TEXT CROSS WITHIN THE BOOK ONLY

UNIVERSAL
LIBRARY

OU_162161

UNIVERSAL
LIBRARY

FREE BANKING



MACMILLAN AND CO., LIMITED
LONDON • BOMBAY • CALCUTTA • MADRAS
MELBOURNE

THE MACMILLAN COMPANY
NEW YORK • BOSTON • CHICAGO
DALLAS • ATLANTA • SAN FRANCISCO

THE MACMILLAN COMPANY
OF CANADA, LIMITED
TORONTO

FREE BANKING

AN OUTLINE OF A POLICY OF INDIVIDUALISM

BY
HENRY MEULEN

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON
1934

PRINTED IN GREAT BRITAIN
BY R. & R. CLARK, LIMITED, EDINBURGH

CONTENTS

PAGE

PREFACE TO SECOND EDITION ix

PREFACE TO FIRST EDITION xi

CHAPTER I

SOCIALISM AND ANTI-SOCIALISM 1

Individualism not identical with anti-socialism. The socialist economic solution has induced the rise of a socialist ethical philosophy. The latter considered.

CHAPTER II

A REVIEW OF PROGRESS 8

The aim of politics. The "Economic man". Historical evidence of the growth of the liberty principle. A definition of liberty, and of beneficial interference. The cause of the modern growth of the plea for more State interference. The deadlock between scientific political economy and simple human sympathy. Does the future lie with increased centralization of industry?

CHAPTER III

THE PROBLEM RESTATED 34

The fundamental problem: the excess of labour supply over demand. Its solution by a supply of cheaper credit. An enquiry into the conditions prevailing at the time of the industrial revolution, and the cause of monopoly traced. The inadequacy of the socialist explanation of monopoly.

CHAPTER IV

THE PRINCIPLES OF EXCHANGE 49

Credit an indispensable part of any free system of division of labour. A definition of credit. "Over-production" results from credit restriction. The principles of exchange examined; and an ideal system of credit sketched.

CHAPTER V

THE HISTORY OF EXCHANGE 66

The choice of a gold exchange medium represented the introduction of credit. The exchange medium and standard of value two separable functions. The growth of the credit principle traced through the invention of Bills of Exchange and goldsmith's receipts.

CHAPTER VI

PAGE

THE BANK OF ENGLAND 85

The growth of governmental interference in banking. Efforts of the Bank of England to maintain its monopoly. Effects of banking restrictions shown at the industrial revolution. Factory legislation not a cure for the evil. Incorrect opinions on banking induced by governmental interference.

CHAPTER VII

THE WAR OF PAMPHLETS 100

The drain of gold necessitated by continental wars draws attention to the currency. General confusion of ideas on the principles of credit. The Bullion Report. The attempt to regulate the issue of credit by the amount of gold in the country. The succession of financial crises. Tracts of Lord Overstone. Views of Col. Torrens.

CHAPTER VIII

A REVIEW OF SCOTTISH BANKING 205

Foundation of the Bank of Scotland in 1695. The development of banking in Scotland different from that in England. The error of the prohibition of the "option-clause" note. Prohibition of small notes and its effect. Yet the Scottish banks were the foundation of Scotland's prosperity. An object lesson in free banking. Their note issue the cause of the banks' power in aiding prosperity. Suppression of the system in 1845.

CHAPTER IX

THE ACT OF 1844 AND ITS EFFECTS 146

The restriction of bank note issues. Substitution of cheques for bank notes. Inadequacy of the cheque system explained. Handicap on the farmer and small manufacturer. The Act automatically causes financial crises. The course of events in a crisis detailed. The causes of drains of gold from the banks. The case against the present credit system. A criticism of the "free" gold market. Walter Bagehot on small note issue. Bishop Berkeley's queries. A criticism of J. S. Mill.

CHAPTER X

THE INTERNATIONAL ADOPTION OF A GOLD CURRENCY . 205

Severity of foreign competition felt by British manufacturers towards the end of the 19th century. The inadequacy of popular explanations thereof. The cause lay in the international adoption of a gold currency in 1873 and after; foreign importers thereby favoured. The resulting gold famine and financial crises. The question of Free Trade *v.* Protection.

CHAPTER XI

AN EXAMINATION OF PRESENT SYMPTOMS . . . 214

Inability of manufacturers to find markets explained. Production should be the cause of demand. Mr. J. A. Hobson on unemployment. The miss-

PAGE

ing link in his reasoning. Other symptoms. Industry bears an unnecessary burden of dividend receivers. The disease of company promotion. The Limited Liability Act a further symptom. Bankruptcy Laws. Purchase on credit.

CHAPTER XII

AN INVARIABLE UNIT OF VALUE 236

Fallacy of the term "Standard of value" as at present employed. Disadvantages of a commodity unit of value. An invariable unit of value. Early proposers of the scheme. Historical examples of the invariable unit in practice. Bimetallism. Our "free" gold market.

CHAPTER XIII

REFORM 281

The French *banquier* system. Raiffeisen and similar banks. The central danger: drains of gold. The abolition of the gold standard. The dangers and benefits of free banking. Publication of bank accounts. Reform of present conditions necessitates a certain increase of prices. The danger of over-issue; and of excessively long date loans. Legal restriction considered. The 1908 Report of the Banking Committee of the Association of Chambers of Commerce. A criticism of Prof. Bonamy Price. Errors of previous theorists. Mutual banking—its defects. Communism. Effects to be expected from the introduction of free banking. Cheaper administration of justice.

CHAPTER XIV

STANDARD OBJECTIONS 348

The uselessness of fresh production in a system which already exhibits over-production. The inevitability of Trust monopoly. The fear of "fevered competition". The "waste" of competition. "Production for profit." The danger of freedom to create money. Temptation to overtrading. Fallacy of Prof. Jevons' objections to competition in note issue. That we have passed beyond the period of the usefulness of notes.

CHAPTER XV

INTEREST 385

Prof. E. von Böhm-Bawerk's contribution. His definition of Interest. The Productivity Theory. The Use Theory. The Abstinence Theory and Lassalle's criticism thereof. The Exploitation Theory. Böhm-Bawerk's Theory. An examination of the problem, and a criticism of Böhm-Bawerk. The abolition of Interest. Conclusion.

APPENDIX I. THE LAND QUESTION 401

APPENDIX II. THE WAR, FINANCE, AND ECONOMICS . . 409

APPENDIX III. FINANCE SINCE THE WAR. . . . 413

INDEX 425

PREFACE TO SECOND EDITION

WHEN the first edition of this book was published, in 1917, banking and currency discussion was left to a few experts: it was held to be a subject for professional economists only. Amongst money reformers it was freely said that for a newspaper to make banking reform part of its policy would ruin that paper swiftly and surely. To-day it is different. In the last few years we have seen a shower of books and pamphlets on currency. The subject seems to be growing popular. In the hope therefore that this book may reach a wider public than was possible in 1917, a second edition is now issued.

In preparing this book for the second edition I have allowed my criticisms of the gold standard to remain because, although we abolished the gold standard in September 1931, the mass of orthodox opinion in the country is still at this date (March 1934) solidly in favour of the gold standard, and is pressing for its re-introduction at the earliest possible date. Moreover, the present opposition to the gold standard proposes to replace it by a currency managed by a central bank, mainly by reference to the index of commodity prices. I think this system inferior to one in which each banker maintains his own gold reserve, and makes his own paper price for gold.

