depression of the last decades of the nineteenth century were aggravated by the exclusion of silver from playing its full part in providing the metallic basis for the world's money at a time when the annual output of newly mined gold was inadequate and progressively declining. It is also probable that, in the period since the war, if silver had been available to supplement gold in the metallic reserves of the Central Banks of the world, there would have been some considerable lessening of the strain on those reserves and of the consequent deflation arising out of the maldistribution of gold and its excessive accumulation in France and the U.S.A.

On the other hand, the political and economic causes which led to such maldistribution and accumulation would have been in no way affected by the addition of silver to gold in the world's metallic reserves. The only obvious difference would have been that, instead of gold only being hoarded, both silver and gold would have been gradually drawn away from the reserves of the debtor countries into those of France and America, possibly at an even more rapid rate in proportion to the larger physical volume of available metal. The way in which this might have happened is most

easily visualised if it is assumed that the bimetallic standard was in world-wide operation in its most ingenious and in some ways most attractive form, that of symmetallism. Symmetallism is the name given to a proposed system under which, instead of gold and silver being equally acceptable at some fixed ratio for international payments or for purposes of currency reserve holdings, the two metals would be melted down together into bars containing, if the ratio adopted were 20 to 1, twenty parts of silver and one of gold, and would be utilised for international currency purposes only in this form. The international standard of value would thus consist of symmetrical bars, and these bars would pass to and fro for settlement of international balances just as gold bars do to-day.

A world which misused its gold reserves in the way they have been misused since the War would have found no difficulty in misusing in equal degree reserves consisting both of silver and of gold or of symmetrical bars. It may further be observed that China has at least escaped some of the discomforts of heavily falling prices owing to the fact that she has been on a silver standard and the fall in the gold value of silver has prevented internal prices in China, expressed in terms of silver, from reflecting a great part of the fall in world gold prices. Had China been on an international bimetallic standard, the world-wide depression would have been extended without mitigation throughout China.

To admit, however, that the world would have been wiser to retain the bimetallic standard in 1870, does not involve the conclusion that it would be

wise—still less that it is possible—to restore it throughout the world to-day. As to the wisdom of an attempt to revert to bimetallism, it must be borne in mind that the most that its advocates claim for it is that it would tend to keep prices more stable than is possible under the monometallic gold standard. True stability of the price level is in no way secured by bimetallism, which makes no attempt to deal with any of the factors causing instability other than variations in the supply of and demand for gold. The prior question to be asked is whether a metallic standard in any way comparable to that to which the world has hitherto been accustomed is necessary at all. The conclusion would seem to be that, if a metallic standard is indispensable, a bimetallic or symmetallic system has clear advantages over a monometallic system, but that these advantages are not enough to justify twentieth century humanity in reconciling itself to merely tinkering with its old inadequate monetary machine.

If there are but small gains to be hoped for from the successful re-establishment of bimetallism, the obstacles in the way of success are formidable. It is out of the question for any single nation or even for a group of nations so economically powerful as the British Empire to think of admitting silver to a partnership with gold in their currency systems unless it is done by international agreement. It might be possible to achieve success by an agreement between the British Empire as a whole and the U.S.A., but a wider preliminary understanding would be most desirable. One very serious difficulty which has to be overcome is the fact that the silver

producers of the world, and particular large holders of silver, stand to make immense profits, which if not made at the expense of others would at least be balanced by no corresponding benefits to the majority of their fellows. The gold-producing interests, on the other hand, whether rightly or wrongly, would be certain to take alarm and to believe that they were being sacrificed. In these circumstances it is difficult to believe that the difficulties of an international monetary agreement already alluded to would be to any material extent modified by an attempt to approach the matter from the standpoint of silver. It is much more likely that silver would prove to be a red herring drawn across the trail, and that schemes for re-establishing bimetallism would make international discussions on money even more confused and more empty of results than they are.

CHAPTER VII

A CONSTANT PRICE LEVEL

“ Poor fellow ! never joyed since the price of oats rose ; it was the death of him.”—SHAKESPEARE. *King Henry IV.*, Part I., Act II., Scene I.

WHAT exactly is meant by a Constant Price Level ? Stability of prices is one of those concepts which seem at first sight to be simple and easy to grasp, but prove on examination to be elusive. From the standpoint of the average consumer, it would naturally be taken to imply that the prices of all the things he is in the habit of buying should be everywhere and always the same—as unvarying, for example, as was the penny postage for inland letters until it became a penny halfpenny. Clearly this interpretation will not hold. There must be some allowance for differences in costs of transport according to distance from the source of supply and from the markets ; and even if eggs might conceivably be sold at the same price all the year round, fresh strawberries must be cheaper in the middle of the strawberry season than just at its beginning. Fixity of particular retail prices is quite impossible, even in an absolutely static society. Nor can a Constant Price Level mean fixity of particular wholesale prices. It has already been pointed out

that, even under a system of barter where money was unknown, relative prices, whether retail or wholesale, must vary from time to time and from place to place according as the seasons varied and as supply was affected by changes in production costs and as demand grew or diminished. A Constant Price Level must leave room for large changes in the prices of particular goods and services.

The ideal which is being sought after is a local currency that will provide a measure of value which can be spoken of as a yardstick without the metaphor being hopelessly overstrained, a currency of which the purchasing power will remain stable from year to year and from decade to decade, so that the money value in a money contract entered into for a long period, such as a life insurance policy or a mortgage or a subscription to a Government loan, may represent the same purchasing power over commodities throughout the period of the contract. This ideal would be most nearly realised if stability could be attained in some index number which adequately measured the sum of all the most important activities of the economic life of the nation. Though the professional economists have given increasing attention of late years to the subject of stabilisation of prices, there is a remarkable absence of any specialised study of the question of the framing of a suitable index number. A monograph on this question from a qualified authority would be timely and welcome. The required index number would have to be comprehensive enough and sensitive enough to ensure that all important economic happenings were at once reflected in movements of

the individual prices of which it was a summation. It would have to be very carefully weighted in order to give the right relative importance to such happenings. It must not be a mere statistical record giving accurate information of what has occurred long after the event, but must supply reliable evidence of economic trends and probable happenings sufficiently in advance to permit of timely action.

For this reason as well as for others which will appear, an index number of wholesale prices rather than of retail is likely to be of most assistance in maintaining a Constant Price Level, though subsidiary help can be drawn from additional indices of employment, stocks of commodities, stock exchange values, wages, etc. Movements in the wholesale prices of commodities such as cotton, coal, wheat, wool, steel, leather, and so on, are prior in time and more far-reaching in their reactions upon national economic life than movements in the retail prices paid by the ultimate consumer for articles into the manufacture of which these primary products enter. Such wholesale prices are less affected by local events and can be collected from a few significant markets. To be completely adequate the index number should certainly include much more than the prices of primary products. Further close study of the composition of a suitable index number is therefore much to be desired. It is probable, however, that this is one of those cases where only practical experience and the method of trial and error will ultimately lead to the desired goal, and that the best way to proceed is to begin with some index number which is recognised

to be imperfect, in the sure hope that practice will quickly make perfect. Meanwhile it might justly be assumed for present purposes that an Index Number framed on the lines of the existing Board of Trade Index Number of wholesale prices would afford a reasonably satisfactory starting point for purposes of maintaining a Constant Price Level.

If the policy of stabilising internal prices is to be adopted in any country, the moment chosen for compiling the index number which will fix the par of internal prices must obviously be one at which economic conditions are in a state of reasonable equilibrium. Economic equilibrium implies that in general the relations between the prices of the products of different industries, agricultural and manufacturing and extractive, are not abnormal, and that in each industry the selling prices are such as to cover costs of production and overhead charges, with fair standards of remuneration to the persons employed and a reasonable margin of profit, but no more, to the ordinary shareholder or, to take a more comprehensive designation, the equity holder. This does not mean that the margin of profit should be identical in every industry or throughout each industry. Stability of the index number, so far from requiring this, would be made more difficult of achievement. The margin of profit must be elastic enough to allow for considerable variations of conditions from industry to industry and from time to time. What has to be guarded against is anything corresponding to those among the Wartime Excess Profits which, apart from any statutory definition, were excessive, and were generally recognised as

excessive, just because they were the inevitable outcome of a monetary policy which was leading to an excessive upward movement in the price level. Specially big profits in a particular industry almost inevitably attract special competition, and as new plants spring up an excess of productive capacity is created which makes quickly for disequilibrium. It is undesirable that the par of the price level represented by the index number when first framed should be subject to this kind of disturbing influence.

The fact that the index number remains at par in spite of changes in the relative prices of the commodities included in it must imply that movements upwards or downwards in particular commodities are compensated by corresponding movements in the opposite direction in the prices of the remaining commodities. A rise in one or more commodities is spread over all the rest in the form of a slight fall. A fall in one or more commodities is balanced by a slight rise in all the others. This is exactly what would happen in a barter economy, and it is only the introduction of a money which is not a stable measure of value that prevents it happening in the world of to-day. Yet the bald statement that this is what the advocates of stability of prices desire invariably meets with startled protests and indignant exclamations. "Where does the poor consumer come in? Why should I pay more for a dining-room table because someone has invented a means of producing steel cheaply? If that is what a Constant Price Level means, I don't think I like it."

Economic life to-day is affected even more than during the last century by the instability which

flows from the commercial application of new scientific discoveries and inventions. The goal of Planning in relation to production has already been defined as maximum output with minimum costs. Planned Money cannot contemplate the discouragement of new invention and of improved methods of production, since the cheapening of production is one of the major objectives. Nor can it contemplate putting obstacles in the way of any reduction of particular prices which is justified by reduced costs of production. And if, when the application of some improved method leads to a big reduction in the costs of producing, for example, steel, the steel producer is expected to pass on the benefit to the community by reducing his prices, it cannot be in accordance with the intentions of Planned Money that the extra profit should simply go into the pockets of other producers, as would seem to be the natural consequence of forcing or allowing them to put up their prices. *Ex hypothesi* their costs of production have not increased. On the contrary, in so far as they are interested in the price of steel, they are able to produce more cheaply than before. It would be a strange outcome of a new invention in the steel industry that, while the steel maker reduces his price and gets only the same margin of profit as before, every other producer gets a rather larger profit. It is in view of considerations of this nature that financial writers in the daily press often say glibly that a general fall in prices is objectionable if it is due to monetary causes, but is right and proper and eminently desirable if it is the outcome of improved methods of production.

Planned Money with its objective of a Constant Price Level must make full provision for every possible improvement in method and technique of production with consequent reduction of costs. The ever-increasing tempo of change induced by applied science shows no signs of slackening. Planning suggests large-scale organisation, and this always involves some risks of stagnation and want of progressiveness. Planning must be on continual guard against these dangers. It may indeed be that, even at the risk of offering an additional target for criticism of this nature, Planning will endeavour to exercise some control over the time and manner of the introduction of new and disturbing discoveries of applied science into commerce and industry, as well as to prepare the way in advance for meeting the resultant shocks to economic equilibrium. In the absence of such preparation, the introduction of a new process or new invention on a commercial scale under the present unplanned system too often results in the sudden destruction of a great part of the fixed capital of an industry or even of an industry as a whole. Valuable plant and machinery and inherited skill are thrown out of employment and can find no market. Firms such as Rolls-Royce Ltd. pay careful attention as a matter of regular business practice to the time and manner in which new inventions and improvements are adopted in their works. Planning will have to break fresh ground in working out methods for dealing with obsolete and obsolescent plant and disinherited labour, not piecemeal or in individual factories, but by each organised industry as a whole on behalf of its

members. By this means it is to be hoped that some of the effects of new inventions in industry which are most disturbing to prices may be minimised. This, however, is a separate and wider issue.

The question remains how can a Constant Price Level be maintained when a particular price, for example, the price of steel, included in the index number, is heavily reduced owing to a fall in production costs? Under the present dispensation the benefit goes to the consumer of steel, though often only after a considerable interval and considerable economic friction, the steel producer striving to retain for as long as he can the increased margin of profit. Planned Money contemplates no change in this respect, except that, with the steel industry organised as a whole, one of the conditions of its privileges would be that, subject to proper provision for obsolescence of plant and labour due to the new invention, it should at once pass the benefit on to the consumer of steel with as little economic friction as possible. The consumer of steel has now to spend less on steel than before and is accordingly in possession of a surplus of purchasing power, which at the next stage becomes widely diffused among consumers generally, since steel enters into a large variety of manufactures, all of which would show some reduction in price owing to steel having become cheaper. They in turn expend this surplus on goods and services of all kinds, thus creating an increased all-round demand. This all-round demand causes the prices of all commodities to rise, including the price of steel, which would recover a little from its lowest point. The index number thus remains at par

or moves back to par. It will indeed have a tendency to rise above par, but the argument at the moment is based on the hypothesis of a Constant Price Level, and the ability of the central bank to control that level must be discussed later. If as the result of its cheapness steel tends to replace other commodities to some extent, the prices of these other commodities may fall below their previous level—a frequent cause of economic friction at present—or may rise less than commodities generally, and the number of individual prices in the index number which have changed relatively will be increased, but this does not preclude the maintenance of parity in the index number as a whole. At this stage the prices of many commodities will be higher than before but the costs of their production will not have altered. The extra margin of profit which started by being potentially in the possession of the equity holders in the steel industry has now been spread among equity holders generally. Justice and economic equilibrium are still unsatisfied. One final stage is needed. Costs of production must absorb the extra margin. There must be an all-round increase in the remuneration of services, that is, in the general level of salaries and wages, throughout the country, and a parallel increase in the remuneration of the equity holder. The new invention in the steel industry meant a real addition to the national dividend. That additional dividend has now been distributed in the form, not of reduced prices to the consumer, who though paying less for steel is paying a little more for most other things, but in the form of an all-round increase in the remuneration of the services of all the members

of the community who are engaged in any form of economic activity.

There are several comments to be made on this somewhat idealised picture of how a Constant Price Level would work out in practice, assuming it to be realisable. It is to be noted in the first place that, apart from the assumption that the changes induced would operate more swiftly and with less economic friction, the course of events imagined to follow upon the invention of a new process for producing steel cheaply is not very different from what would actually happen as things are, if the moment of introducing the new invention chanced to fall in a period of expanding trade. When a new invention coincides with a slump the first effects are apt to be an intensification of the depression by the introduction of a new disturbing factor. With a Constant Price Level, booms and slumps so far as they are due to the instability of the measure of value—and this is certainly their main cause—would no longer occur. While therefore under the existing *régime* a new invention of the kind indicated brings its full benefit to the community only in specially favourable conditions, there is every reason to expect that under a *régime* of stable prices the community will always reap the full benefit. The very fact that the business world knew that the accepted policy was the maintenance of a Constant Price Level would help to bring about the readjustment of relative prices smoothly and swiftly, as it would make its calculations on the expectation of such readjustment. Furthermore, it would know that the all-round rise in demand would not be allowed to

develop into a boom which would carry the index number far above par. Business would not therefore be subject to the influences of that boom psychology which in present conditions would be the probable next stage in the development of the expanding trade cycle.