The title "Industrial Justice through Banking Reform" was intended to call attention to the connection between the two ideas. The public now realizes the connection, I think, and the title of this book has accordingly now been made more brief and precise. I have added an appendix dealing with currency events and discussion since the war.

HENRY MEULEN

LONDON, *March* 1934.

PREFACE TO FIRST EDITION

WHILST the evil of governmental restrictions on banking was frequently noticed by economists (notably by Spencer) during the last century, the theories hitherto advanced are, for the most part I think, seriously defective. Most of the earlier critics—those that wrote during the latter part of the eighteenth century and the first half of the nineteenth—objected merely to governmental restrictions on the establishment of banks and the issue of notes: they generally overlooked the necessity for the abolition of the legally fixed price of gold. Sir James Steuart, however, in the eighteenth century; Earl Stanhope, James Taylor of Bakewell, Jonathan Duncan and John Gray, in the earlier part of the nineteenth century; then Proudhon, Josiah Warren, and, latterly, Tucker, drew attention to the more radical evils of our credit system. Their work was carried on by Messrs. Hake and Wesslau, A. Kitson, and also by a little knot of men who formed the Free Currency Propaganda in London during the last decade of the nineteenth century, of which men Messrs. Armsden, Badcock, Seymour, and Tarn stood out most prominently.

Yet, even the works of most of the above-named reformers are somewhat defective in that they fail in the first place to trace the successive steps which must lead from the present system to their own. Their plans are usually for such ideal systems of banking as call for a greater development of mutual trust in the commercial world than exists at present, and since they omit to show how this increased mutual confidence is to be generated, their schemes have been brushed aside as visionary. Secondly, they have usually failed to meet the

objections of orthodox economists regarding the effect of paper credit issues upon the movements of gold, a serious omission, as I shall later show. There still remains much to do in the elaboration of the case for banking reform. My chief motive in preparing this book was to show that a paper exchange medium, issued by private bankers, is the natural outcome of a movement which has been proceeding from the earliest days of the division of labour, and that an essential feature of the movement has been the gradual voluntary displacement of a commodity exchange medium by a *circulating* paper evidence of mutual trust. I may lay some claim to originality in pointing out the importance of the "option-clause" notes: I know of no other writer who has remarked the significance of this innovation in the process of the development of the ideal credit system. I trust further to have done some service in unravelling a little the tangle of ideas which characterized the period of financial history from the Bank Restriction Act of 1797 to the Bank Charter Act of 1844. The distinction I have drawn between the cheque and the bank note in respect of diverse effects on the evolution of credit, is, so far as I am aware, original, and forms a most necessary link in the chain of argument for banking reform. Furthermore, the opponents of banking reform have invariably feared the effect of cheaper credit upon the country's gold supply; I hope to have made a useful contribution to this controversy, and also to the subject of the effect of cheaper money upon prices. Lastly, a portion of the theory adduced in support of the central idea of the chapter on "An Invariable Unit of Value" is original, as may be ascertained by a perusal of the only other works which, so far as I am aware, seriously grapple with this subject, namely, Mr. Kitson's *Money Problem* (London, Grant Richards, 1903), the first edition of which was published in Philadelphia in 1894, Mr. Wm. A. Whittick's

Value and an Invariable Unit of Value (Philadelphia, Lippincott, 1896), Prof. F. A. Walker's *Money* (London, Macmillan, 1891), and a few paragraphs in Prof. Irving Fisher's *Purchasing Power of Money* (New York, Macmillan, 1911), p. 331.

The general plan of the work calls for some explanation. It may be thought unwise to commence such a book by attacking socialism. But one of two courses had to be chosen. Socialism is advanced upon its ethical as well as its economic grounds. When one explains the case for individualism *via* banking reform to a Socialist, he frequently listens indifferently, subsequently explaining his indifference by his conviction that "the ethical basis of individualism is all wrong". On the other hand, many Socialists admit the possibility of corruption and social bickering under a complete Marxian socialism, but ask how the present social inequity may be remedied without the nationalization of industry. On the whole, it has seemed to me the more logical course to commence by vindicating the ethical and historical basis of the doctrine of free exchange and I trust that the frequent reference in the earlier chapters to "proposals for reform which will hereafter be set forth" will not tax the patience of the practical reformer too severely.

I am convinced that it is owing to their failure to notice the far-reaching effects of State restrictions upon banking and the issue of money that the Manchester economists have fallen into such disfavour to-day. It is of small use to lecture the able working man upon the disadvantages of State interference with trade, when a supposedly free competitive system leaves him starving for want of work. At a meeting of the British Constitution Association (a centre of anti-Socialist propaganda) some time ago, when the principle of individual liberty was often appealed to, I pointed out that the able and willing worker was calling for bread, but

objections of orthodox economists regarding the effect of paper credit issues upon the movements of gold, a serious omission, as I shall later show. There still remains much to do in the elaboration of the case for banking reform. My chief motive in preparing this book was to show that a paper exchange medium, issued by private bankers, is the natural outcome of a movement which has been proceeding from the earliest days of the division of labour, and that an essential feature of the movement has been the gradual voluntary displacement of a commodity exchange medium by a *circulating* paper evidence of mutual trust. I may lay some claim to originality in pointing out the importance of the "option-clause" notes: I know of no other writer who has remarked the significance of this innovation in the process of the development of the ideal credit system. I trust further to have done some service in unravelling a little the tangle of ideas which characterized the period of financial history from the Bank Restriction Act of 1797 to the Bank Charter Act of 1844. The distinction I have drawn between the cheque and the bank note in respect of diverse effects on the evolution of credit, is, so far as I am aware, original, and forms a most necessary link in the chain of argument for banking reform. Furthermore, the opponents of banking reform have invariably feared the effect of cheaper credit upon the country's gold supply; I hope to have made a useful contribution to this controversy, and also to the subject of the effect of cheaper money upon prices. Lastly, a portion of the theory adduced in support of the central idea of the chapter on "An Invariable Unit of Value" is original, as may be ascertained by a perusal of the only other works which, so far as I am aware, seriously grapple with this subject, namely, Mr. Kitson's *Money Problem* (London, Grant Richards, 1903), the first edition of which was published in Philadelphia in 1894, Mr. Wm. A. Whittick's

Value and an Invariable Unit of Value (Philadelphia, Lippincott, 1896), Prof. F. A. Walker's *Money* (London, Macmillan, 1891), and a few paragraphs in Prof. Irving Fisher's *Purchasing Power of Money* (New York, Macmillan, 1911), p. 331.

The general plan of the work calls for some explanation. It may be thought unwise to commence such a book by attacking socialism. But one of two courses had to be chosen. Socialism is advanced upon its ethical as well as its economic grounds. When one explains the case for individualism *via* banking reform to a Socialist, he frequently listens indifferently, subsequently explaining his indifference by his conviction that "the ethical basis of individualism is all wrong". On the other hand, many Socialists admit the possibility of corruption and social bickering under a complete Marxian socialism, but ask how the present social inequity may be remedied without the nationalization of industry. On the whole, it has seemed to me the more logical course to commence by vindicating the ethical and historical basis of the doctrine of free exchange and I trust that the frequent reference in the earlier chapters to "proposals for reform which will hereafter be set forth" will not tax the patience of the practical reformer too severely.