The really significant difference between the present system and the policy of stability of prices is that the former aims at giving the benefit of improved methods of production to the community through the consumer, while the latter relies on increasing the purchasing power of the human factors in production. This is the answer to the objections of those who urge that the policy of stable prices ignores the interests of the consumer. It does ignore the consumer *quá* consumer. It takes account of the well-being of the nation as a whole and acts on the belief that this will best be promoted by using each increase in the national dividend to improve the remuneration and thereby to increase the purchasing power of all those who are engaged in creating that national dividend.

The category of those engaged in creating the national dividend includes all but a very few of the consumers. It embraces the wage earner, the salary earner, whatever form his activity takes, the ordinary shareholder, the professional man and woman, the official, every one in the community, in fact, except the very small class whose income derives solely from fixed-interest securities. Though the index number registers changes in the wholesale prices of only a selected list of commodities largely primary, these commodities are chosen just because they

enter into the whole range of economic activity and to a large extent govern the prices of practically everything that is bought and sold. The maintenance of that index number at par involves the assumption that the remuneration for services rendered in the production of primary commodities will set the standard for the remuneration of services generally. This assumption is necessary both in order that an increase in the national dividend may be shared in the form of increased remuneration for services by those engaged, not merely in primary production, but in all branches of the nation's economic life, and in order that economic equilibrium may not be upset by glaring inequalities between the earnings of the human factors employed at the various stages between primary production and final delivery to the consumer. It is interesting to observe that, though this interest in the citizen not as consumer, but as creator of the national dividend, is the distinctive feature of the policy of stable prices, the change from present practice is not so great as would appear at first sight. In fact, whatever the theory may have been, a gradual increase in the cost of services as opposed to things has been a marked feature of modern civilisation for a long period.

It remains to consider shortly the position of the rentier, and in the same connection the view put forward by some economists that a slowly falling price level is preferable to one that remains constant. It is true that in his capacity as rentier, that is, in so far as his income depends on the interest which he receives directly or indirectly from Government

securities or similar fixed interest investments, the rentier as such does not share in an increased national dividend distributed in the form of enhanced remuneration for services rendered in creating that dividend. Is this an injustice, and even if not unjust will it not tend to diminish the inducement to save money and invest it in Government loans and debenture issues of industrial concerns? There is no injustice in the fact that the commodity value of money so lent to-day remains constant throughout the period of the loan. The purchasing power of the income also remains constant in terms of the index number of wholesale prices. In present conditions the rentier takes a considerable risk of prices rising with consequent diminution in the purchasing power both of his interest and of his principal. It is indeed one of the most striking anomalies of present conditions that in order to safeguard the interests of their beneficiaries the law compels many trustees to invest in Government securities which the experience of the last twenty years shows to be an extremely speculative venture. A policy of stable prices will relieve the rentier of all risks flowing from changes in wholesale price levels. It is probable, however, that as time goes on the increase in the cost of services will gradually increase some of the charges which have to be met out of his fixed income; for example, the charge for domestic service. To the extent that this happens there is some element of hardship in the position of the rentier. There is no need to examine deeply into the further question whether under the new conditions the flow of investible capital into fixed-interest

securities will be checked. The advantage of protection against loss due to a rise in prices must go far to compensate for the absence of any speculative hope of profiting by a fall, and some increase in the inducement to the rentier to take a share in the national economic life by becoming an equity holder is not contrary to the general interest. On the whole, therefore, the case of the rentier against the Constant Price Level cannot be regarded as a strong counter-argument.

This conclusion is reinforced by another consideration. A period of falling prices is generally discouraging for commerce and industry. Optimism, even a tendency to be over-sanguine, seems to be psychologically conducive to success in business. Even if prices were falling so gradually as to make the movement scarcely perceptible, the prospect of a continual process of falling prices would be unlikely to stimulate maximum energy in business, nor would the need for meeting so gradual a fall by reducing costs of production be an important stimulus to keeping costs down, as compared with the expectation of continually improving conditions and profits which a constant level of prices offers. These considerations appear to be sufficient to rule out a gradually falling price level as a goal of policy. Indeed, another school of economists has been led by them to advocate the opposite policy of a gradually rising price level as desirable in order to stimulate business activity and efficiency. This view appears, however, to give insufficient weight to the unsatisfactory position of the rentier with his purchasing power continuously shrinking, and per-

haps leaves too much room for such an expansion of profits as would make them disproportionate to that increase of the remuneration for services which must always be the main channel for giving to the community as a whole the benefits of increased production under any policy of control over the price level.

See Appendix for further discussion of the effects of a Constant Price Level.

CHAPTER VIII

CONTROL OF THE PRICE LEVEL

“secure
Of surfeit where full measure only bounds
Excess.”

MILTON. *Paradise Lost*, V., 639.

THE last chapter was devoted to an examination of the concept of a Constant Price Level and of the way in which it would operate in practice supposing it to be realisable. A Constant Price Level has been found to mean such stability of the wholesale prices of all the important commodities entering into the economic activities of the nation as would result in an index number, adequately composed and carefully weighted, which was built up as a summation of those prices, remaining constantly at or close to par. The question within what limits the index number might be allowed to vary from the absolute par without stability being lost has not yet been approached. The most significant difference between present conditions and those involved in a Constant Price Level has been found to be that the latter relies on distributing to the community any increase in the national dividend due to improved productivity, not through the consumer by reduction of prices, but through the human factors engaged in creating the national dividend by increasing the remuneration

for their services. It is time now to turn to the question whether it is possible so to manage the currency as to maintain a Constant Price Level.

The ideal monetary system would combine stability of the internal price level with stability of the foreign exchanges, but in existing circumstances the two are not completely compatible. The conclusion has already been reached that the objective of a Constant Price Level is unlikely to be attained, except on the basis of independent local currencies. The habitual juxtaposition of the words "currency" and "exchange" is clear evidence of the economic interdependence of the nations in the sphere of currency. It will be convenient, nevertheless, to begin the study of the subject by imagining a local currency in operation in a closed system with no external contacts. In a closed system the Currency Authority, which for simplicity's sake may be spoken of as the Central Bank, is free to exercise its function of managing the currency with no anxieties regarding external payments or movements of capital to and from abroad. The internal price level is not subject to disturbances due to changes in the prices of imported commodities. Nor are either prices or the currency liable to be upset by external changes in the value of a precious metal, such as gold, over which the Central Bank has no control. The Central Bank can concentrate its whole attention on so managing the local currency as to facilitate internal exchanges of goods and services and in so regulating the supply of currency as to prevent fluctuations in its purchasing power. Not only is the Central Bank relieved of the fear of trouble arising from fluctua-

tions in the value of gold due to events outside the area of its jurisdiction, but it has no need to hold gold or silver or any precious metal as a reserve against currency in circulation. The medium of circulation may be supposed to be made up of a paper note issue and of subsidiary token coins—in other words, of notes of higher value which are unlimited legal tender printed on paper and notes of lower value with limited legal tender privileges for use as small change printed on silver or copper, the intrinsic value of which is only a fraction of their face value. It is essential that there should be political stability and confidence in the integrity and capacity of the central bank, so that everyone may accept the notes without question.

The currency will be receivable at all times at face value for purposes of payments to Government, but this is not the factor on which its value in exchange essentially depends. The purchasing power of the medium of circulation depends solely on the relation between the quantity in which it is available and the work which it is at any given moment called upon to perform. If the currency system is to satisfy public requirements, there must be no suspicion of its volume being liable to be arbitrarily increased to finance Government expenditure, that is, the Government must balance its budget and other outgoings either out of taxation or from loans duly subscribed for by the citizens out of current savings, and must be precluded from calling upon the Central Bank to print additional notes simply to meet a Government deficit. Not only would any such suspicion militate against public confidence in the currency, but the

Central Bank could not perform its function of managing the currency and regulating its volume according to the economic requirements of the country if it were liable to demands for additional notes based not on economic considerations but on the exigencies of Government finance.

The notes of the Central Bank will be inconvertible. They are not promissory notes which the Bank undertakes to redeem on demand. Supposing the currency to be British sterling the £1 note does not bear the legend "The Central Bank promise to pay the Bearer on demand the sum of £1," or any such legend. The notes are legal tender money. Each note represents 10s., £1, or £5, or whatever the denomination may be, and the simplest way to express this fact is to print 10s., £1, £5, etc., in words and figures on the face of the note, together with the name of the bank of issue and the signature of the individual authorised to sign for the bank. This would be no innovation. Notes in this form are in circulation in many countries, and for some fourteen years from August, 1914, onwards, currency notes were issued by the British Government in what was in essentials the same form. The notes actually carried the slightly ambiguous legend: "Currency notes are legal tender for the payment of any amount." Whereby hangs a tale. Somewhere in the early hours of August 7th, 1914, three weary Treasury officials were engaged in drafting the various rules and regulations and other documents needed to give effect to "the Currency and Bank Notes Act, 1914." They had spent most of the previous night in drafting the Bill which had then

passed through all its stages in both Houses of Parliament and received the Royal Assent during the afternoon and evening of August 6th. Among the documents to be completed and sent to the printer forthwith were the drafts of the £1 and 10s. currency notes, and if a last moment alteration had not been made, the above legend would have conveyed to the public the remarkable information that "This currency note is legal tender for the payment of any amount."

The Bank of England notes in circulation to-day bear the traditional legend : " I promise to pay to Bearer on Demand the sum of £1 " (or whatever the denomination may be). Even between 1925 and 1931 this legend was questionable, since there was no obligation on the Bank to redeem individual notes in gold coin. Since September 21st, 1931, when the Bank of England was relieved of the liability to make payment in gold bullion or specie, the promise has been nugatory. There has been no means by which the Bank could discharge its promise other than the tender of a similar note or of a draft entitling the holder to obtain a similar note from elsewhere. Exactly the same conditions would exist in regard to the inconvertible notes of the Central Bank under the system which is here suggested. Anyone who pays in notes to the Central Bank will receive in exchange either a credit to his account with the Bank, if he keeps an account there, or a draft in his favour which he can place to the credit of his account with some other Bank. *The notes are Money.* They give the holder a claim to goods and services within the country ; they represent a stated amount, measured in money, of internal purchasing power, exerciseable

at the bearer's option anywhere within the country at any time present or future that he may choose. They represent nothing more and nothing less, and their value in terms of commodities depends, as already stated, solely on the relation between the quantity in circulation and the work which it is at any moment required to perform.

As backing for this inconvertible note issue the Central Bank will hold self-liquidating Bills of Exchange, Treasury Bills and other Government short-term obligations, and longer-term Government and other suitable securities. The question whether gold or foreign securities of any kind should be held does not arise so long as a closed system with no external contacts is being postulated. It is customary in most countries to place strict limits on the amount of notes which the Central Bank may issue. Such restrictions are usually bound up with laws and regulations regarding the amounts or proportions of the total issue which must be covered or backed by gold or particular kinds of securities, internal and external. There is no need for any such restrictions in the local currency system now under discussion—at any rate, in one which has no foreign contacts. The right amount of currency in circulation at any given moment is that amount which will do the work required of it at a given level of prices. If it is too much, prices will rise. If it is too little, they will fall. If the Central Bank has been given the task of maintaining a constant level of prices, it should not be hampered by any restrictions on the amount of notes it may issue, and it would be wise to leave it wide, if not complete, discretion as to

the nature of the cover which it will hold against its notes. No particular harm would be done by fixing a maximum note issue which was far beyond any figure reasonably likely to be reached in the near future. The object of fixing such a maximum could, however, only be to secure that the Bank's management of the currency should come under review in the event of its desiring to exceed the maximum. This purpose could be much better achieved by other means, as, for example, periodic revision of the Bank's charter. The community's interest is not to prevent the Bank's issuing currency beyond a particular limit, but to enjoy the benefits of a stable measure of value, and the criterion by which the Bank should be judged ought to be its success in maintaining a Constant Price Level.

This being the character of the local currency of which the Central Bank is in charge, the maintenance of a Constant Price Level depends on its capacity so to increase or decrease the quantity at any time in circulation as to secure that it is never either in excess or in defect. So far as concerns subsidiary coins, all that is needed is that arrangements should be adopted similar to those now in operation in this country for studying the convenience of the public, so that demands for small change may be smoothly met and any excess supplies temporarily withdrawn from circulation. The purchasing power of the currency and therefore the level of prices will be regulated by the Central Bank's operations upon the volume of legal tender notes. If it can so regulate their volume as to keep it always in the same relation to the work which the notes in circulation

have to do, the country will enjoy a Constant Price Level. Central Banks everywhere, and above all the Bank of England, have long practical experience in operating upon the volume of currency in circulation. Their objective has been the maintenance of stability of the foreign exchanges. The novelty of the new proposals consists in giving the Central Bank the function of regulating the currency with a view to maintaining parity of the price level. Many of the means at its disposal for maintaining parity of the exchanges will be no less effective in helping it to discharge this new responsibility. The two main instruments at the Bank's disposal will be as before the Discount Rate and what are called Open-Market operations, that is, the purchase or sale by the Bank of securities to be held or already held as backing for its note issue.

Neither of these methods operates quite automatically on the amount of the note issue in circulation, but both can be quickly effective. Purchases or sales of securities in the open market, under the British system of a separate Issue Department, have as their first result an increase or decrease of the securities in reserve in the Banking Department and a corresponding increase or decrease of the deposits (for practical purposes the deposits of the Joint Stock Banks) in the same department. The volume of notes in actual circulation is increased or decreased as soon as the depositor either draws on his increased deposit or makes a payment to his account at the Central Bank to make good his depleted deposit. The important part played by the raising or lowering of the Discount Rate in relation to payments to and

from abroad is irrelevant for the present argument. In a closed system they would still have great value as instruments for affecting both the volume of currency in circulation and the flow of credit.

A reduction of the Bank rate in a highly organised money market such as London makes itself felt at once in reducing the expense of carrying stocks of commodities on borrowed money. It affects costs of production and costs generally in so far as charges for interest on short-term borrowings enter into costs, that is over a very wide range of business, even though in many cases these charges are small in relation to other factors entering into costs. It tends to stimulate enterprise and increase the volume of business transactions and so to increase the demand for currency. Even more important is its effect upon the prices of securities since it tends to reduce the long-term rate of interest, which is also one of the effects of open-market purchases of securities. The long-term rate of interest is of very special moment in all businesses. Either they or their customers or both are always anxious to take advantage of the opportunity of borrowing at favourable rates on long term, in order to obtain capital for new developments, and it is above all capital extensions and new developments which lead to active trade and widespread employment. Raising the Bank rate has naturally the opposite effects and tends, therefore, to diminish the demand for currency in circulation and to enable the Central Bank to curtail the supply.

There is, therefore, no great difficulty in securing for the Bank ample powers for increasing or decreasing the amount of notes in circulation at will. It is

mainly a matter of developing existing powers and of closer attention to the flow of investment. So far as concerns the mechanism of control, the Central Bank is well armed for bringing about an expansion or contraction when it wants to raise or lower the price level. Experience shows that it meets with more resistance when trying to contract than when expanding currency, though as against this there is probably no moment in the trade cycle at which price levels have proved less responsive to currency management than at the trough of a depression. Business psychology will still tend under the new order to dislike contraction, but the resistance should be very much lessened by the fact that stability of prices has been publicly proclaimed and accepted as the objective of monetary policy. Many of the criticisms and attacks which are now made against the actions of the responsible financial authorities are the not unnatural result of the absence of any public statement or explanation of the policy they are designed to serve. The task of maintaining the gold standard has too often involved the Central Bank in action which did violence to internal economic equilibrium in the effort to protect the exchanges. Once stability of prices has been adopted as a national policy, and in proportion as this policy is successfully pursued, it will tend of itself to create conditions favourable to continued stability. The Central Bank will thus find it easier to use its existing powers effectively.

The main difficulties of the Central Bank's task arise, not in using effectively the wide powers it possesses for raising or lowering the price level, but

in knowing when to act. The same volume of notes in circulation will result in widely different price levels in different circumstances. If all that was necessary was to maintain a constant relation between the volume of currency and the volume of goods produced, increasing it as production increased and diminishing it as production diminished, the Central Bank's task would be fairly easy. Reasonably accurate and up-to-date information as to the course of production would meet all its needs.

It is not the mere volume of production, but the rate of flow of goods from the raw material stage to the delivery of the finished article at the consumer's door, together with the activity of all the services that enter into economic life, that measures the nation's need for currency. What is called the velocity of circulation is subject to great changes. Upon the basis of the legal tender medium of circulation there is built up a superstructure of credit, bank balances, bills of exchange, short-term securities which are customarily regarded as all but the equivalent of cash, all of which are factors affecting both the volume and the velocity of the circulation of legal tender money. Money, in fact, and legal tender money are not identical for all purposes. It is true that all other forms of money derive from legal tender money and that the superstructure is built up on the foundation of legal tender notes. There is therefore a definite, though not a constant, relation between the volume of legal tender notes in circulation and the volume of credit money and credit instruments. Management of the note issue thus remains the key to control of the price level,

but successful management and control have to contend with extraordinary complexities and to find a way through many obstacles. Credit and credit money have to be managed as well as legal tender money, if prices are to be successfully controlled and kept stable.

Yet the magnitude of the task can be overestimated. The difficulties are not fundamental, but technical, such as the technician is apt to magnify beyond what the facts warrant. The Bank of England was able for nearly a century up to 1914 to keep sterling at parity with gold, and though it did not keep prices stable or envisage stability of the price level as its objective, the position of sterling in world finance was so dominant that in fact the Bank of England was regulating world gold prices. It was to a large extent the course of prices that it watched in maintaining the gold standard in this country, and though prices altered greatly during the century, price movements either upwards or downwards were seldom violent, and in comparison with what has happened recently prices from one year to the next were notably steady. Under the new conditions postulated, the Central Bank will be charged with the duty of maintaining a Constant Price Level, but will not be distracted by any responsibility for keeping the local currency in any fixed relation to other currencies or to a world monetary standard. It will have at its disposal from day to day the special index number of wholesale prices. It will be able to see exactly what movements are taking place from day to day both in the index number itself and in the prices of each of the com-

modities of which it is a compilation. At the outset the index number may be allowed to oscillate around parity within fairly wide limits, perhaps as much as five points either way : that is, if par is 100, it would swing between 105 and 95. At a later stage experience might enable the Central Bank to narrow these limits. If prices were successfully kept from falling below 95 or rising above 105, stability would be an accomplished fact.

Experience will suggest improvements from time to time in the index number itself, apart from the larger changes which may prove necessary in the weighting, at comparatively long intervals, as new inventions and the development of national economic life bring about permanent alterations in the relative importance of different commodities. Besides the main index number of wholesale prices, the Bank will have available a number of other significant indices and statistical and other information of all kinds. It is reasonable to expect that a great advance will rapidly be made in its own and the national organisation of statistical services. Both for the purpose of obtaining the necessary data and for the purpose of making fully effective any step which it decides to take to expand or contract currency, the Central Bank will be entitled to rely on the full support of other banks and of the organised money market. Mutual co-operation between the Central Bank and other banks, the Stock Exchange, the Issuing Houses, the Acceptance Houses, and in general the leading representatives of Finance, Commerce and Industry, will be all-important. If Planning, as has already been said, is impossible

without Planned Money, full success in the regulation of currency and in stabilising prices demands a more consciously planned organisation of the national economic life and in particular of its financial machinery.

Even with all these powerful aids the task of the Central Bank in rightly interpreting the information which comes to it and in choosing the right moment and the right method for action will still demand constant skill and attention. There is no reason, however, to regard it as a superhuman task. It is not in essence so formidable as the maintenance of the currency on a parity with gold in conditions of economic instability. Except that they are asked to break new ground, the controlling authorities have less difficulties to contend with than under an international gold standard. In the conditions postulated, in a closed system with no external contacts, with the instability attaching to a metallic standard of value eliminated, their Bank rate policy is far less exposed than at present to the difficulties arising from having to run counter to the apparent interests of internal trade owing to the need for protecting the exchanges against the effects of happenings abroad. If immediate success cannot be guaranteed for a new experiment, there is every reason for believing that, even allowing for initial disappointments, in due course true stability of prices would be assured.

CHAPTER IX

LOCAL CURRENCIES AND EXTERNAL EXCHANGES

“from this high pitch let us descend
A lower flight, and speak of things at hand
Useful.”

MILTON. *Paradise Lost*, VIII., 197.

BOTH in its ideal of an international monetary standard and in the organisation of its money markets, with their facilities for movements of capital and for international lending and borrowing on long and short term, the world of to-day aims at being a financial unit and has to a certain extent succeeded. In its economic organisation the world is very far from being an economic unit, and the balance of opinion throughout the world does not regard the ideal of economic unity with much favour. To this discrepancy between economic and financial ideals and practice many of the world's present troubles can be traced. The remedy to which the arguments of this book point is a financial organisation under which each economic unit will possess a local currency of its own designed to maintain its own internal prices at parity, and so to secure the most favourable conditions possible for the maximum economic activity within its own area. An examination of the conditions under which such a local currency would be managed and controlled

in a closed system with no external contacts has led to the conclusion that parity of the internal price level could be reasonably maintained. Does this conclusion hold if the local currency has to be managed and controlled in a world made up of a number of economic and financial units which, while independent, are also interdependent? Some sacrifices might perhaps be justified for the sake of stability of internal prices, but the goal of any financial reorganisation must still be to secure the maximum volume of desirable interchanges of goods and services, not only within each economic unit, but with all other economic units. Indeed, the very existence of many hundreds of millions out of the 2,000 million inhabitants of the globe is dependent on active international trade.

In its management and control of its local currency the Central Bank's task of keeping prices stable is affected in very many ways by the need for providing for external contacts. Many of the commodities included in the Index Number of wholesale prices are imported from abroad and their prices are largely or entirely governed by world supply and demand, costs of production abroad or special conditions in the exporting country or countries. Similarly, the prices at which articles manufactured at home can be sold abroad are dependent on external conditions not subject to control by the Central Bank. Even more significant for the day-to-day conduct of its business by the Central Bank are the influences upon the credit situation of movements of capital into and out of the country and of payments falling due by or to non-residents upon

current account. In the London money market transactions of every conceivable kind are entered into every day involving payments to and from abroad, in connection with this country's imports and exports, movements of goods from one external market to another, foreign travel, shipping, insurance contracts of every description, loans to and from abroad, the purchase and sale of securities on Stock Exchanges in other countries.

The Bank of England has been in the habit of keeping a close watch on the aggregate of these transactions, as reflected in the demand for and supply of short-term funds in the market and in the movements of the foreign exchanges. This was, of course, necessary when the Bank was charged with the duty of keeping sterling at parity with gold. It was helped in performing its task by the sensitiveness of the price of gold to movements in the exchanges and by the evidence afforded by actual shipments of gold. In recent years, too, it has derived additional assistance from being in constant communication with other Central Banks, and since 1929 from participation in the Bank for International Settlements. Under the new system the Central Bank will be free from the obligation to keep its local currency at par with gold or with any other currency. Violent day-to-day fluctuations of all the exchanges, however, make external trade very difficult and inevitably diminish its volume. The Central Bank must be in a position to introduce reasonable moderation into the movements of exchange, if only to prevent particular prices, especially of imports, which are largely

affected by exchange movements, from becoming so unstable as altogether to upset the equilibrium of the index number. A course has to be steered between the two extremes of sacrificing valuable commercial and financial business with other countries and permitting dealings in their currencies to jeopardise the stability of the internal price level.

The inwardness of the problem which arises at this stage can be clearly seen when stated in another form. The nation has adopted the policy of a stable standard of value and has entrusted its Central Bank with the duty of maintaining a Constant Price Level. The index number of wholesale prices has been carefully framed so as to include the prices of all those commodities which play a significant part in the economic activities of the country. There is, however, one commodity, or rather one class of commodities, which enters largely into the nation's multifarious economic life and reacts in very many ways on its everyday business, and this commodity or class of commodities is *ex hypothesi* unstable and is not represented and cannot be adequately represented in the index number. The currencies of other countries are bought and sold daily in terms of the local currency. From the point of view of the Central Bank they are not dissimilar to other articles of import and export. The price of each external currency varies in terms of the local currency in accordance with demand and supply, and it is of the essence of the policy of stability of internal prices that the prices of external currencies should be left to find their own levels. Unfortunately for the Central Bank, the demand for and supply of external

currencies are extremely irregular and largely unpredictable and their prices are therefore liable to wide fluctuations. It is not surprising that, in these circumstances, the problem of reconciling active dealings in foreign currencies with stabilisation of the internal price level should raise acute difficulties.

The very fact that the level of internal prices was stabilised might in some circumstances provide an extra inducement for speculative dealings in external currencies. One of the major risks against which the Central Bank has to guard even in a closed system with no external contacts is that the additional purchasing power, which it makes available when it wants to stimulate the demand for commodities, may be diverted to finance the wrong kind of Stock Exchange speculation. It may be entirely reasonable and conducive to the general interest and to the Bank's immediate purpose that a moderate stimulus should be given to the Stock Exchange. Activity in the Stock market is likely to make conditions favourable to new issues and so to increase production trade and employment. If, however, healthy activity on the Stock Exchange, or, as it may justly be called, legitimate speculative activity, develops into unhealthy gambling in new issues, economic equilibrium is endangered and the Central Bank has a delicate task to perform in retaining control.

In a closed system the market's knowledge that the accepted policy is to prevent commodity prices from soaring is in itself a deterrent to exaggerated speculation either in commodities or on the Stock Exchange. If, however, there are external markets for com-

modities in which price movements are subject to no such control and external Stock Exchanges which offer exciting prospects of speculation in securities, and the holder of local currency in the country of stabilised prices can use his purchasing power to buy external currencies freely, the very absence of specially attractive opportunities for speculation at home will tempt the speculatively inclined to gamble in external markets. They may even have an added inducement to buy external currencies in the expectation that the outward movement of capital to which they are contributing will bring about a fall in the exchange value of their own local currency in terms of the currency which they are purchasing. Equal difficulty may be created for the Central Bank by a movement of capital inwards, due to some external occurrence, as, for example, distrust of their own currency by the nationals of some external country.

If the problem to be solved were the maintenance of parity of the price level in a single economic unit, even in one financially as strong as Great Britain or the United States of America, in a world in which the currencies of all the other units were in a state of disorder and their prices totally unstable, a satisfactory solution might well be regarded as unattainable. Stability of the internal price level and a stable measure of value would be bought at too high a price if ample opportunities are not left for active interchanges of goods and services with the outside world not less in volume and value than can be looked for under existing conditions or under any alternative monetary system which can

be reasonably regarded as capable of practical application in the world of to-day. The times are indeed out of joint, but they do not as yet justify the pessimistic assumption that this country, or any other country which desired to adopt stability of the internal price level as the objective of its currency policy, would have to try and realise that objective in a world in which all other external currencies and price levels were in a state of complete instability and disorder. It is in the world of to-day that the reconciliation of internal stability of prices and active external trade has to be attempted. In order, therefore, usefully to pursue the search for the best available solution, it will make for greater clarity to continue the discussion in the form of an examination of the possibilities of the adoption by Great Britain of a monetary policy having as its objective a stable measure of value and a constant level of internal prices in the actual economic and financial circumstances of the present time.

At the moment of writing, September, 1932, a very few countries have currencies which are securely based on the gold standard—the United States of America, France, and some half-dozen more at most. The gold standard has ceased to be entitled to be styled the international gold standard and has become the standard of an important group of countries only. A somewhat larger number of currencies are on what has been picturesquely, but not inaptly called, the insolvency gold standard. Germany, Austria, and most of the countries of Central and South Eastern Europe constitute this group. They may be regarded as hangers-on rather than as

members of the gold standard group. In view of their inability to meet their liabilities, their claim to be on the gold standard is only a polite fiction. Russia has a special and separate currency system of her own. China is on the silver standard. Great Britain and all the rest of the world are on local currency standards not linked to gold.

British sterling occupies a peculiar position. In spite of its divorce from the gold standard it remains by far the most important currency in international trade and the most widely used international standard of value. India and practically the whole of the British Colonial Empire either have currencies directly linked to sterling at the same fixed ratio as before September, 1931, or in some cases actually use British sterling. Australian and New Zealand pounds are also directly linked to British sterling, but have been allowed to fall to a discount of 25 and 10 per cent. respectively. In the Union of South Africa the pound is still on a gold basis, but the two Rhodesias and the rest of British Africa are linked to British sterling. Canadian dollars are an independent local currency, divorced from gold, with a value in exchange about midway between the present gold value of British sterling and the old gold par as represented by the United States dollar, and subject to powerful attractive influences from both quarters. Palestine has a currency directly linked to sterling. So also have Iraq and Egypt. The Scandinavian countries and Portugal have their own independent local currencies, but they are closely bound up with the fortunes of British sterling, with which they may be said to be loosely linked.