I am convinced that it is owing to their failure to notice the far-reaching effects of State restrictions upon banking and the issue of money that the Manchester economists have fallen into such disfavour to-day. It is of small use to lecture the able working man upon the disadvantages of State interference with trade, when a supposedly free competitive system leaves him starving for want of work. At a meeting of the British Constitution Association (a centre of anti-Socialist propaganda) some time ago, when the principle of individual liberty was often appealed to, I pointed out that the able and willing worker was calling for bread, but

present Anti-Socialists could offer him nothing but a philosophical principle. The workers now possess the vote, and we must not be surprised if they choose the bread offered them by socialism, with all the restrictions entailed by that system, rather than the fierce competition and frequent periods of semi-starvation offered them by orthodox Anti-Socialists. It is because I believe that the removal of State restrictions upon banking will provide such an access of prosperity to wage-earners as will enable the great movement towards individual liberty to proceed in the path sketched by Spencer and the Manchester school that I am moved to place the following ideas before students of the social question.

The absence of reference in this book (except in Appendix II.) to the present war demands some explanation. I make no claim to detachment from the European catastrophe. This book was completed just at the outbreak of war; but in the general turmoil, publication was naturally delayed.

Finally, it is a pleasure to me to acknowledge the assistance that I have received from the writings of Messrs. Kitson, Seymour, Tucker, and Wesslau, and from personal discussion with all four.

HENRY MEULEN

LONDON, *October* 8, 1917.

CHAPTER I

SOCIALISM AND ANTI-SOCIALISM

In these days when the battle between Socialists and so-called Individualists has become so fierce, it may be thought an unwise expression of partizan spirit to show in the title of such a book as this that its author favours individualism. It will however be noticed that I refer to the battle as between Socialists and *so-called* Individualists; it should rather be termed a contest between Socialists and Anti-Socialists.

Individualism in economics is, briefly, the doctrine that the individual should receive for his own efforts whatever under free exchange another is willing to give him. Let us pause here to remark that individualism is an exclusively political and economic doctrine. It provides no man with an ethical rule. Individualism emphatically does not require each individual to aim at the satisfaction of his more grossly selfish side only; it simply affirms that, in the present industrial stage of society, that community will experience the greatest material prosperity, together with the least social friction, wherein each member is permitted to form his own relations with his fellow men with the least possible directive interference from his neighbours. It would seem to follow that no man would, under true individualism, give up the results of his labour for anything less than an equivalent in commodities or service. Now, while the opponents of socialism contend that the substitution of State rewards for the system of individual competition must lessen the stimulus to industry, yet the number of those who assert that under present conditions the average worker obtains an equivalent for his

labour is steadily decreasing under the pressure of facts received from all sources. The defenders of the present system simply protest that socialism would set up greater evils than those it proposes to remedy. In naming myself an Individualist, however, I wish to show that I desire reform of the present system, and I hope to attract the sympathy of all those who desire that the individual shall receive a just reward for his labour.

Those Socialists who have not yet assumed a "nationalizing bias" will admit that the basis of their objection to the present system is, not that one man is rich and another poor, but that riches do not on the whole come to the man who serves society most. Yet, one of the most common of human weaknesses is the tendency to set up means into an end. I find everywhere, among my socialist friends, men who have for so long insisted that the only way to remedy unmerited poverty is to nationalize the means of production, that they now advocate nationalization for its own sake, and condemn competition, "private profit", and individual ownership as things pernicious in themselves. Among these men has grown up an entire philosophy of history, setting up nationalization of industry as the consummation of a tendency discovered by them in social progress of all times. They have attracted to themselves numerous converts from among those who find that the common ownership of goods seems the embodiment of the teachings of Christianity. Side by side with this version of economic history has also grown up a moral philosophy which exalts a peculiar altruism and "subordination of the individual to social ideals". This philosophy has evidently been called into existence by the previous conception of economic needs. Certain men have discovered what they believe to be a solution of the problem of unmerited poverty. Their solution provides for the extinction of industrial competition among individuals, and the establishment of State-organized production. It

was inevitable that the advocates of this system should endeavour to prove that their economic solution applied also to the realm of ethics, for Monism has set up in us an awe of principles which can be shown to hold good throughout natural phenomena, and we are readily impressed by such demonstration.

We had thought that the evolution of a superior type involved the elimination of inferior types since no organism voluntarily submits to extinction; but we are now told that such struggle is evil since it hinders the growth of "social solidarity", although no mention is made of the friction and retrogression which must result from the forcible binding together of superior with inferior types—the only alternative to a system of free selection.

This inversion of philosophic principles is spreading throughout current ethics. The conception of evolutionary struggle is everywhere being condemned, whilst an exaggerated brotherly love and mutual aid is exalted. We are assured that it is anti-social for men to seek their private profit in exchange. But the essence of all honest trade is the exchange of what is in excess for what is in defect. If I wish to exchange my watch for another's ring, I evidently desire his ring more than my watch, and I am thus seeking my private profit. But he desires my watch more than his ring, and the exchange equally affords gratification of his desire for private profit. Thus free exchange results in gratification to both parties. Lord Avebury phrases the matter neatly thus:—

> "Ruskin pours scorn on the maxim that you should sell in the dearest and buy in the cheapest markets; not realizing that by so doing you sell to those most in need of your goods and buy from those most in need of your money."

The tendency of all men to seek what they individually desire, combined with freedom of choice, results in the

production of such goods and the performance of such services as are desired by the majority of the community. All that is necessary is that free competition be supported by such a development of methods of securing justice as shall ensure that no person be able to obtain the goods or services of another without giving something which that other freely accepts in exchange.

Let it be understood that I do not affirm that the competition of to-day results in an equitable distribution of wealth. This book is an endeavour to prove that competition is to-day hindered by vicious State interference, and that the greater part of present social inequity results from this restriction of competition. In this chapter I aim only at proving the political expediency and ethical justice of free competition.

It is protested that exchange consists in trading on the necessities of others, and is therefore inhuman. But freedom of exchange has been established only because we find that a prevalent feature of organic life is the tendency to satisfy desire at the least cost of energy to self. Productive labour still requires a steady and somewhat monotonous output of energy which is distasteful to the normal individual. Therefore, since we desire the services of others, we find it expedient to prevent them from satisfying themselves upon the results of our labour until they have given or promised an equivalent. But to make such conditions is to "trade upon their needs". Alas! we must admit the charge. But such exchange has been one of the chief factors in the establishment of social sympathy or morality. The history of civilization is a record of the endeavours of men to avoid productive labour, no matter how small be the exertion required to assure existence, or how inhuman the manner of avoiding such labour. Painfully, and by infinitely small degrees, is the average human being learning the lesson of the folly of aggression and coercion. The few stand out and point the way towards good

fellowship and voluntary labour; but the many are driven by their needs, their desires, and the kicks of those on whom they would otherwise batten parasitically, towards productive labour, habit only gradually rendering the new course a little more attractive.

The absence of coercion on either side in exchange is the chief inducement to men to produce goods that others desire, instead of following their own whims; even when making full allowance for the part played by long herding in the production of social sympathy. De Tocqueville and others have shown conclusively that social sympathy develops most generously under a free democracy where men are at liberty to accept or reject the co-operation of others.