In Argentina and some other South American countries the local currencies are also, if not loosely linked to British sterling, at any rate so intimately connected by their trading and financial relations with Britain as to be within the orbit of British sterling.

It may thus be said that the currencies of the world apart from China and Russia fall into three groups: the gold standard group, including its hangers-on, the British sterling group, including a number of currencies which come within its outer orbit, and a third group of entirely independent local currencies not linked in any way to either of the first two groups or to each other. Apart from Russia and China, all the countries occupying a position of economic or financial importance in the world's business belong to one or other of the first two groups, with Canada regarded as belonging partly to both.

To whatever group they belong, every one of these countries is suffering acutely from the appreciation of the purchasing power of its currency and the economic disequilibrium occasioned by the disastrous fall in prices. Most of the countries have imposed rigid restrictions upon dealings in the currencies of other countries, the result of which is to hamper external trade and progressively to diminish its volume. In the countries on the insolvency gold standard the absurd situation exists that every effort is made to impede the free working of the machinery which facilitates the interchange of goods and services with other countries in order to maintain the gold standard, which

is in theory supposed to exist for the special purpose of encouraging and increasing the volume of such interchanges. Recognising the fatal consequences to the welfare of their own countries and of the world which a continuance of these conditions threatens, the statesmen of the world have agreed to hold an International Economic and Monetary Conference to frame concerted measures for their amelioration. There are certain important subjects, the exclusion of which from the agenda is ominous, but the field appears to be clear for free discussion of currency questions.

What programme will the British Government put before the Conference? The Report of the Committee on Monetary and Financial Questions adopted by the Imperial Economic Conference at Ottawa is the best available guide to the present attitude of the British Government and is worth quoting in full. It reads as follows :—

REPORT OF THE COMMITTEE ON MONETARY AND FINANCIAL QUESTIONS OF THE OTTAWA CON- FERENCE

1. (a) A rise throughout the world in the general levels of wholesale prices is in the highest degree desirable. The evil of falling prices must be attacked by Government and individual action in all its causes, which are political, economic, financial, or monetary.

(b) For dealing with the problem in its widest aspect the Governments represented at this Conference record their conviction that inter-

national action is urgently necessary and announce their desire to co-operate with other nations in any practicable measures for raising wholesale prices.

(c) The Conference has considered what action can be taken by nations of the Commonwealth to help towards raising prices.

As regards monetary action, the Conference recognises that the central position of the United Kingdom, not only among countries of the Commonwealth but in world trade and finance, makes the United Kingdom a main factor in anything that can be done. The Conference therefore welcomes the following statement made on behalf of the United Kingdom by the Chancellor of the Exchequer :—

“ His Majesty’s Government desires to see wholesale sterling prices rise. The best condition for this would be a rise in gold prices, and the absence of a rise in gold prices inevitably imposes limitations on what can be done for sterling. A rise in prices cannot be effected by monetary action alone, since various other factors which have combined to bring about the present depression must also be modified or removed before a remedy is assured. His Majesty’s Government nevertheless recognises that an ample supply of short-term money at low rates may have a valuable influence, and they are confident that the efforts which have successfully brought about the present favourable monetary conditions can and will, unless unforeseen difficulties arise, be continued.”

(d) The Conference recommends the other countries of the Commonwealth represented here to act in conformity with the line of policy as set out in the statement of the Chancellor of the Exchequer so far as lies within their power.

In the monetary sphere the primary line of action towards a rise in prices should be the creation and maintenance, within the limits of sound finance, of such conditions as will assist the revival of enterprise and trade. Among these conditions are low rates of interest and an abundance of short-term money. While regard must be had to the different conditions applying to the various types of loans, the rate of interest for all purposes should be kept as low as financial conditions permit.

At the same time it is necessary that these favourable monetary conditions be achieved, not by the inflationary creation of additional means of payment to finance public expenditure, but by an orderly monetary policy, safeguarded, if necessity should arise, by such steps as will restrain and circumscribe the scope of violent speculative movements in commodities or securities.

It must be kept in mind, however, that the success of any such policy will be hampered, and might be nullified, by failure to modify or remove important non-monetary obstacles. Of non-monetary factors which are depressing the level of prices many are of international character and require an international remedy. The nations of the Commonwealth should nevertheless take all steps that lie in their power to increase public confidence, especially in the field of business enterprise, and to facilitate trade.

(e) The Conference recognises the great importance to traders of stability of exchange rates over as wide an area as possible. The complete solution of this problem must await the restoration of conditions for the satisfactory working of an international standard, as referred to below. In the meanwhile, and pending such a solution, this Conference has considered the possibility of achieving valuable results in two directions—first, by creating an area of stability among countries regulating their

currencies in relation to sterling ; and, secondly, by avoiding wide day-to-day fluctuations between sterling and gold.

As regards the latter, the Conference has noted with satisfaction that the United Kingdom has already established machinery aiming at preventing wide fluctuations in gold value of sterling caused by speculative movements. As to the former, the Conference recognises the value of countries within the Commonwealth whose currencies are linked to sterling maintaining stability between their exchange rates, and looks to a rise in the general level of wholesale prices as the most desirable means for facilitating this result.

2. The Conference recognises that the ultimate aim of monetary policy should be the restoration of a satisfactory international monetary standard. Such a standard should so function as not merely to maintain stable exchanges between all countries, but also to ensure the smooth and efficient working of the machinery of international trade and finance.

This postulates international agreement among the great trade nations of the world, and, while certain of the States here represented hold very definite views on the question of the most desirable standard, the Conference refrains from making any recommendation on the subject, in view of the fact that the question is shortly to be discussed at an international conference.

There are, however, several conditions precedent to the re-establishment of any international monetary standard. The most important among them are :—A rise in the general level of commodity prices in various countries to a height more in keeping with the level of costs, including the burden of debts and other fixed and semi-fixed charges ;

and an adjustment of factors, political, economic, financial, and monetary, which have caused the breakdown of the gold standard in many countries, and which, if not adjusted, would inevitably lead to another breakdown of whatever international standard may be adopted.

It is also, in the view of the Conference, of the utmost importance to the future working of any international standard that international co-operation should be secured and maintained, with a view to avoiding, so far as may be found practicable, wide fluctuations in the purchasing power of standards of value.

It is no secret that this Report, though unanimous, conceals considerable divergencies of view, and that there was much disappointment among the delegations of some of the Dominions and of India at the absence of any readiness in the British delegation to enter deeply into fundamental questions of currency and at the unwillingness of the British Government to give a strong lead. The Report must, however, be taken at its face value. It will be seen that the Governments of the Empire regard a rise throughout the world in wholesale prices as in the highest degree desirable and "record their conviction that international action is urgently necessary and announce their desire to co-operate with other nations in any practicable measures for raising wholesale prices." On the question of the future "the Conference recognises that the ultimate aim of monetary policy should be the restoration of a satisfactory international monetary standard," but "while certain of the States here represented hold

very definite views on the question of the most desirable standard, the Conference refrains from making any recommendation on the subject, in view of the fact that the question is shortly to be discussed at an international conference." The Report does, however, indicate certain conditions precedent to the re-establishment of any international monetary standard including an adjustment of factors which have led to the present breakdown of the gold standard in many countries, and in its final paragraph it stresses the need for international co-operation in the future working of any international standard "with a view to avoiding, so far as may be found practicable, wide fluctuations in the purchasing power of standards of value."

It appears, then, that the British Government will go into the International Monetary Conference with proposals for first raising the world level of wholesale prices and then restoring an international monetary standard on conditions not clearly specified which will include some provision for limiting the range of price fluctuations. It is ominous that stabilisation of prices, which is the essential point, is left to the last paragraph and mentioned only as a vague aspiration. In view of the fact that the recommendation of the Genoa Conference of 1922 that action should be taken to avoid undue fluctuations in prices has proved nothing but a pious hope, it is difficult to feel any confidence in the efficacy of any fresh resolution couched in general terms emanating from another International Conference. The *sine quâ non* of any agreement to return to the gold standard is the establishment of effective machinery which will

guarantee that gold shall henceforth be a stable measure of value.

At the Ottawa Conference it was the British delegation which was the least willing to take up a forward position. It is more than probable that at the forthcoming International Conference the representatives of the British Government will find themselves surrounded by representatives of the other leading countries who are far less progressive than they are in matters of currency theory and practice. France and the United States of America are unlikely to come to the conference with their minds open to the possibility of any standard other than a metallic standard. The influence of the Bank for International Settlements will be on the side of the restoration of the international gold standard. The prospect of obtaining anything approaching general agreement as to the removal of the stumbling-blocks which led to the recent breakdown of the gold standard in this country and elsewhere is extremely remote, and the hope of any general international undertaking to adopt concerted measures to make world prices reasonably stable is negligible. Nor is this surprising. As was shown in an earlier chapter, a single international monetary standard cannot easily be made to work satisfactorily in a world consisting of independent economic units, however much they are interdependent.

The Bank for International Settlements might conceivably, if the various Governments were willing to trust it with adequate powers, become the Central Reserve Bank of the world and do much to mitigate the effects of those big movements of short term

funds from one national financial centre to another which form one of the major obstacles to stability of exchange between national currencies and an international money standard. It is doubtful, however, whether the necessary personnel would be forthcoming capable of sustaining the burden of managing the business of the Bank for International Settlements on these lines in a world of jealous national units. If reasonable stability of prices is to be regarded not merely as a pious hope but as a goal of practical policy, it can be reconciled with an international gold standard only if some body or institution is effectively in control of the purchasing power of gold. A mere agreement among the world's central banks to co-operate for the purpose of managing gold would be useless. If the task is to be undertaken internationally, it must be entrusted to the Bank for International Settlements, but here again the responsibility would overwhelm any personnel which could be gathered together at Basle to manage the Bank, and the extent of the national surrender of powers into the hands of an international body is so vast as to be politically inconceivable. A Super-Central Bank of the World might be an instrument of a Super-State. It is altogether out of harmony with the ideas of the present-day world of independent and sovereign national economic units.

In the prevailing state of world opinion on the subject of gold, a monetary programme which seeks to dethrone gold must necessarily come as a shock to an international conference. It is true that the proposal that the Bank for International Settlements should control the price of gold in relation to an

international index of wholesale prices makes gold something less than even a constitutional monarch, since if the price of gold is to be determined by the price level and the latter is to be kept stable, it is the price level and not gold which is the real standard of value. There is, however, often great practical advantage in keeping up appearances, and so long as there is any hope of any form of international agreement to make gold a stable measure of value, it is worth while retaining some sort of gold standard, provided always that assured stability of the price level is insisted upon as an overriding consideration. In these circumstances the British Government might well examine the possibilities of an agreement with the United States of America, which would for a time at least secure stability of gold prices.

It has been pointed out that during the nineteenth century London's financial supremacy gave her a predominant voice in determining gold prices, and though she did not even try to secure a constant price level, gold prices were in practice kept fairly stable and fluctuations were moderate in comparison with recent experience. London alone can no longer offer the world a similar service, but a combination between London and New York would be all-powerful even to-day. If the United States of America and Great Britain could come to a firm understanding first to raise prices to the desired level and then to keep them at or very close to that level, the world would be assured of something very nearly equivalent to stability of world gold prices. All that is required is harmonious agreement and concerted

action by London and New York to control gold in relation to an International Index of wholesale prices, and to maintain stability of exchange between American dollars, British sterling, and gold. There would have, in addition, to be careful provisions for economising gold to guard against a shortage due to hoarding or to falling off in the production of the gold mines. The essential points are complete agreement between this country and the United States and determination and ability on both sides to keep gold prices stable. If these points can be secured by what is after all only lip service to the gold standard, since gold will be managed in relation to prices and prices, not gold, will be the ultimate measure, it would be well worth the while of the British Government to postpone action to promote any alternative programme for a world-wide international monetary system, until public opinion becomes more enlightened. That the United States of America would be able and willing to enter into binding undertakings resolutely to put this policy into effect cannot be regarded as more than a possibility, but it ought not to be neglected.

If this hope also fails, then the moment will have come to ask the question whether the governing purpose of the International Conference cannot be better served than by obstinate insistence on an International gold standard. The objective of the Conference is the restoration of activity to international trade which includes activity of the internal trade of each country as well as of its external trade. It is an indispensable condition of success that there

should be effective provision for maintaining stability of the price level. Is it possible for the British Government to put forward a constructive programme which will achieve these objectives by an alternative method of approach ?

CHAPTER X

A BRITISH MONETARY PROGRAMME

“The roof was fretted gold . . .
. . . Far within
The great seraphic lords and cherubim
In close recess and secret conclave sat,
A thousand demigods on golden seats.”

MILTON. *Paradise Lost*, I., 717, 792.

WITH a very slight modification in the wording of the Monetary Report of the Ottawa Conference the programme of the British Government at the World Monetary Conference can be stated in a form that does not beg any fundamental question, and summed up under two heads, viz. :—

(1) Co-operation with other nations in any practicable measures for raising wholesale prices ; and

(2) Establishment of a satisfactory international monetary system.

The modifications introduced are in the second part only and consist of the substitution of the word “establishment” for the word “restoration,” which goes too near to suggesting that the problem is to restore the international gold standard, and the replacement of the word “standard” by the word “system” in order to avoid the implication that a single international monetary standard is necessary or desirable. Though it could have little hope of

immediate world-wide agreement, the British Government is in a position, if it chooses, to put forward a constructive proposal for an international monetary system capable of world-wide adoption as an alternative to the attempt to revert with or without adequate safeguards to the international gold standard.

Simply stated, this constructive proposal is that each national economic unit should have its own local currency and should declare its intention to keep the internal purchasing power of that currency stable and to maintain a constant price level, and that the nations of the world assembled at the International Monetary Conference should undertake to co-operate to the best of their ability in giving practical effect to this declaration each within its own domain. If this policy were accepted and put into force by all the nations, or even by a portion of them only including the United States and Great Britain, the problem of reconciling stability of internal prices with active international trade would be solved. The nations of the world would secure what they have never had before, a stable measure of value, a monetary yardstick, for all their internal dealings, and the exchange value of each local currency in terms of other currencies would approximate very closely to complete stability. For with each nation keeping its own internal prices stable, variations in the exchange values of the different local currencies would occur only infrequently and after longish intervals. The fact that the policy of price stability was being simultaneously put into force by the strongest economic units in the world

and by many if not all of the remaining nations would get rid at once of all the vexing doubts and difficulties which were found in the last chapter to confront the Central Bank in trying to combine a constant price level with active dealings in external currencies. So far from the task of the Central Bank being made more onerous by its having to provide for external contacts, it would actually be simpler than in a closed system. It would have the active assistance of other Central Banks, and would be furnished with important statistical information from outside and would be able to read more clearly the meaning of internal happenings by measuring movements in the exchanges against movements in the index numbers of other countries. The international monetary system here suggested can therefore claim that it provides for both stability of exchange and stability of prices. It does this without any such surrender of sovereignty as is involved in an international gold standard or in any other form of international monetary standard. It is truly international in its comprehensiveness. It provides the maximum possible facilities for international commerce and finance, and it does this, not by ignoring nationalism, but by using it as the corner-stone.