State Socialism, we are assured, will displace production for profit and substitute production for use. This is an error. Men to-day generally aim at the satisfaction of their needs with least expenditure of energy on their own part; and socialism will not alter this. If, under freedom, the individual can reap a certain profit by the production of shoddy articles, he nevertheless risks the rapid loss of both custom and reputation as soon as the community discovers the fraud. Under socialism, on the other hand, the individual still tends to conserve his energy, but, in the absence of the possibility of acquiring increased pecuniary profit, the tendency will show itself in shirking, and, since the community will be unable to express its displeasure in the direct manner of removing its custom to a competitor, much social discord must arise on each such occasion, because the complaint will have to go the round of the various State departments and battle against the various conflicting streams of political influence, which influence may have other aims than the provision of efficient public service.

We are told it is unjust to make men suffer for their lack of ability since they did not make themselves. But when I exchange with an inferior workman, either he or

I must suffer; and if I find that by making *him* feel the pinch of his own incapacity I induce him to improve his methods and that we accordingly both benefit, shall I not do so?

It is said that competition is merely an endeavour of one man to rise on the backs of others. Here the part played by economic circumstances in producing a philosophical principle is clearly in evidence. As I shall demonstrate later, State restrictions upon the lending of capital have caused over-competition among employees by obstructing the avenue to the possession of machinery. Hence the majority of men look upon competition solely from the point of view of an employee whose position is continually threatened by some starveling willing to work for a lower wage. Since conditions generally prevent employees from competing with the employer, and wage-earners are for the most part ignorant of the State restrictions upon the lending of capital, they ascribe the employer's advantage to competition, and declare that the sole result of competition is to enable the employer to exploit their labour. But if competition in the provision of credit established, as I contend it must, an easier path from the position of employee to that of employer, and a stronger demand for labour among employers than the supply could stand, the employee class would understand the virtues of free competition, since if one employer were underpaying his men, so far from the latter needing to seek fresh employment, they would be sought out by other employers, competition gradually increasing their wages to the utmost that employers' profits could afford. Let the workers but secure a fair reward for their labour and they will appreciate the advantage conveyed in competition, the advantage of freedom to exchange with whom one will. Freedom of exchange when one possesses something urgently desired by another, is vastly different from the same freedom when one's sole possession,

labour power, is a drug in the market. Prosperity will cause the workers to appreciate the obstinate defence of competition set up by the present possessing class.

Further inconsistencies in this exaggeratedly altruistic philosophy might be pointed out, but the somewhat strictly economic nature of this work forbids such digression. Strange it is, however, how easily we set up a philosophy to justify ourselves in what we wish to do. Error in this direction is not confined to Socialists. If we have seen the exaggerations of a Morris and a Blatchford, we have equally seen the Mallocks who protest that fortune to-day comes solely as a reward for ability and industry—a surprising assertion in face of the deep division of existing society into comparatively idle dividend receivers and underpaid workers.

Nevertheless, the tendency to-day is towards socialism. State feeding of children, Insurance Acts, Minimum Wage Bills, all prove that the Liberal Party is, consciously or unconsciously, following a socialist lead. Hence, since I have advanced individualism as the ideal social system, it is necessary to vindicate the historical basis of the liberty doctrine, and I propose to devote a chapter to that purpose, trusting that if the fallacy of the socialist version of economic history can be demonstrated, the socialist ethical philosophy will disappear with that which gave it birth.

CHAPTER II

A REVIEW OF PROGRESS

SEARCHING back for a ground which shall be common to the political controversialists of to-day, I reach the principle that the aim of modern politics must be the happiness of society as a whole. On the interpretation of the word "happiness" there is of course room for much discussion. The finest fruit of civilization, however, has been the increasingly general recognition of the desirability of permitting the individual to form his own interpretation of the word, provided that his search for happiness does not interfere with the normal activities of others to a greater extent than is the rule in the community wherein he dwells.

The older school of political economy set up the hypothetical "economic man"; that is, its system was arranged on the hypothesis that *every* individual sought only his personal gratification in a primitively selfish fashion. The modern wave of sympathy induced by the suffering connected with our industrial system has strongly attacked this conception. We are told that the "economic man" is a monstrosity, that men are not selfish, that they desire to help their fellows; and on these grounds it is proposed to set up a system wherein the individual shall be *compelled* to work in the manner, and at wages, fixed by majority vote, private enterprise being forbidden, or restricted in such a way as to render it virtually unprofitable. If, however, the older "economic man" was merely an hypothesis, so equally is the socialist "ethical man". If the former is a monstrosity, the latter is a saint of equally rare occurrence. But the older political economists recognized at least that in

order that the individual should be happy in his philanthropy, his efforts in that direction must be voluntary. Certain men may desire to help their fellows, but the desire vanishes with the appearance of compulsion, leaving bitterness and hate in its place. Hence it is advisable to set up a system wherein each individual may satisfy his selfishness to the fullest extent compatible with the like liberty of others, all further philanthropic and co-operative effort being left optional. In other words, to assure happiness to the greatest number, the social system must, for many generations hence, allow for the existence of primitively selfish people, merely ensuring that the predatory selfish members shall not profit at the expense of the others. A social system must deal with people *as they now are*.

In his work *National and Social Problems* Mr. Frederic Harrison pours scorn upon Mill's statement that there are *laws* of political economy. Perceiving only Comte's remedy for social inequity, namely, a wakening of the conscience of capitalists, he is led to deny the view that scientific principles may be set up concerning men's actions in commodity exchange. Yet, later on in the same work, he frequently postulates that in certain given conditions men will act in such and such a manner, obviously expressing his belief in a normal type of man who may be expected to act in a certain definite manner. On precisely these grounds the Manchester school asserts that the normal man to-day will usually endeavour to accumulate as much wealth as possible. Even the most convinced Individualist does not deny that there are many men who devote energy unselfishly to other ends than the personal accumulation of wealth, or that the tendency is for this type of unselfishness to increase; he simply asserts that if our schemes are built upon the assumption that the *average* man of to-day will act thus unselfishly, we shall find that they will fail, because the present average man will almost ruthlessly take as much

wealth and leisure as the law allows him, the principle admitting of slight modifications in respect of his relations with his own family and friends only. If we want anything done to-day, we may be certain that if we offer a large enough monetary reward we shall in most cases be able to find someone who will do it; whereas experience demonstrates that it is quite impossible to count upon the sympathetic spirit in the ordinary person for the performance of that inevitably monotonous labour which is necessary for the continued production of necessaries. Even if the present perfection of machinery were sufficient, as some enthusiasts assert, to provide for the comfort of every person upon the results of three hours' labour per day per man, we know full well that, in the present stage of development of the sympathetic instinct, the average men would find some more congenial occupation, or lack of occupation, even for those three hours, than the performance of the task expected of them, unless they were personally threatened with loss of material comforts. The possibility of losing the respect of others is decidedly an inadequate stimulus to productive labour for ordinary men as we now know them. The present average type of man must be threatened with an almost automatic loss of personal material comfort if his efforts are to be kept up to the standard of efficiency, and the Manchester school recognized that to transfer the right of breaking off exchange relationships with an unsatisfactory worker from the individual to the State, was to hinder the detection of the offender, and set up social discord. Hence its advocacy of liberty in the choice of co-operators—free exchange.