There are innumerable details of the edifice which require to be filled in. Only a few of them can be mentioned here. Others will be referred to at a later stage. Many must be omitted from this book in the interests of brevity. There would be no reason for closing down the Bank for International Settlements. Its place in the new order would have

to be thought out afresh, but it is potentially of extreme value as a focus for discussion and practical co-operation between the Central Banks. There would still be room for gold to play an important *rôle* in the new international monetary system. Gold is not needed as cover for the various local currencies. If there were any risk of its still being regarded as the standard or if a large holding of gold were looked on as in some way a sign of national financial strength, it would impede the smooth functioning of the machinery for maintaining a constant price level, and perpetuate that competition for gold which is an obstacle to easy and frank dealings between Central Banks. If, however, gold is dethroned as an international measure of value, it might usefully be employed as a convenient medium for making international payments, when, for example, there is a temporary or seasonal balance of payments due by one country to another, and it is for the moment not convenient to meet this by temporary borrowing or by any of the more normal methods of payment. The various Central Banks might well make a practice of holding both gold and external values in moderate amounts for the purpose of correcting temporary fluctuations in the demand and supply of each other's local currencies. Possibly the Bank for International Settlements might be employed to hold both gold and external currencies on behalf of the Central Banks.

Attractive as this programme is—it would in any case attract universal interest—it is too novel and startling to encourage any hopes that it could win universal assent at the forthcoming International

Conference. It would be said—and with justice—that the policy of price stabilisation is an untried experiment. Or it would be argued—with less justice—that the Federal Reserve Board of the United States of America tried for some years up to 1928 or 1929 to keep dollar prices stable, and that this policy contributed in large measure to the development of the wild Stock Exchange boom in New York and the crash in which it ended in the autumn of 1929. It is only partially true that the American financial authorities under the leadership of the late Benjamin Strong adopted as a considered policy the stabilisation of dollar prices. This policy was pursued for a time, though not as a permanent objective, and it was pursued with considerable success. At the period when it was being followed, there was great instability in prices and currencies in many parts of the world, and the American money markets were not organised for the purpose. A large proportion of the banks in the United States are outside the Federal Reserve System. Finally it was adopted only as an objective subsidiary to the maintenance of the international gold standard. At most the American experiment offers some useful lessons for future guidance when price stabilisation is being put into practical operation. It cannot be reasonably regarded as an argument against the general adoption of that policy.

The fiercest and most intractable opposition to the suggested British programme will arise out of that gold mentality previously referred to, which has a firm hold on the minds of so many of the leading financial authorities. There is a rational basis for

this unwavering affection for a gold standard. Gold is something more than a fetish. It is not merely that the habits of several millennia make it impossible for a large part of the population in many lands to escape from their instinctive conviction that the precious metals and in a special degree gold are the only real values, and that paper money in any form is nothing more than a warehouse receipt for gold stored away in some safe place and is valuable only because it is convertible into gold on demand. This state of mind among the general public has to be reckoned with in any currency plan, but there is ample experience, for example, the readiness with which paper money is accepted and even preferred for its convenience as a medium of circulation in India, to justify the generalisation that a well-managed inconvertible paper currency can be made to meet fully all ordinary currency requirements. The demand for sound money, like the parrot cry of sound finance with which new suggestions in the field of money are invariably assailed, often justifies the retort—*vox et præterea nihil*—sound and nothing more. Yet there is at any rate one sound argument for clinging to gold. If it is to dispense with gold in its currency, a nation must have orderly government and a Central Bank in whose integrity and capacity it has full confidence. There is a genuine fear, an almost physical terror, based, moreover, on bitter recent experience, in many parts of Central Europe, that neither Governments nor Central Banks can be trusted to manage a currency unless they are tied down to a gold standard by rigid regulations and their function in management limited to keeping the

currency on a parity with gold. This fear is reflected in the horror with which many Central Bank authorities receive the suggestion that they should be saddled with the duty, and become a target for attack in their efforts to shoulder the responsibility, of managing the currency with reference to any other objective. If a nation cannot trust its Government and its Central Bank, it is probably right in clinging to gold. Apart from this, account has also to be taken of the ineradicable belief specially prevalent in France that a large holding of gold is essential for purposes of national defence. It is useless to try and meet arguments founded on the gold mentality by counter-arguments, to demonstrate that in any currency system large powers have to be delegated to the currency authorities, that every existing currency becomes in fact inconvertible as soon as the right to convert is widely exercised, and is certain to be declared inconvertible as soon as an emergency arises, or that a nation which habitually keeps a large amount of gold as cover for its note issue is generally least able to use that gold during a war because of its fear of impairing internal confidence in its currency. The only argument which is certain in due course to carry conviction is the successful adoption of the new policy by other countries.

If it be accepted as practically certain that the proposed British programme will not be generally adopted, and further that France and the United States of America will adhere to the gold standard and will press Great Britain to accept as an ultimate objective the restoration of the international gold

standard, what line of action is then open to Great Britain? Having failed to carry her plan for a new world-wide international monetary system, has she any other choice than to come to the best arrangements she can with France and the United States and the rest for (a) immediate action to raise prices, and (b) ultimate return to the international gold standard? It should be observed that acceptance of her programme for a new international monetary system would remove all obstacles to immediate international action to raise prices. The statement of the British Government at Ottawa that "a rise in prices cannot be effected by monetary action alone" is not literally true. It is easy enough to raise prices by monetary action. The moot point is how far it is desirable. In any case, a general agreement so far-reaching in scope as the adoption of the suggested British programme would clear the way at once for the necessary action both in the monetary and in other spheres to enable prices to be raised throughout the world to a figure at which economic equilibrium would be restored.

Though world-wide adoption of the policy of price stability is eminently desirable as soon as it can possibly be secured, the British Government can still take the lead in inviting as many nations as are ready to do so to join in with Britain and concert measures for the practical application of that policy within their own areas. The course of the monetary discussions at Ottawa gives clear evidence that such an initiative by the British Government would be welcomed with acclamation by nearly the whole of the British Empire. The Union of South Africa

would remain wedded to gold, though it is difficult to believe that she can continue indefinitely in a course which wrenches her economic life away from its historical associations and its source of supply of capital, and creates a currency division within British South Africa itself. Canada might well hesitate, but the implications of the Ottawa Conference in the matter of tariff preferences and trade agreements and of the recent revival of British lending to Canada suggest that she would follow the British lead. There appear moreover to be fewer traditional prejudices and a more objective attitude towards currency questions in Canada than in most other countries, which would incline Canadian thought to sympathetic appreciation of the inwardness of the British programme. The rest of the Empire could be counted on to join enthusiastically in an agreement to adopt the new policy and collaborate in its practical application. Adherents would not be lacking outside the British Empire. Not only would Egypt and Iraq wish to remain linked to British sterling, but the Scandinavian countries would be among the foremost to range themselves alongside Great Britain. They would feel that at last they had been vouchsafed the strong lead for which they had been anxiously and at times despondently waiting. Other countries whose currencies are within the orbit of sterling would at least take a keen interest in the British programme and do their best to become associated with it. London's highly organised facilities for international financing would be a strong inducement.

The grouping of the Governments represented at

the Conference would thus correspond fairly closely to the grouping of existing currencies as analysed in the last chapter. It is probable however that Germany and some of the other countries which are at present only nominally on a gold standard would be more than sympathetic to the British point of view. Whether they would feel able to declare their adherence to the programme there and then would depend on the course of events in other directions. There is a strong body of opinion in Germany, and not least among the Nazis, which would see in the new programme the opportunity for which it has been looking to escape from the tyranny of the gold standard. Countries belonging to the third group are at least as likely to be attracted to the British standpoint as to the gold standard. Many of them are dependent on the world prices of a very few primary products. They have never successfully maintained their currencies on the gold standard for long periods at a time, and would feel that they would at any rate have a better prospect of keeping some sort of relation with stabilised sterling. Such countries can however only hope to approach real stability either of prices or of exchange as their internal economy becomes more balanced. Much would depend on the force with which the British proposals were presented. Both the British Government itself before it takes the initiative suggested, and the other Governments before they can follow it, must be convinced that a stable level of internal prices can be successfully maintained by a group of countries which does not include the United States of America and other financial and commercial

powers. They must also have a clear understanding as to the nature of the relations to be established between the members associated together in the group and between them and the countries on the gold standard or with local currencies which are entirely independent.

It is not necessary that the local currencies of members of the associated group should be definitely linked to each other or to any common standard at a fixed rate of exchange. On the contrary the one and only final objective of each of them is the maintenance of their internal prices at par. Historical causes and the logic of existing facts would naturally give British sterling a special position. The portions of the world within which sterling is the main international currency have of late come to be spoken of as the sterling area, or the sterling Empire, or even "Sterlingaria." The phrase is a convenient one, but it is important to emphasise the fact that it does not mean that there would be any surrender of sovereignty in the financial sphere to Great Britain. Some members would probably find that the best way of making their local currency a stable measure of value would be to keep it linked to sterling at a fixed ratio for long periods and not to contemplate any change in that ratio once established unless and until the pace and direction of their own economic development as compared with that of Great Britain made it clear that an adjustment up or down was required. The difficulties of maintaining parity between their local currencies and British sterling would be less than those of maintaining parity with gold under the old system. With British internal

prices stabilised, exchange fluctuations would be less troublesome. In view of the greater experience of London in management of currency and exchange and of the presence there of a market more highly organised and offering greater facilities of all kinds than might be possible locally, stabilisation of their local currencies in terms of sterling might well make a special appeal to a number of the associated countries. The fact that British internal prices were constant would in itself make for a very near approach to stability in their own internal price level.

The simplest form in which to conceive of Sterlingaria is thus of a group of countries, all of whose currencies are linked to sterling at a fixed ratio, just as under the old system they were linked to gold. Each would have its own local currency. A single currency whether for the Empire or for Sterlingaria is both needless and undesirable, nor is a single Central Bank in any way requisite. If it happened that the Scandinavian countries chose to fix the rate of exchange with sterling so that 1 krone = 1s., or Canada made \$1 exactly equivalent to 4s., this would be an extra convenience but no more. Whether many or most of the countries decided to establish a fixed rate of exchange or preferred to have one which varied slightly would be a matter of expediency, not of principle. In any case, rates of exchange between the currencies of the associated group would tend to remain stable and changes would be small and infrequent.

There would be no surrender of sovereignty. All the members of the group would have a sense of

partnership in a common undertaking and would agree to work together in concert for the achievement of the objective of internal price stability. The fact that important countries were outside their group would give the associated countries a common interest in the smooth regulation of the exchanges between their own local currencies and the currencies of the rest of the world, and in particular gold, if France and the United States of America remained on the gold standard. Their Central Banks would naturally keep in close touch with each other and in course of time arrangements would grow up naturally for mutual credits to tide over temporary movements in the balance of payments within the group. These might well be extended to include some pooling of assets such as gold and holdings of the currencies of the leading gold standard countries in order to minimise fluctuations in the rates of exchange between gold and the currencies of the group as a whole.

There is no reason to look for any sort of hostility in the relations between this associated group and the gold standard group. The two groups have adopted different objectives as the goal of currency policy, the one giving priority to stability of the internal price level and the other to the stability of the external exchanges. The members of each group have equally strong reasons for desiring friendly commercial and financial relations with each other and the promotion of active world trade. The members of the gold standard group do not wish for instability of their internal prices. The members of the associated group desire to avoid big

fluctuations in exchange. Gold itself might well be used to provide a convenient bridge between the two groups. While the Central Banks in the associated group would not hold gold for the purpose of making their notes convertible, each of them might well decide to fix from time to time buying and selling prices at which they would agree to receive gold from or pay gold to other Central Banks, subject to stated maximum amounts and with a fairly wide margin between buying and selling prices, undertaking further that, subject to such maximum not being exceeded, these prices would remain unchanged for a specified minimum period. By this means short-period fluctuations in the exchanges with gold standard countries would be altogether eliminated, while longer period variations would be gradual and moderate.

Given these conditions, which are not in any way fanciful, the task imposed on the Central Banks of the associated group of maintaining a constant internal price level would not be seriously complicated by the existence of active financial and commercial dealings with countries on the gold standard which had not adopted the policy of price stability. Further consideration will be given in the next chapter to questions such as international lending and borrowing with particular reference to transactions between the two groups and to other matters affecting their business relations. It may be said here, in anticipation, that while the existence of two such well-defined groups will naturally lead to considerable modifications in the direction of trade and in financial practice, the new order would hold

out reasonable prospects of the growth and development of international interchanges not less in volume and value than the world had accustomed itself to expect in the period up to 1929, and far exceeding anything that can possibly be secured by hankering after an unrealisable international gold standard. In these circumstances Great Britain will be fully justified in putting forward her monetary programme for adoption by such countries as are willing to follow her lead. She is certain to be joined by enough countries to render the financial and economic strength of the group amply sufficient to ensure attainment of her objective of a stable measure of value. She is able further to claim with confidence that her programme is well designed to promote world-wide activity in international trade and finance. In this assurance, even though disappointed of the hope of persuading the Conference as a whole to adopt the policy she favours, Great Britain need not hesitate to invite the co-operation of the many countries within the British Empire or outside it which are ready to join her in concerting measures for the practical application of her programme.

What of the transition period and the first item in Britain's policy at the Conference, immediate steps to raise the level of the world's prices? The first preoccupation of the Associated countries would be to take common action in agreement with each other for raising their internal price levels and bringing about that equilibrium between costs and prices which is the necessary starting point for the maintenance of a constant price level. The group

would be strong enough to adopt bold measures for achieving this end, and by so acting it would at once increase the volume and activity as well as the profitability of trade within its area. Nor would it have great reason to fear the effects upon its relations with the gold standard countries. One curious but convenient result of the coming together of a group of countries on a local currency standard not based on gold would be the release of a considerable quantity of gold, and even more important, the withdrawal of a number of the competitors for newly mined gold, leaving the field clear for those countries which remain attached to the gold standard. The effect of this addition to the supply of monetary gold, and even the prospect of its becoming available, would quickly make itself felt in raising gold prices, that is to say, prices in the gold standard countries. Such a rise would be very far from unpleasing to the authorities in those countries, who would therefore have no incentive to take steps to sterilise gold or prevent it from bringing about its natural consequences so long as the rise in prices did not carry them far above the levels of three or four years ago. It is interesting to observe that at Ottawa the British Government definitely stated that the best condition for a rise in sterling prices would be a rise in gold prices. The fear that a monetary policy directed to raising sterling prices might have among its consequences a large further fall of British sterling in terms of American dollars and other gold currencies has no doubt been one of the motives deterring the British Government from positive action to raise the price level. There would clearly be less objection

to such action if it were taken in concert with an associated group of countries which were acting in a similar way to raise their own prices along with sterling. The suggested programme therefore not only removes some of the difficulties in the way of monetary action to raise sterling prices, but also contributes materially towards a rise in gold prices.