The worth of the liberty principle is confirmed by the histories of communities. In primitive days the incessant inter-tribal warfare permitted the survival only of such tribes as adopted the military form, namely, complete subjection of the individual to the leader or chief, and

common ownership of goods. With the growth of peace arose the under-chiefs and barons, who united for war against a common enemy, but claimed for themselves self-government, that is, the liberty to order the affairs of their own estates and subjects without interference from the war-lord. Within the feudal community we find the relics of common ownership of goods in the various dues and labour for the lord. With the further decay of militarism, self-government was also claimed by the ordinary folk in the modified form of a claim to a voice in their own government, and we observe the rise of the democratic movement. In domestic matters the democratic movement was accompanied by a demand for free exchange in place of the previous semi-communist system of production. In the township which gained its trade charter we may trace the movement towards individual freedom. The imperfect administration of justice and the unruliness of the feudal lords, however, accompanied doubtless by general ignorance of the desirability of more individual liberty, caused a certain military form of industrial organization to be retained, hence the appearance of gilds. As a method of defence of industry against aggression, the gilds were extremely useful; but history shows that with the growth of peace, the restrictions and regulations imposed by the gild upon its members were felt to be increasingly irksome. Regulation of the hours of labour, and of wages, of the material to be used in production, of the price of the product and the manner of production, was the rule among the gilds, and it is not surprising to find that invention was stimulated and social bickering reduced when the more independent craftsmen were allowed to set up private workshops. As is shown in most historical text-books, the *advantages* of the less restricted system eventually caused the disappearance both of the gilds and of various other minor governmental regulations of industry, the depredations by Protector Somerset upon

gild funds merely hastening a process which was already operating. Briefly, the principle came gradually to be recognized that the individual should, so far as possible, be allowed freedom to do as he liked, the governing body existing merely to ensure that no individual encroached unduly upon another's like liberties.

Considerable confusion has arisen over this point. Modern apologists for the extension of governmental interference have pointed to the perfection of methods of securing justice as a precedent for positive State interference, and we find this statement of Mr. H. G. Wells in *A Modern Utopia*, in the chapter "Concerning Free-"doms": "Consider how much liberty we gain by the "loss of the common liberty to kill." But Mr. Wells, in his desire to support with historical evidence his proposals for a renewal of restrictive legislation, confuses the loss of the liberty to kill with the existence of machinery to punish the wrong-doer. We do not gain liberty by the loss of the common liberty to kill, but by the establishment of a superior power to deal with the *criminal* killer. We still permit, and will, I imagine, permit for many generations, the liberty to kill under certain conditions, e.g., self-defence against a would-be murderer. It should be noticed that two entirely distinct branches of governmental interference are here involved. On grounds of pure principle, interference is evil when it directs or prohibits the performance of any definite actions; it is good when it infallibly exacts reparation for an action found by judge and jury (representing majority opinion) to have encroached unduly upon another's sphere of equal liberty. The individual should be left free to adapt himself to his environment in whatever manner he may contrive. This is the system which provides the strongest stimulus to individual initiative, and is richest in opportunities for the appearance of variety in production and service. Acts of aggression will occasionally be committed; yet the gain to

society from individual enterprise and rapid education of the character of its members out-weighs the risks of aggression. Moreover, in proportion as compulsory reparation for damage becomes automatic and infallible by reason of improved methods for securing justice, the individual will become more careful of the liberties of others.

The administration of justice is the last stronghold of the State, but the characteristic feature of ruling bodies has been an exorbitant levy of taxes as the charge for poor service rendered, accompanied by a prohibition to use any other service than that provided by the body in power. The characteristic accompaniment of the growth of popular control over the ruling body, on the other hand, has been the reduction of unnecessary taxation, and the perfection of the administration of justice—justice being conceived as that which neither compels nor prohibits any specific action, yet automatically compels reparation on the part of any individual who is judged by majority voice in the community, or the representatives of that voice, to have overstepped the bounds of equal liberty. The Individualist Anarchist[1] argues that such reparation will ultimately be enforced with least social friction by voluntary societies, and the State—a body which compels allegiance from all persons within its sphere, and taxes them for its own support, with or without their consent—will disappear. This system accords with nature's methods. We are permitted to live or eat in whatever manner we please, yet when, in satisfying one desire, we prevent due satisfaction of another desire, we inevitably suffer. Certain acts by themselves, e.g., the adoption of sedentary labour, would produce discomfort in us, yet freedom for experiment has enabled man to discover that these acts may be committed with impunity provided that they are followed or accompanied by certain other acts. The result is a

[1] See *Instead of a Book*, by Benj. R. Tucker (New York, 1897).

net gain to mankind. The substitution of voluntary protective associations in place of the compulsory and routine-bound State method follows the direct path of progress towards specialization of function. With the decay of the danger of aggression by foreign nations, the need for a centralized national coercive body disappears, and the possibility appears of variety in method of protecting individuals from aggression at home, the new system being probably accompanied by some sort of agreement between the various protective associations as to the treatment of offenders, on similar lines to that consent which prevails between various nations to-day.

I have said that the distinction above drawn between the administration of justice, and directive governmental interference, is deduced from consideration of pure principle. In practice our system is a continual compromise between the paternalistic policy of a gradually disappearing age of militarism,[1] and the dictates of an enlightened policy of industrialism. Our politicians have yet to learn that when, in spite of due warning, a mature individual persists in a course which is harmful to himself, that man is marked down by nature for elimination. We have as yet found no avenue of escape from the law so pithily expressed by Spencer: "The final effects of "shielding a man from the results of his folly is to fill the "world with fools." We persist in diminishing for the sake of the weaklings the rewards for temperance and wisdom; and whilst sympathy may warrant particular efforts in this direction, the policy may easily become anti-social in an industrial stage of society. I am perfectly willing to admit that so long as international jealousy and the danger of war persist, the military state will doubtless survive and call for the retention of some measures of State interference with the liberty of the individual in regard to payment of taxes for armament;

[1] This, alas, was written before August 1914.

but the present advocates of increased State interference, the Socialists, are generally anti-militarist and propose this regimentation precisely as an aid to industrialism. It is the error of the socialist view that I am here concerned to demonstrate.

To return to the history of the evolution from militarism to industrialism. With the growth of the movement towards liberty came Protestantism (an assertion of the claim to freedom of opinion), liberty of the press, free speech, and a gradual freeing of trade from governmental interference. Roughly speaking, the movement recognized that, with the decay of the danger from outward aggression, might be permitted to decay also the idea that the individual existed for the sake of society instead of society for its members. With the change from militarism towards industrialism the mighty man of industry rather than the man of war began to assume prominence, and it was seen that by permitting to the individual freedom of choice between various offers of service from the rest of society the most industrious type tended to be preserved. The individual was permitted to discontinue relations with any member of society who did not give what the former considered an equivalent for his labour product. Thus did each individual play his part in the great scheme of natural selection, and automatically and without friction were slowly eliminated the unfit members of society. With the change, the government too threw off its strictly militarist form, and, recognizing the growing value of the man of commerce as compared with the fighting type, began gradually to devote itself to the task of preventing the triumph of physical force or cunning over industrial ability.

Thus were laid, in theory at all events, the foundations of a society wherein the individual should be able to become rich only by great service. We see that the ideal of society was based upon freedom of contract be-

tween individuals—the ideal of the Manchester school —and that progress lay in the direction of the promotion of social sympathy by increased freedom of contract and a continual reduction of directive State interference. This process culminates in the dissolution of the coercive State in philosophic anarchism, and the continuation by voluntary associations of the process of discouraging aggression between the members of society. Political economy could foresee no break in the progress towards freedom of contract. How then explain the growth of the present philosophy of State interference?

History provides the clue. The reduction of State interference with freedom of contract proceeded steadily until the period of what has been called the industrial revolution, that is, the period of the substitution of machine for hand labour. Hitherto, such tools as had been used in production had been comparatively cheap, and almost any worker who wished to supply a particular demand had been able to make his own tools, or buy them cheaply. With the introduction of expensive steam-driven machinery, however, arose the factory system, under which the worker no longer owned his tools nor disposed of his own product, but used the tools of another man and threw upon the latter the onus of finding a market for the goods produced. This was undoubtedly a progressive step, since manual skill and organizing ability are two widely different qualities, and specialization of individuals upon these respective branches ensured a higher degree of economy in production. There arose now, however, an evil to which society was unaccustomed, namely, that in the contracts which were now made between worker and factory owner the former was unable to obtain a fair reward for his labour, although no compulsion was used, so far as could be seen, to determine the contract. In theory the individual could become rich only by great service; yet there arose a class which acquired riches through factory

ownership or dividends, without providing as much service as the wage-earning class, although the law was not transgressed in the process of acquiring these riches.

Here began the contest between scientific political economy and simple human sympathy—a contest which has proceeded and become increasingly bitter from that day to this. On the one hand were those who subordinated their sympathies to their knowledge of the results of certain institutions upon society; on the other were those who were overwhelmed at the sight of unmerited poverty, and were willing to adopt almost any measures to remove it. Most social questions which have arisen since the introduction of machinery may be resolved into the simple form: Shall one party to a contract be compelled by the State to give better conditions than the other could obtain by unaided bargaining? The orthodox political economists contended that any such interference with freedom of contract implied disregard of the principle derived from experience, according to which progress and social harmony (in the present state of human evolution) are dependent upon exposure of the individual to the results of his actions so far as is possible and compatible with social sympathy. They affirmed that the substitution of a fixed reward to labour for the system of permitting the consumer to reject or accept and arrange a price for commodities and service without State interference put a premium upon incapacity, and encumbered the whole process of natural selection. They looked upon the diversity of men's desires, and decided that general happiness could only spring from individual liberty to select voluntarily such service from society, and reward it in such a manner, as accorded with the *individual's* desires. They therefore held that the functions of the State should be restricted to the office of ensuring reparation in cases of criminal aggression. Such reasoning, however, was limited to the few. The majority was led by the sight of suffering to

initiate the long series of governmental acts of interference with freedom of contract.

Yet the defenders of freedom fight hard. If the evil of unmerited poverty has increased, and social sympathy developed, so also have education and the tendency to submit emotions to wider reflection. The restrictionists have abandoned the policy of endeavouring to regulate conditions of labour contract between individuals, and have followed their principle to its logical conclusion by advocating that the State shall take over the great branches of production and set up an official system of rewards for labour. The opposing party contends that such a system will be the grave of all the qualities which have brought man to his present position, and predicts the degeneration of any nation which adopts that system.

Here then is the deadlock. From the anti-Socialist party are poured forth books and pamphlets detailing patiently the facts of biology relating to the origin and determining causes of human qualities, such books invariably ending with the appeal: "Will you sacrifice these principles for the sake of assuring comfort to men who are largely incapables?" The other side responds with books of statistics and emotional works, all in effect proving how great is the evil.

To the cry: "Let us not abolish individual freedom", the Socialist replies: "What freedom have you now?" instead of the direct reply which, in fact, could not be made, that socialism would not abolish freedom of contract. The fact remains that to-day the superior classes of workers in all industries have still a certain degree of freedom of choice of employment, and have also a hope, extremely limited it is true, of riches through industry. The evil is that neither their liberty of action nor their hope of riches is as full and certain as is the case with others who seem to perform far less service to society. The Anti-Socialists, when they admit the existence of

industrial exploitation at all, are willing to sacrifice those capable workers at the bottom of the wage-earning class who are being at present unfairly crushed out, because they believe that socialism, the only alternative at present offered, would reduce the stimulus to the superior workers. Socialists, however, either persistently deny the effectiveness of the stimulus of private profit, or else protest that the present social evil is so great that, if we are unable to find another remedy, we must adopt socialism and do the best we can without this stimulus of private profit. In the final resort temperament determines which side in the controversy the individual will take. They move towards socialism who estimate present suffering as greater than any difficulties which may result from increased State interference. The rest remain in opposition, their sympathy with present suffering being subordinate to their conviction that greater evils in the shape of discouragement to capable workers must result from any adoption of socialism.

The contest therefore seems interminable. If I wished merely to add to the literature on either of the above sides, I could scarcely, at the present day, appeal for attention from the already harassed student of sociology. It is because I notice that present students have, for the most part, overlooked a series of circumstances which vitally affects the social question that I enter the arena.

Let me here state briefly what I hope to prove in the following pages. Most political economists hitherto have, I believe, overlooked the importance of the relation of credit to the exchange system. Commerce has almost invariably been looked upon as the exchange of commodities for commodities. It should on the contrary be regarded as the exchange of commodities for gold, and gold again for commodities; or, as Greene puts it in his *Mutual Banking*: "We must remember that when "we sell anything for specie we buy the specie; and "when we buy anything with specie we sell the specie."

The control of gold dominates production, owing to legal prohibition of the use of *efficient* substitutes for gold. The movements of gold are at present controlled by bankers and financiers, and I shall demonstrate that our theories of political economy are incomplete when we overlook or underestimate the relation of banking to commerce. Legal restrictions upon the production of any form of ordinary wealth harm merely consumers of that particular form of wealth, and even this harm is usually mitigated by the speedy introduction of a substitute. The prohibition of credit and exchange medium, however, affects the entire wealth production of the community, and it will be hereafter demonstrated that State regulations prevent the use of a suitable substitute for the prohibited medium. Coquelin, the French economist, traces two great stems of industrial progress: improvements in (1) machinery; (2) the instruments of exchange. We have concentrated our energies upon the former; but have almost overlooked the importance of the latter.[1]

The advocate of banking or credit reform comes with a solution to the industrial question, which, while maintaining liberty of contract for the individual—nay, extending and deepening such liberty—yet offers the worker the full reward for his efforts. While therefore I appeal to those who are convinced of the necessity for supporting those principles of individual liberty for which Spencer stood, I trust that the unbiassed Socialist who reads these pages may not feel himself in entire opposition to one who labels himself Individualist.

[1] In my recent reading I have encountered one notable exception to the general attitude of accepted economists. Prof. Dibblee writes in his book *The Laws of Supply and Demand* (Constable & Co., London, 1912): "A severe "fall in prices may therefore be caused either by over-production of goods "at any time, or under demand for goods; or equally by a sudden drain of "gold at any time or a gradual contraction of credit." Prof. Dibblee, however, makes no attempt to trace the causes of such disturbances of the currency; nor does he demonstrate the full evil effects of them upon trade.