This book is concerned with the planning of a monetary policy for the longer future rather than to discuss ways of escape from the immediate financial crisis. It would therefore be outside its scope to examine in further detail that part of the agenda at the World Conference which is concerned with removal of existing obstacles, particularly such as are not strictly monetary, which stand in the way of a recovery in prices. Some considerations affecting the period of transition which have a bearing on the longer future, when the suggested British programme is in operation, can be most conveniently discussed among subjects to be dealt with in the next chapter.

CHAPTER XI

INTERNATIONAL LENDING

“ I thank my fortune for it,
My ventures are not in one bottom trusted
Nor to one place.”

SHAKESPEARE. *Merchant of Venice*,
Act I., Scene 1.

ONE of the most remarkable features of world finance in the nineteenth century was the immense development of international lending and borrowing. Kings and rulers had frequent recourse in earlier centuries to international financiers, such as the Hanseatic League, the Lombards, and later the Dutch merchant-bankers. Private citizens in Great Britain were often interested in large organised external trading ventures, and in the Colonial plantations and in the stock of the East India Company they found themselves participating in businesses involving the placing of considerable capital abroad. It was, however, not till after the close of the Napoleonic Wars that international lending and borrowing began to fill an important place in the world's financial and economic life. Amsterdam and Paris, and later the financial centres of Germany were active markets for the placing of capital abroad, but up to 1914, London had no

rivals. Great Britain was the unchallenged leader in this class of business and lent more outside her own borders than all the other countries taken together. The placement of long-term capital abroad took two main forms, loans to foreign or external Governments and municipalities and investments of all kinds in local economic activities in foreign or external countries. It is necessary to use the word "external" as well as or in place of "foreign" in order to include the overseas possessions of the lending nations. Side by side with the development of long-term loans there grew up an intricate system of short-term credits, under which London became the world's banker, having very large sums lent out for periods not usually exceeding three months for the financing of the movement of goods all over the world—not merely between Great Britain and other countries—or in anticipation of the issue of long-term loans, and on the other side of the account holding very large deposits at call or short term left with her by external banks or customers.

In theory, at any rate so far as London was concerned, there was complete *laissez-faire* in external lending. Capital sought whatever fields seemed to offer it the best return with reasonable safety. In the earlier years British investors did much to equip the Western and Northern nations of Europe with plant and machinery to enable them to become industrialised along lines similar to those which Britain had followed one or two generations earlier. For example, the initial development of the Ruhr coalfields was largely undertaken by British capital

assisted by British mining engineers and miners. In due course German industry and capital grew strong enough to meet Germany's internal needs and the foreign investors were bought out. Meanwhile British capital sought other spheres of activity and found them chiefly in the less developed regions of the world, where reciprocal trading relations could most easily be fostered. In the United States of America, in South America, and in what are now the British Dominions, British capital helped large new populations to grow up in enjoyment of transport facilities and other amenities of Western civilisation.

The money provided by the British investor went abroad in the form of British manufactures, for which the expanding populations provided continually expanding markets, and the borrowers met the charges for what they had borrowed by sending to Britain the raw materials and foodstuffs required by British industry and British workmen. Even if a large part of the sums paid by way of interest and principal on previous loans was re-lent to the same or to new borrowers for new capital development, the relations between Britain and her investment markets abroad were truly reciprocal. The advantages were mutual. Finance worked hand in hand with commerce and industry. Trade relations between borrower and lender were complementary. It was British industrial activity that furnished the savings which became new capital available to be lent abroad. Finance directed it into channels which opened up new outlets for the products of industry. The new economic activities of the growing populations of

the borrowing countries furnished Britain with primary products for consumption by its workmen and by its factories. The process was essentially the same in countries such as India and China. Large as their populations were at the beginning of the era, British capital helped to remove the previous barriers to their increase, and gave their peoples opportunities of satisfying wants hitherto beyond their reach. To these countries also British capital went out in the shape of the products of British factories, and the charges were met by return cargoes mainly of foodstuffs and raw materials. The interchanges were, of course, very often triangular or multi-angular, that is to say, the borrowers sent goods not direct to Great Britain but to some other market, and gave London a claim on other goods from that market in discharge of their own obligations. For example, India sent jute to the United States of America, thereby enabling Britain to pay for cotton in the U.S.A. This kind of triangular interchange greatly enlarges the area of complementary trade.

It was in this way that the immense development of international interchanges of goods and services which has made all the nations of the world economically interdependent was realised in the hundred years after Waterloo. External investment by other countries, in spite of some important differences in national habits, followed essentially the same course. Right up to 1914 the United States of America was still the largest field for new European capital, but, as her own industrial and financial power grew, the relative shares of other borrowing countries rapidly increased. All through

the period British finance and industry worked together to seek those areas for expansion where complementary trading opportunities were most auspicious. It was only because during the nineteenth century new openings continually appeared for new development and because finance and industry worked together in singling out the countries where such openings presented themselves that the vast growth of external investment was rendered possible. While therefore complete *laissez-faire* in external investment was the accepted theory, there was, in fact, a very real, if unconscious, plan of operations. Whether it was deliberate or not in its motives, the financial policy of the authorities controlling sterling in London in relation to the gold standard found itself continually drawn by the logic of the situation to further this plan by facilitating especially those movements of capital which made for reciprocal trade and frowning upon proposals for external investment which might lead to heavy demands for export of gold rather than of goods and services.

It is often convenient to speak of this or that country as a creditor country and of others as debtor countries. It is true that in countries such as India and Australia a considerable portion of the money borrowed has been borrowed by the Governments for the purpose of public works, and that in this sense some countries can be correctly described as debtors. It is important, however, to remember that, apart from those Inter-Governmental Debts, which are a product of the Great War, the lenders are individual citizens and not the Government or

the community in any corporate capacity. In this sense there are no creditor countries. If this distinction is ignored, false analogies are apt to pave the way for wrong and sometimes dangerous conclusions. Loose thinking along these lines bears a not inconsiderable part of the responsibility for the unhappy story of Reparation and Inter-Governmental War Debts. Indeed, the whole history of external lending and borrowing since the war is one long series of mistakes based on misreading of the lessons to be learnt from the world's experience of international investment in the nineteenth century. The scale has been enlarged out of all proportion. This alone has been enough to break down the whole system. It has been forgotten that the system grew up in a period of rapid material expansion all over the world and that the conditions which made it possible were peculiar and ephemeral. Account has not been taken of the need for mutual partnership between finance and industry in the export of capital, and there has been a total failure to recognise the cardinal importance of the contribution made by what has been called Britain's unconscious plan of fostering those financial relations which made for complementary trade.

On the subject of the repayment of capital invested abroad there has been equal misconception. When an individual investor in this country subscribes for a new loan placed in the London market by an external Government, for instance by the Australian Commonwealth, he rightly calculates that he can recover his capital either by selling his stock in the London market or by having it paid

off by the borrowing Government at the maturity date announced in the prospectus. The London issuing house makes it its business to see that the borrower enters into a suitable contract to make proper provision for redemption at the due date, and the borrowing Government presumably satisfies itself, before it decides to issue the loan, that the public works, for example an irrigation project, on which the money is to be spent will, when completed, earn sufficient to pay both interest and amortisation charges on the loan. All the parties to the loan contract assume as a matter of course that the loan will be paid off at the due date, the interest having been paid regularly during its currency. This assumption may be absolutely justified both in prospect and in fulfilment. Yet it is more than probable that there is a tacit assumption underlying the whole transaction that, in order to take advantage of the opportunities offered by the irrigation scheme, additional capital will have to be borrowed for ancillary purposes, the housing of new settlers, the provision of transport, communications, sanitary services and the like for the new population. What in fact occurs is that the capital provided by British investors becomes part of the fixed capital of Australia, and can never be finally withdrawn or can be ultimately withdrawn only after some very long interval, a century or more, when the internal industrial and financial resources have grown to dimensions scarcely conceivable at the time when the original loan was contracted. Exactly the same considerations apply to money subscribed to a new debenture issue by an Indian Railway, and with an

issue of shares by an Argentine railway company owned in Great Britain having its head office in London the fact that repayment is not expected becomes explicit.

By far the greater part of British external investment is of the character, not of capital temporarily exported and capable of being re-imported within any period that can be foreseen, but of a participation by the British investing public in the economic activities of the country in which the capital is employed. The individual investor can recover the cash with which he has parted either by selling his security on the London Stock Exchange or by actual repayment out of funds remitted home by the borrower, but in the latter event the sums remitted will in ninety-nine cases out of a hundred be made good by fresh loans raised in London. There are, of course, numerous individual instances where the borrowing country does actually repay in due course. The money provided for the development of the Ruhr coalfields is a case in point. The German investor in that case provided the capital needed to buy out the British investor. The exceptional circumstances of the war and the vast growth of American financial resources enabled the British Government to finance some of its war outlay in the U.S.A. by mobilising and re-selling to American investors securities previously subscribed for or purchased by British citizens. Since the war the American investor has in some cases provided funds to buy out British-held companies in South America, thus taking the place of the British investor as creditor of the South American borrower.

It remains true, however, as a broad generalisation that only a very small part of the capital which Britain exports or has exported in the past is recoverable in the form of actual repayment. The British investor remains the owner of the external security, but the repatriation of the capital unless it is replaced by new money subscribed by a new set of British investors is outside the bounds of practicability. The individual investor gets his return in the shape of income exactly as if he held some internal security, but in so far as they are not met out of the proceeds of new lending, both interest and principal can be paid and received only in the shape of goods and services furnished by people in the borrowing country. So far from conditions admitting of actual repayment of principal, it may very well happen and often does happen that it does not suit the lending country to receive even the whole of the interest in the form of imports. This is specially likely to happen if the trade of the borrowing country is competitive with that of the lender rather than complementary. In these circumstances the payment by countries such as Germany of either principal or interest on large debts, whether due to the Government or to private individuals, is possible only if this country is willing to see competitive German goods take the place of British goods in the British market and in other markets throughout the world or alternatively to go on relending both principal and interest to Germany indefinitely without ever taking effective payment in any form.

Laissez-faire in international lending will clearly

not work either in theory or in practice in this twentieth-century world. Once this point is clearly grasped, it becomes impossible to maintain that an international monetary standard is essential because its absence renders impossible the free operation of that system of world-wide international lending upon which the development of international trade depends. Quite apart from its objective of price stability, Planned Money is urgently needed to re-introduce reason and order into the system of international lending. It is no longer sufficient for Great Britain to have a plan of action in this field which is not fully conscious and deliberate. The purpose of external investment is to foster international exchanges of goods and services. This purpose will not be effectively served unless the flow of capital abroad is carefully directed into channels where it will be fruitfully employed. A British loan to Austria at the present time, for example, except in so far as it is a mere refunding operation, though possibly justifiable as an expedient for averting immediate collapse, would do little or nothing to increase the volume of world production and trade, and the payment of interest and principal by Austria cannot be naturally met out of the proceeds of trade which would be complementary to that of this country. On the other hand, a loan of equal amount for the purpose of an irrigation project in India or for the development of a new area for settlement in Rhodesia or Argentina would, if the project was well conceived, bring about both an increase in the world's material resources and an increased demand for British products. In the one

case Austria would be given purchasing power in Britain which she could exercise only with difficulty unless she took payment in barren gold. In the other the borrower would use the purchasing power placed at her disposal to buy goods for export, thus increasing the volume of British production, and would have every prospect of meeting the charges on the loan by sending to this country foodstuffs and raw materials required here.

An international monetary system based on a number of local currencies so managed as to maintain a constant level of internal prices would necessarily involve modifications in international lending. Even more considerable modifications would be required in a world in which there were two main groups of countries, one with stabilised local currency standards and the other on the gold standard. When two countries are both on the gold standard, borrowers in one country who raise a loan in the market of the other know that, so long as the gold standard is maintained, the sum borrowed, though expressed in terms of the currency of the lender, will throughout the term of the loan represent a constant amount in terms of their own currency. It may, however, vary widely in terms of purchasing power in both countries. This is, of course, the present position, or rather it was the general position in the world till the gold standard broke down. International lending and borrowing as between countries which belong to the gold standard group under the new conditions will therefore undergo no changes. As between two countries in the stabilised currency group, the borrower in one country, if he

borrowers in terms of the currency of the lender, will know that the commodity value of the money borrowed will remain constant in the lending country throughout the term of the loan, but that the purchasing power in terms of his own currency of the amount required to pay principal and interest will be subject to some possible variation, though very small and gradual, in that the rate of exchange between the two countries is not absolutely fixed. On balance he is able to calculate much more clearly the extent of the commitment into which he is entering and to make plans ahead with more confidence than the borrower in the gold standard group. There remains the case where the loan transaction is between a borrower or lender in a stabilised currency country and a lender or borrower in a gold standard country. In this case, if the loan is in terms of the stabilised currency, its commodity value in terms of that currency is constant, but payments on account of interest and principal will vary in terms of the currency on the gold standard as exchange fluctuates. If the loan is in terms of the gold standard currency, its gold value will remain constant, but its commodity value will be subject to change in terms of both currencies, and so will the charges for interest and principal in terms of the stabilised currency.

Evidently the existence of the two groups with different goals of currency policy will tend to facilitate and therefore to foster active trade and financial interchanges within each group, rather than between a member of one group and a member of the other. This will be particularly marked in

regard to long-term lending and borrowing. If short-term fluctuations of exchange are minimised in the manner already outlined, transactions which are settled by cash payments or with the help of short-term credit only will be scarcely at all disturbed and can still be carried out smoothly and without special risk to either party, in spite of their belonging to different groups. Long-term investment in each other's currencies, whatever form it takes, will involve a certain degree of speculation. Long-term investment is a very important factor in strengthening and extending business relations between two countries or a group of countries. It follows unavoidably that the proposed monetary system, so long as it is not world-wide, will tend to increase international exchanges of goods and services within each group, but to put some check on such interchanges between members of one group and those of the other, in so far as these are bound up with long-term investment.

How will British interests be affected by this situation? and is it likely to lead to an increase or a diminution of world trade? As compared with the theoretical possibilities under a stable world-wide international monetary standard, the volume of world interchanges would clearly be less, but such a standard is not workable in a world of independent national units. World-wide acceptance of the stabilised local currency standard would certainly be conducive to greater international trade activity than the emergence of two separate groups one on that standard and one on the gold standard; but such agreement is not attainable at the moment.

The questions asked above must be examined in the light of existing possibilities. Now it is obvious that the proposed British monetary programme proceeds on lines which accord closely with the Ottawa policy of an Empire Economic Family, and would be a powerful instrument for drawing closer the business and commercial relations of the countries of the British Empire. Apart from the Union of South Africa, Sterlingaria includes the whole of the British Empire. Most of the other potential members of the group such as Denmark and Argentina are in it just because they are countries whose trade is complementary with that of Great Britain. The group will, in fact, include practically all the countries of the world in which there are really promising outlets for British long-term investment. The existence of the group will thus facilitate the task of directing the flow of British capital into the channels where it is likely to be most productive and into which it ought to be consciously directed. Large new exports of capital from this country will be advantageous neither to borrower nor to lender if they are not dovetailed in with the interests of the British industrialist and producer, and the money might much more profitably be retained at home. So far, then, as trade and finance within the associated group are concerned, the suggested British Monetary programme is fully in consonance with British interests and is calculated to bring about a marked increase of external trade between the members of the group.

Trading and financial relations between Britain and gold standard countries such as France and the United States of America will tend to be less close

than they were when all three countries were on the gold standard. With the gold standard working as unsatisfactorily as it did in the years preceding 1931, it will be a gain and not a loss to Britain to have her hands free and her powers of independent action unhampered by being directly tied up with the fortunes of the American dollar and the French franc, and by having her prices largely at the mercy of gold prices. There will thus be both gain and loss. If the alternative to the proposed British monetary programme is adherence to a gold standard which is not safeguarded against a recurrence of the conditions which led to its breakdown and does not offer any reasonable prospect of the stabilisation of world gold prices, the gain will far outweigh the loss. The extent of the loss will depend on the magnitude and frequency of exchange fluctuations between sterling and gold standard currencies. Though it may be hoped that these will be minimised, it is safer to assume that they will be substantial enough to make movements of long-term capital between New York and Paris on the one hand, and London on the other, sufficiently venturesome to prevent their taking place freely in really large volume.

In spite of the immense industrial development of the United States of America, there is still a large element of reciprocity in her trade with Britain. The divergence between the currency aims of the two countries will not prevent active trade and financial interchanges, but it will tend to limit their range. Conditions will, at any rate, be more favourable for commercial and financial dealings than they are now with sterling neither linked to gold nor managed

on the basis of price stability. Good sense on both sides will be able to do much to maintain active intercourse, which will be in everyone's interest. There is, after all, no motive hostile to Great Britain in America's decision to remain on the gold standard, and no motive hostile to the United States of America in Great Britain's decision in favour of a stable measure of value. And it will be to the interest of the United States of America to keep her own internal prices as stable as possible on a gold standard. She will be much helped in doing so by the stability of sterling prices. In markets other than those of gold standard countries, the stability of Britain's internal prices will give her a distinct advantage over the United States, not only in countries which are associated with Britain in the policy of keeping their own internal prices at parity, but also in the markets of countries belonging to the third group whose local currencies are linked neither to gold nor to sterling, but are entirely independent.

The experience of the last twelve months shows that British sterling can still retain its position as the leading international currency in spite of its divorce from gold. A well organised forward market in foreign exchange would solve many problems. London will remain the banker of a great part of the world under the new dispensation. She will be established more firmly than ever as the financial centre of Sterlingaria and as the intermediary between the associated countries and New York, a position which, while profitable, carries heavy responsibilities also. Very carefully devised arrangements will be required to give the Central Banks of

the associated group, and particularly the Bank of England, powers to influence the flow of short-term funds as well as long-term capital from or through London to New York. In place of laissez-faire in the export of capital, there will have to be conscious management and direction. So far as this country is concerned this will involve not so much the invention of new machinery as the elaboration of a technique already well understood though not always explicitly acknowledged.

This kind of control may be of very special importance during the period of transition, especially if definite steps are being taken to raise the level of prices here faster than in gold standard countries. In that event it would be impossible to permit British capital to take part in a vigorous and unrestricted speculation in American dollar and other gold securities in anticipation of a fall in the exchange value of British sterling in terms of gold, even though this tendency were counteracted, as it would be, by the prospect of business becoming more profitable and security prices rising in this country. At the same time it must always be remembered that, under the proposed currency system, British sterling is an inconvertible local currency giving the holder purchasing power in this country, and in this country alone. This fact sets comparatively narrow limits to the power of holders of British sterling to obtain external currencies in the absence of willing sellers of such currencies, and thereby simplifies the task of the authorities in directing the flow of capital abroad whether for long-term investment or for short-term use.

CHAPTER XII

A FINANCIAL SOCIETY OF NATIONS

“let this world no longer be a stage
To feed contention in a lingering act.”

SHAKESPEARE, *King Henry IV.*,
Part II., Act I., Scene 1.

“There is a tide in the affairs of men
Which, taken at the flood, leads on to fortune.”

SHAKESPEARE, *Julius Cæsar*,
Act IV., Scene 3.

THROUGHOUT the Dark Ages the ideal or pretence of the Unity of Christendom was preserved in more than a few curious survivals from the days of Constantine the Great. One of the most interesting of these living records of the long past, which is seldom mentioned by historians, was the continued circulation throughout the Holy Roman Empire of the besant, the gold coin of the Eastern Empire, taking its name from Byzantium, and the abstention of Kings and Emperors in the West from arrogating to themselves the right to coin gold. It was not until the Fourth Crusade in 1205 turned aside to capture and sack Constantinople and to crown a Latin Emperor in Santa Sophia, that the old order

was felt to have passed away and the monopoly finally infringed. In England, Henry III. was the first King to exercise the sovereign prerogative of minting gold money. Up to that time the besant proclaimed to the world that Christian Europe had one single universal currency. Only the infidel Muslim world challenged that unity by minting and circulating a rival gold piece, as a symbol of its defiance. Naturally the actual facts were very different and the theoretical unity was of little practical importance in a world of isolated local currencies.

The logical completion of the theory of the International Gold Standard would be the universal use in all countries adhering to that standard of a single gold coin, minted for the gold standard world by some central authority, into whose hands all the nations would have duly resigned the monopoly of coining gold. It is an attractive ideal, and its realisation has been the subject of active international study and discussion on more than one occasion. The last attempt to arrive at an agreement broke down over the insistence of the Emperor Napoleon III. on his claim that the international currency should bear his effigy. In a gold standard world the minting of national gold coins is both wasteful and misleading. It obscures the central aim of an international monetary standard to give the world a single standard of value. The fact that the nations have continued to mint their own local gold coins, each with a different weight and different fineness, whereby needless complexities are imported into the calculations of parities and rates of exchange,

is eloquent of the unbridged gap between theory and practice, which must remain unbridgeable so long as the world continues to be organised as a series of national and independent economic units.

There are some who feel that, however unsatisfactory its recent history, the international gold standard is, at any rate, an institution which transcends narrow national bounds, and not only keeps the ideal of harmonious collaboration between the nations prominently before their eyes, but also provides daily opportunities based on motives of material advantage for international practice in the mutual adjustment of national view points. The thought of building an international monetary system frankly on the foundation of economic and financial nationalism is startling. It arouses fears that sectional interests will predominate and that the evils arising from the world's refusal adequately to recognise and provide for its obvious economic interdependence will be accentuated. The further proposal that, in the absence of world-wide agreement, action might be taken which would bring into existence two main groups, pursuing different currency policies, suggests an alarming picture of a world divided into two hostile camps waging economic war upon each other and all too likely to be politically at variance.

If experience showed that the attempt to cling to an international gold standard was truly calculated to promote friendly international intercourse and to expand the volume of world trade, there would still remain the strong objection that it holds out no

hope within any foreseeable future of providing humanity with a stable measure of value. Experience, however, suggests a different conclusion, that not only is it impracticable, in the absence of a single predominating financial centre, such as London before the War, to make the international gold standard a workable instrument for facilitating world trade, but that, in sacrificing stability of internal prices to stability of the external exchanges and in ignoring the economic and financial independence of the units of which the world is made up, the attempt to treat it as a financial unit capable of using to advantage a single monetary standard has been the direct cause of economic friction between the nations. "This high man, aiming at a million, misses an unit." For the gold standard yokes together in an uncomfortable partnership individual economic units of which the pace and direction of development are dissimilar and divergent. Just because they feel themselves hampered by the financial tie, the nations are driven, in defence of their right to decide the course of their own national life, to adopt economic expedients, such as high protective tariffs, prohibitions, currency and exchange restrictions, transfer moratoria, and such like, which play havoc with all forms of international intercourse. With their prices tied to the chariot wheels of gold, stability in their internal trading and productive activities is beyond their reach, and the absence of assured stability at home makes them set up barriers against the external world and minimises the extent of the contribution they can make to world interchanges.

The League of Nations, as its name implies, and as is brought out even more clearly in the French form, the Society of Nations, is built on the foundation of the independent political status of all its members, harmoniously associated for the promotion of the peace and well-being of the whole. Its best work is done when it is most fully conscious both of their independence and of their interdependence, alike in their political, their economic and their financial life. That "sloppy internationalism" of which Mr. Baldwin has recently spoken can never promote the cause for which the Society of Nations stands. If Industry and Commerce in this country have found reason to complain that finance is acting as the master and not as the servant, and if a sinister meaning sometimes attaches to the words "international finance," the explanation must be sought in the fact that the theory of the international gold standard, while not providing a stable measure of value which alone would make it tolerable, regards the world as a financial unit and ignores the financial independence of its constituent nations. It leads logically on to the creation of a single world financial authority, a Super-Central Bank of the World, which would dictate the financial policy of every one of the national units, and is not easily conceivable except as the instrument of a Super-State. And when it had finally come into existence such a Super-Central Bank of the World, if it was to give the world a stable measure of value, would have either to abolish gold as the standard of value, or to manage the world currency and regulate the value of gold with reference to an Index

Number of Prices exactly as if gold were not the standard.

The international monetary system which is suggested in this book is founded on the same basis as is the League of Nations, the independent financial status of each of its members. Its aim is a world-wide Financial Society of Nations. If it could secure world-wide acceptance, it would provide greater, not less, opportunities for mutual co-operation. The Central Banks would no longer be in competition with each other for gold and would not be continually driven unwillingly to take measures to contract or expand their internal currency for reasons not arising out of the needs of the situation at home, in order to meet conditions forced on them by the action of other Central Banks. This proposed international monetary system would give the nations both stability of internal prices and approximate stability of exchange.

It is not easy to realise how tremendous would be the benefits of stability of internal prices. A large proportion of the major irritants, which lead to strikes and lock-outs and labour troubles generally, would disappear with the removal of the distinction between money wages and real wages. The atmosphere of suspicion which clouds the relations between employers and their work people would be cleared by the sweeping away of the mist and fog which are engendered by irrational changes in the purchasing power of money. In place of constant friction Trade Unions and Employers' organisations could work happily together, not to exploit the

will ensure for them and for the world as a whole greater activity of international trade than can be looked for, in present world conditions, from any alternative course of action. Regrettable as the absence of world-wide acceptance is, there is no reason for regarding the splitting up of the nations into two main currency groups as a step towards economic warfare between them. The associated nations will be free from the shackles of an international monetary standard which, as has been seen, has both hampered their control of their own economic development and driven them to take measures which, while defensive in form, have often been offensive in their results to other nations. This internal freedom should make for increased harmony in their relations, not only to other members of the Associated Group, but to all the world. The Associated Group will not be confined to the British Empire but will include many nations whose political status and affiliations are entirely distinct. If countries such as Germany come in, either immediately or at a later date, even the special predominance of sterling will cease to be conspicuous.

The better is the enemy of the good. There are many evidences that the surest way of advance towards a harmonious world order is from isolated national units through natural racial or geographical or economic groupings. The coming together of the nations of the British Commonwealth for economic co-operation at Ottawa is only one, though the most striking and the most hopeful, of the movements towards economic association

which are taking place at the present time. The Ottawa Conference itself will give a powerful stimulus to such movements. At the International Monetary Conference one of the subjects for discussion may well be a modification of the principles underlying the Most Favoured Nation Clause in international Treaties dealing with Tariffs in order to facilitate regional trade arrangements.

Regional understandings of this character are deserving of every encouragement. The scale of modern industrial activity is such that small and narrow national economic units cannot hope to give their people adequate opportunities of material well-being in isolation from one another. Economic self-sufficiency is a will o' the wisp even for the most powerful. They must seek a wider field for growth in concert with other nations, while yet aiming to preserve their cherished uniqueness. A Brave New World in which national cultures and specialised gifts are submerged in the standardised drabness of a material civilisation cannot be the goal of human aspiration. In organising its material resources on the basis of economic interdependence, the world must somehow find full scope for freedom both for the human personalities and for the national groupings of which it is made up. It is the merit of the programme which this book suggests that it points the way in Planned Money to a world financial organisation firmly based on national freedom and proceeding through natural groupings of independent economic units to its ultimate goal. It offers to the twentieth century an International Monetary System potentially world-wide

in its operation, in which internal and external interchanges will have the greatest possible hope of expansion, and humanity will everywhere enjoy a stable measure of value.

APPENDIX

“ How quickly nature falls into revolt
When gold becomes her object ! ”

SHAKESPEARE, *King Henry IV.*,
Part II., Act IV., Scene 4.

THE two diagrams which follow were drawn up by Sir Henry Strakosch in 1930 and published as a supplement to the *Economist* on July 5th, 1930. It is by his and their courtesy that they are reproduced here, together with the following extract from the explanation which accompanied them :—

The fall in the general level of commodity prices clearly can have no effect on the physical equipment of the world. The lands, houses, factories, roads, railways and harbours remain, for all practical purposes, what they were when prices were higher. Nor can it have any effect on the possibility of and the need for employing that physical equipment for productive purposes. The population has remained the same and so have its wants. Indeed, the experience of the past leaves little room for doubt that, whatever the movement of general prices, production as a whole increases at a remarkably steady rate, though that rate of increase is perhaps accentuated in times of rising prices and somewhat retarded in times of falling prices.

Whence, then, arises the disturbance that impedes the smooth course of exchange of the commodities the world produces?