One point should however be settled at this stage perhaps, in order that the reader may approach without prejudice the solution to be offered. The present tendency of industry is towards concentration in the hands of a few Trusts. Those who have developed a "nationalizing bias", that is, who believe that State industry is superior to *any* form of private industry, affirm that such centralization is a progressive step since it renders production cheaper. Now, although I am perfectly willing to admit that centralization does in one way cheapen production, let us see whether it is not balanced by greater disadvantages. Let us take a concrete example.

A certain street is served by three competing milkmen. It has been asserted that the efforts of two of the milkmen are wasted, since the street might be equally well and more cheaply served by a single vendor. On the one hand are those who affirm that the two extra milkmen are forced into competition because there is no other opportunity for their labour, while, on the other hand, it is contended by the opposite party that a second milkman will arrive on the scene only when milkman number one is leaving some demand unsatisfied. The truth is that these two motives for fresh competition are inextricably interwoven to-day owing to our abnormal system. The former motive is undoubtedly operative in many cases and is an indication of an evil state of society. The trouble is that all socialist proposals to remove it, would, in effect, remove the second motive for labour, namely, to secure reward by supplying unsatisfied demand, which motive most of us still feel to be the great factor of harmony in our social system, since through its agency men are induced without human coercion to supply each other's needs.

Under free competition (let it be continually remembered that the present system will be shown in subse-

quent chapters to suffer from vicious State interference) the individual producer tends to respond to the demands *of a single individual* for the sake of the extra reward to be thus derived. Under socialism the individual producer, even though he be convinced of the possibility of profitably supplying another's demand, must in most cases wait until the change of production is authorized by his department, the process frequently involving organized appeal on the part of the public, political agitation, and the recording of a majority vote, with all the attendant delay and jobbery. The Socialist argues that it is cheaper for the street to be served by one milkman. We may agree, just as we might agree to the proposition that the production of headgear would be cheaper if we all wore one style of hat. *But cheapness is only one factor of domestic happiness.* The vital question is: What will happen when milkman number one does not serve us satisfactorily—does not provide us with the article which *we* require? All our experience supports the view that in the present stage of social sympathy we get better service from an individual when we are free to dispense with his services if unsatisfactory, and accept the services of another. We have only to decide whether the system of changing a servant by political methods, i.e. petitions and representations to an official department, results in less social friction than that wherein competition among those who desire to serve us renders it profitable for them to supply our wants; and whether men will be more unsparing in their criticism of slipshod service when they themselves are employees of the very body (the State) whose methods they wish to condemn, than when they are either their own masters or are employees of a man who is quite independent of the offender. Personally, I decide unhesitatingly in favour of a competitive system. This is not the place, however, further to discuss this question. I can only refer the reader who has not yet

formed an opinion upon this controversy to the already vast quantity of literature which is the outward and visible sign of that deep and obstinate struggle in society, the struggle between Socialist and Anti-Socialist.

One point I would make however, which I do not remember having seen insisted upon enough elsewhere, namely, that it is an insufficient argument for State socialism to assert that because particular municipalities can to-day supply gas, water, or trams at a cheaper rate than certain private companies, all industry can be to this extent improved by State control. The central disadvantage of State socialism in my opinion is the unresponsive nature of its mechanism. The tendency of all State departments is against change. This will be evident when we remember that politicians depend for their places upon majority vote, and the majority is generally conservative—from fear and stupidity rather than from principle. In a system of privately owned industry we permit the innovator to risk his own capital; he proves his ability to us by actual practice. If his innovation succeed, we benefit; if it fail, we do not greatly suffer. Under State industry the loss from an unsuccessful innovation is a burden upon the whole community. The majority of the population is always timid, and fearful of loss under change. Accordingly its vote is obstinately recorded against change, until, by the slow and painful method of theoretical demonstration, it is at length convinced of the utility of the proposed innovation. We may, of course, seize upon a successful privately-owned industry and demonstrate that its product might, for a time at any rate, be offered to the public at a cheaper rate if the industry were taken over by the State. Experience shows, however, that for every fresh successful private venture there are many which fail. Possessors of capital undertake the risk of loss only because there is the chance of a com-

pensatory reward in the event of success. Any legislative interference which prevents owners of capital from obtaining an adequate reward for successful venture simultaneously reduces the enterprise and initiative of the community.

We have already seen many examples of the evil of majority control over industrial enterprise in the history of our municipal legislation in respect of such semi-monopolies as street tramways and electric light. Mr. H. R. Meyer[1] records the obstruction to the development of these enterprises in this country caused by the greed or timidity of the various municipal bodies. The terms offered to those who were willing to risk their capital in these undertakings have been so onerous as to place this country far behind the United States in respect of such service. The municipalities have clutched greedily at the power given them by our laws to permit private capitalists to risk capital in new enterprises, with the compulsion to sell to the municipality within a short period if the enterprise prove successful. Once in possession, however, the municipal authorities have in many cases obstinately set themselves against the introduction of improvements on the grounds that their existing plant would thereby be rendered useless.

Mr. Meyer has extracted the following striking conversation from the report of the Lords' Committee on the Electric Light Act, 1882. In reply to a question by Lord Ashford whether it was unjust that a company should reap the benefit of success in case it went into a venture upon which the municipality did not care to embark because of the uncertainty of the venture, the Secretary of the Board of Trade said: "I think if it is "a case that it is very doubtful whether the thing turn "out very well or moderately well, and then it turns out "better than is anticipated, the public ought to have the "advantage." In reply to the query: "That is to say that

[1] *Municipal Ownership in Great Britain* (Macmillan, London, 1906).

"the undertakers ought to run the risk of failure and "the public ought to have the benefit of success?" the Secretary of the Board of Trade replied: "It is not "necessary for the undertakers to take it up." Lord Rayleigh queried: "When you say it is not necessary "for the undertaker to take it up, you mean that it is not "necessary that the public should have the electric "light?" The reply was: "The local authorities may "take it up." Lord Rayleigh continued: "Supposing "the local authorities do not see their way to taking it "up, what then?" The reply came: "Then I suppose it "would be postponed for a period." Here the restricted outlook of municipal "business men" is clearly evidenced. They will not grant sufficiently liberal terms to private capitalists to induce the latter to undertake new ventures, because, forsooth, "private capitalists must not be allowed to make profit out of the public"; yet the municipality is too fearful to undertake the enterprise itself, and accordingly a portion of the public is deprived of facilities for the possession of which it would gladly enrich the promoter. The same evil usually attends the introduction of improvements into existing municipal enterprises: either real improvements are ignored, or wasteful "improvements" are introduced, the fundamental defect being the attempt to replace the professional organizer by a person appointed by ignorant majority vote. Hence although present municipal undertakings may succeed, since they use the competitively-produced inventions of private industry and, as will be hereafter shown, are competing with State-handicapped firms, the chances are that there will be loss to the community in respect of possible future inventions if all industry is thus municipalized. If we now see successful municipal gasworks, we also see the above-mentioned defect of State industry exhibited in the undertakings wherein it has had time to appear, namely, the Belgian and French State railways, which,

in speed and comfort, cannot compare with the English privately owned lines.