We all know that, in our complex economic organisation, the vast majority of transactions are not settled when they are concluded, but that they almost always involve contracts expressed in money amounts, the settlement of which is deferred over widely varying periods. In our Gold Standard world, it is the purchasing power of gold, as expressed in the general level of commodity prices, that determines the real obligations (in terms of goods, in which only they can be met) of all these contracts. If the general level of commodity prices falls by 20 per cent., or, in other words, if the purchasing power of money increases by 25 per cent., then a contract entered into before that fall has taken place will compel the debtor to give to the creditor a title to goods 25 per cent. greater than the two parties had bargained for when they concluded the contract. The total available volume of goods, that is, broadly the income of the community, has thus to be divided among the creditor and debtor sections of the community in different proportions than before. But, as the total volume of production increases relatively slightly from year to year, the greater title to goods of the creditor class can only be met by the share of the National Income falling to the debtor class being curtailed. It is this redistribution of wealth, and the fact that the greater title to goods in the hands of the creditor section of the community is, in times of falling prices, exercised haltingly and in a class of goods quite different from

that which the debtor class forgoes, that causes the profound disturbances in the exchange of goods.

THE DISTRIBUTION OF WEALTH

It will be easier to appreciate the reactions brought about by such a redistribution of wealth if we examine a concrete case. Professor Bowley and Sir Josiah Stamp published in 1927 a monograph on the "National Income" of Great Britain in 1924. Largely based on the figures given in this publication, Mr. Joseph Kitchin has compiled for the writer an account in which the national income of that year is apportioned among the principal classes of the community who are particularly affected by a redistribution of wealth due to a change of the general price level. The account does not pretend to represent statistical facts (and the authors of the monograph must not be held responsible for the allocations made), but they are put forward as the best estimate that the available data permit to be made. They are believed to be sufficiently near the truth to serve the present purpose. The account is set out on p. 183.

The distribution of the national income has been split up, it will be observed, into the constituents of (a) public debt service and (b) interest and rent, which are grouped together under the main heading of "Fixed Money Obligations," and (1) Other Governmental Expenditure, (2) Profits of Enterprise, and (3) Wages and Salaries, grouped under the main heading of "Residue." The first group, as the heading implies, comprises the obligations in

NATIONAL INCOME AND DISTRIBUTION ACCOUNT

<i>Income.</i> Money Value, £ Millions.		<i>Distribution.</i>	
		Money Value, £ Millions.	% of Total Income.
4,060	(a) Public debt service .	405	10·0
	(b) Interest and rent .	665	16·4
	Fixed money obligations	1,070	26·4
	(1) Other governmental expenditure. .	285	7·0
	(2) Profits of Enterprise (<i>entrepreneur</i>) .	685	16·8
	(3) Wages and salaries .	2,020	49·8
	Residue	2,990	73·6
4,060		4,060	100·0

respect of contracts involving fixed money payments. It includes, apart from interest and redemption charges on the National Debt, the debts of public bodies and private undertakings, also rent on landed and house property and pensions. These obligations may be said to constitute a first charge on the national income. They have to be met whatever the income may be, if default is to be avoided. The second group, headed "Residue," represents the balance of the national income that is available to meet (a) Governmental Expenditure

other than debt charges ; (b) Profits of Enterprise (*entrepreneur*)—which includes all dividends of a variable type, such as accrue to holders of ordinary or deferred shares of companies—and, finally (c) Wages and Salaries.

RENTIER AND ENTREPRENEUR

A fall of the general level of prices increases immediately and automatically the share of the national income which falls to the section of the community that has fixed money claims. That increase takes place without any apparent friction as between that section and the rest of the community ; indeed, most people do not realise that it has taken place. But, even if it were realised, it is not likely to be resented. The greater purchasing power of money is regarded as a windfall to the lucky ones who have claims to it, and is generally thought to be due, if not to an act of God, then to the folly of the *entrepreneur* class for having increased production unduly. There are few who realise that the greater purchasing power of the money in the hands of those having fixed money claims can only be satisfied by a corresponding increase of production, or, failing that, by a curtailment of the income of the remaining sections of the community, or (using the global term employed for the purpose of the account) of the “Residue.” It is here that the fiercest friction at once and automatically arises. There is less to be divided among the *entrepreneur* and the wage-earning classes. Sacrifices have to be made. Who is to bear them, and if they are to be

borne by both sections, in what proportions? The wage-earner resists having his money wage reduced, even if that wage were to buy correspondingly more goods. But we know that a fall of the general level of wholesale prices does not at once bring down the prices of the goods the wage-earner needs and buys. The cost of living, in other words, does not, except very sluggishly, follow wholesale prices. Besides, the reduction of wages is, in any case, a long and difficult process, often involving strikes which reduce production when increased production is the only means to restore the income in terms of goods of the classes comprising the "Residue."

The whole of the burden of the fall has thus at first to be borne by the *entrepreneur* class. Those among them whose enterprises are less exposed to foreign competition will try to lighten their burden by combining for the purpose of maintaining or raising the prices of the commodities they produce or the services they render. The result is that the burden falling on the *entrepreneur* class whose industries are more exposed to foreign competition, and who are therefore less able to control the prices of the goods they have to sell, is further increased. Hence the well-known phenomenon of the unsheltered industries being the first to be badly crippled or put out of action by a fall of general prices. But even if both the sheltered and unsheltered industries were prepared to shoulder the burden rateably, they would only be able to support it if the fall of prices were relatively unimportant, simply because their share of the National

Income, even in times of stability, is but a small proportion of the whole. The National Income and Distribution Account shows that their share in 1924 has amounted to just over 16 per cent.

DIVIDING THE NATIONAL INCOME

To aid the reader in visualising the nature and the relative extent of the changes in the distribution of the National Income consequent on changes in the general level of prices, a diagram (coloured Annex I.) is inserted which attempts to show this. It is built up from the figures of the National Income and Distribution Account given earlier in this paper, the vertical line above the figure 100 at the bottom of the chart representing the National Income as distributed in that Account. To the left of this vertical line can be read off the effect which any given fall, and to the right any given rise, of the general level of commodity prices has on the distribution, on the supposition that the National Income remains stationary, and that the "Residue" is divided between its constituents in exactly the same proportions as it is divided in the original account shown in the vertical line above the figure 100. It will, of course, be understood that the presentation in this form is a purely schematic one, and does not—indeed could not—take account of the innumerable subsidiary influences which are constantly at work in the direction of accelerating or retarding the redistribution of the shares in the National Income as between one section of the community and another.

It, however, faithfully represents the change in the proportions of the National Income that fall to those having fixed money claims on the one hand, and to the "Residue" on the other, consequent upon changes in the general level of commodity prices on the assumption that the National Income neither increases nor decreases. But the division between the main constituents of the "Residue," viz., the wage-earning and *entrepreneur* classes shown in the diagram is an ideal one. The line denoting that division has been drawn simply to illustrate how each of these classes would be faring if they bore rateably the burden consequent on a fall, and enjoyed rateably the benefit consequent on a rise in the level of prices. In point of fact it is the process of dividing the "Residue" (especially if the "Residue" becomes smaller as a result of a falling price level) that causes the struggle and friction between the two classes which right through history has accompanied every violent change in the level of prices.

THE BURDEN ON ENTERPRISE

Of far greater significance in that connection are the lines shown on the diagram which denote the wage-earners' share of the National Income if money wages remain constant (*AB*) and their share if their standard of living is to be maintained stable (*CD*). The first, in particular, illustrates strikingly the friction that even a relatively small fall in the general level of commodity prices sets up between the wage-earning and *entrepreneur* classes. It shows how deeply the wage-earners' share cuts into

“ Profit of Enterprise ” while money wages remain unaltered, and how urgent, therefore, a re-adjustment of money wages becomes. Line *CD*—which pre-supposes a readjustment of money wages to a point at which the real wages, *i.e.*, the standard of living, is maintained unaltered—shows that even this involves a rather substantial encroachment on “ Profit of Enterprise.” Conversely, if the latter is incapable of bearing the burden (and there is, of course, a limit beyond which “ Profit of Enterprise ” cannot be curtailed without killing enterprise), it shows that a fall of prices forces upon the wage-earning community a debasement of their standard of living. An increase of production alone is capable of mitigating that situation. But if it is considered that an annual increase of production of 3 per cent. will counteract the ill-effects of a fall in the general level of prices of only about 2·9 per cent. per annum, the profoundly disturbing effect of the fall of 16 per cent. during the last seventeen months will be appreciated.

Little imagination is required to visualise the many implications which spring from this state of things. Thus it is clear that industries which are most vulnerable to competition are the first to suffer, and that, failing very large resources to meet losses, they are quickly reduced to impotence and compelled to suspend operations. Unemployment is the result, but that unemployment is not merely confined to the particular industry that has to suspend operations but spreads over most other industries, for the suspension of operations by one industry immediately reacts on others through the

curtailment of the requirements by the former of goods produced and services rendered by the latter. A reduction of money wages, possibly to a level constituting a debasement of the standard of living, becomes inevitable. Wage reductions of so drastic a character can hardly be expected to be accomplished without strikes. These in turn aggravate the evil ; production is further curtailed and unemployment further increased, and that at a time when an increase of production alone can remedy the disequilibrium !

DEMAND CURTAILED

Meanwhile, the greater title to goods which the fall of general prices gives to those having fixed money claims remains unexercised. While money appreciates, a reluctance to exchange it for goods is only natural ; and that is particularly true of those having fixed money claims, for they can afford it, the greater title to goods they so acquire constituting, in fact, an increment over and above their accustomed standard of life. They are thus unlikely to exercise it until they believe that the fall of prices has come to an end, and when they do, it will be in goods of a different character from those in which it would be exercised if it were in the hands of the wage-earning community. The latter would exercise it mainly in the purchase of consumable goods, while the former would exercise it in the purchase of capital goods through the acquisition of bonds and shares.

In a period of falling prices, there is thus a falling-off in the demand for consumable goods owing to the

reduction of income of the wage-earning classes, and of capital goods owing to the reluctance to exercise their increased purchasing power by those having fixed money claims. Added to this, there is the psychological factor of falling prices reacting on the *entrepreneur* class in the direction of limiting their purchases of commodities to their immediate needs. Hence the curtailment of demand for both classes of goods, and the consequent accumulation of stocks of most primary commodities.

IF PRICES RISE

Not much space need be devoted to the analysis of the consequences of a rise in the general level of prices. They are pretty well the reverse of those of a fall. The diagram (coloured Annex I.) clearly shows how the share in the national income accruing to those who have fixed money claims is reduced, how the "Residue" is correspondingly increased, and how the "ideal" division of the "Residue" among the wage-earning and *entrepreneur* classes (*i.e.*, its division in the same proportions as those of the original National Income and Distribution Account) raises the standard of living of the former and yet leaves the latter with a greater profit. The need for a readjustment of money wages is again strikingly illustrated by the lines *AB* and *CD*, but it will be apparent that the readjustment, though no doubt liable to cause friction, is a much less difficult matter than in the case of falling prices. To divide the benefit of a surplus is a much less unpleasant affair than to divide the burden of a deficiency.

The increased title to goods which accrues to the "Residue" is exercised at once; both consumable and capital goods are in brisk demand, the former mainly by the wage-earning community and the latter by the *entrepreneur* class, as well as by those having fixed money claims. The exchange of goods proceeds unchecked and at an accelerated rate. This, and the psychological effect of rising prices, stimulates enterprise, sometimes much beyond its legitimate limits, until it is fiercely checked by the supply of currency and credit being no longer capable of expansion owing to the limitation put upon it by the available supply of monetary gold. The trend in the reverse direction is set in motion, with all the evil consequences to which reference has been made.

STABLE PRICES

Having illustrated diagrammatically (coloured Annex I.) the effect on the distribution of the National Income of fluctuations of the general level of commodity prices, it may be helpful to show, in similar form, the development of things when general prices are stable. A further diagram (coloured Annex II.) has been drawn for the purpose. Like the earlier diagram, it is built up from the figures of the original account, the vertical line above the figure 0 at the bottom of the chart representing the distribution in that account. It assumes that the National Income increases at the rate of 3 per cent. per annum compound, that the Public Debt service remains at a constant figure, but that "Interest and Rent" (Private Debt) increases at

the same rate as the National Income, viz., 3 per cent. per annum, it being assumed that the additional capital equipment needed to produce the 3 per cent. increase of the National Income will be provided by a rateable increase of Private Debt. The "Residue" is divided in the constant proportions of the original account, viz., Other Government Expenditure (9·5 per cent.), Profits of Enterprise (22·8 per cent.), and wage-earners (67·7 per cent.).

It will be seen that (except for the increase of Private Debt on the assumption made) those having fixed money claims will be receiving the same amount of real income right through the period, and that practically the whole of the increase of the National Income accrues to the "Residue." It would be difficult to show that this distribution does not do full justice to all sections of the community ; those having fixed money claims will be receiving the same amount of money of the same purchasing power they bargained to receive when the Creditor and Debtor position was created. In accepting a fixed money claim and receiving in return for it the superior security of a first charge on the income, they clearly gave up their claim to a share in any increase of income that arises from greater productivity. Those, on the other hand, to whose enterprise, energy and willingness to bear risks the greater productivity is in the main due, *i.e.*, the wage-earners and *entrepreneurs*, are justly entitled to share between them the fruits of having created it. The division of the "Residue" between wage-earners and *entrepreneurs* in the constant proportions of the original account

secures to both an increase of income at a rate somewhat greater than 3 per cent. per annum. The line *AB* drawn across the diagram indicates the proportion of the National Income that is needed to give to the wage-earners a constant standard of living, on the assumption that the population increases at the rate of 1 per cent. per annum. That line brings out in a particularly striking manner how an increase of production in conditions of monetary stability makes available for the improvement of the standard of life of the wage-earners a steadily increasing margin, and yet satisfies the just claims of the *entrepreneur* class to a rateable share in the increased production.

THE SMOOTHER FLOW

The diagram thus indicates that, in the conditions assumed, the standard of life of the wage-earners would be doubled in thirty years; indeed, that no section of the community benefits as much from an increase of production as they do. That increased production does not reach the wage-earner unless money wages are increased accordingly. Friction may, but need not arise in the process, for, as in the case of rising prices, it is a question of dividing between wage-earners and *entrepreneurs* not the burden of a deficiency, but the benefit of a surplus. Besides, in conditions of stability, it should not be beyond the wit of man to devise a system by which the wage-earner's due proportion of the increased production is currently—almost automatically—transferred to him. But even if friction were to arise here and there, it can affect but slightly the

immeasurable benefits which arise from the fact that in conditions of price stability a redistribution of wealth is avoided, and, with it, the profound disturbances that spring from it. There would be no check to the smooth flow of goods, the steadily increasing income accruing to the "Residue" being currently exercised in the purchase of consumable as well as capital goods. There would be no undue stimulus or deterrent to enterprise, nor would the smooth flow of savings to the capital market be interfered with. In a word, there would be no check to economic progress.