The cheap tourist tickets on the Belgian State lines are invariably pointed to as an example of "Production for use"; but I am convinced that if an English railway company served a district wherein were situated as many "show" spots in so small an area as is the case in Belgium we should have just as cheap tickets, and should not be compelled to travel in such antiquated and uncomfortable coaches as are provided by the Belgian Government. It should also be pointed out that in spite of the fact that certain of our own lines possess a virtual monopoly of traffic in particular districts, the companies yet see that it is to their advantage to keep their fares low in order that more persons may be induced to travel. The stimulus to initiative provided by private ownership induces the Great Eastern Railway Company to run excursion trains at cheap rates to popular watering-places on the east coast where it possesses a virtual monopoly of transit facilities. Such enterprise is always attended by considerable risk of loss; but we view the company's activities in this direction with equanimity since it risks its own capital: we are not tempted to rush off to our member of Parliament and call public meetings to protest against extravagant use of funds taxed from us. Hence private ownership tends at once to efficiency and freedom from social bickering.

I fully admit that certain persons may advance in all sincerity an opinion that the disadvantages of State service here enumerated are not so serious as those which result from the present system. It will be remembered that my criticism is directed against the argument that State industry is inherently superior to *any form of competitive production*. The choice between the evils of the present system and those of State socialism depends upon temperament. I have merely attempted

to show that State industry *is* attended by well-defined disadvantages.

To those who would like to see some reform of our present system without going to the length of State socialism, if such reform be possible (and I imagine that the great majority of persons, including a considerable number of present Socialists, comes within this category) the more important problem is: whether or not our present centralized system provides the cheapest service with the least social friction. With our present labour-saving machinery, a degree of centralization is inevitable and economical. Yet I am convinced that when centralization reaches a particular point, the waste arising from the employment of many managers who are not so personally interested in the success of the enterprise as is the original owner, and the unwieldy, unresponsive nature of the whole concern, would favour the rise of smaller and more agile firms, *were not the Trusts protected from competition by our restricted credit system.* Adam Smith frequently remarks the disadvantages of large industrial organizations. I will quote one passage only:[1]—

> "To buy in one market in order to sell with profit in another, when there are many competitors in both; to watch over, not only the occasional variations in the demand, but the much greater and more frequent variations in the competition, or in the supply which that demand is likely to get from other people; and to suit with dexterity and judgment both the quantity and quality of each assortment of goods to all these circumstances, is a species of warfare, of which the operations are continually changing, and which can scarce ever be conducted successfully without such unremitting exertion of vigilance as cannot long be expected from the directors of a joint-stock company."

[1] *Wealth of Nations,* Book V. ch. i.

Mill's opinion coincides with that of Smith. He states:[1]—

"The successful conduct of an industrial enterprise requires two quite distinct qualifications: fidelity and zeal. The fidelity of the hired managers of a concern it is possible to secure. When their work admits of being reduced to a definite set of rules, the violation of these is a matter on which conscience cannot easily blind itself, and on which responsibility may be enforced by the loss of employment. But to carry on a great business successfully, requires a hundred things which, as they cannot be defined beforehand, it is impossible to convert into distinct and positive obligations. First and principally, it requires that the directing mind should be incessantly occupied with the subject; should be continually laying schemes by which greater profit may be obtained, or expense saved. This intensity of interest in the subject it is seldom to be expected that anyone should feel who is conducting a business as the hired servant and for the profit of another. There are experiments in human affairs which are conclusive on the point. Look at the whole class of rulers and ministers of State. The work they are entrusted with is among the most interesting of all occupations: the personal share which they themselves reap of the national benefits or misfortunes which befall the State under their rule is far from trifling, and the rewards and punishments which they may expect from public estimation are of the plain and palpable kind which are most keenly felt and most widely appreciated. Yet how rare a thing it is to find a statesman in whom mental indolence is not stronger than all these inducements. How infinitesimal is the proportion who trouble themselves to form, or even to

[1] *Political Economy*, Book I. ch. ix.

attend to, plans of public improvement, unless it is made still more troublesome to them to remain inactive; or who have any other real desire than that of rubbing on, so as to escape general blame. On a smaller scale, all who have ever employed hired labour have had ample experience of the efforts made to give as little labour in exchange for the wages as is compatible with not being turned off. The universal neglect by domestic servants of their employers' interests, wherever these are not protected by some fixed rule, is a matter of common remark, unless where long continuance in the same service, and reciprocal good offices, have produced either personal attachment, or some feeling of a common interest."

The Socialist will protest that men are remiss in their service to-day because they know they are working for the profit of another; they will be more industrious when they are working for "themselves", the State. I reply that if negligence of the interests of the State is so marked among the comparatively educated and cultured politicians and ministers, what reason is there for supposing that it will not be even more marked among the masses of less educated industrial workers?

Professor W. E. Hearn writes:[1]—

"Another limit to the use of co-operation is found in its magnitude. In proportion to the increase in the number of co-operators, their motive for exertion grows weak. . . . That limited liability which to the capitalist is the great charm of co-operative enterprise implies also a sense of limited responsibility. If it diminish the penalties of failure, it thereby diminishes the security against that conduct which leads to failure. The whole of the reward does not

[1] *Plutology* (London, Macmillan, 1864), p. 229.

attach exclusively to the deserving; the whole of the punishment does not fall upon the indolent. . . . Though ability may be hired, zeal never can. In all such associations the great interest stimulus to unremitting industry is wanting. No contrivance that has yet been invented can supply the place of the feeling that the workman is labouring not for another, but for himself; and that it is exclusively upon his own behaviour that his success or his ruin depends."

Professor Sidgwick endorses this passage in his *Political Economy*.

If we exclude the effects of our present burdensome banking laws in causing the appearance of over-centralized business concerns, there is very little doubt that the few remaining cases of huge accumulations of capital that exist may be partly accounted for by the extraordinary business capacity of particular individuals. Our credit laws already shield such individuals from competition, and their unusual business ability enables them to survive the natural disadvantages of centralization. But this ability cannot be delegated to a body of directors, and the business would usually collapse with the death of its moving spirit, were it not artificially protected by our credit laws. Mr. F. W. Hirst, former Editor of *The Economist*, gives a list of the failures of these over-centralized organizations. He instances the Calico Printers' Association as affording a spectacle of management that is likely to become classic. He states:[1]—

"When the organization, with an issued capital of £8,226,000, was complete, it consisted of a 'mob of eighty-four directors with no real authority' to represent the eighty-four distinct houses previously

[1] *Monopolies, Trusts and Kartells* (London, Methuen, 1905), p. 167.

engaged in calico printing and now amalgamated, and another 'mob of 114 vendor-managers'. For the first two years the Association was unable to pay a dividend on its ordinary shares, though the prospectus estimated an annual profit of nearly half a million. The condition of the concern appeared so desperate that an investigating committee was appointed consisting of eminent men of business. The Report gave in a few sentences the inherent weakness of these huge combinations:—'In most cases 'where a business is converted into a public com-'pany, and to a greater degree when a large number 'of businesses are combined and sold to the public, 'the necessity of meeting outside competition is no 'longer felt to the same extent, and the incentive to 'work the business economically in order to obtain an 'adequate return upon the capital employed is seri-'ously lessened. Too much reliance is placed upon 'the possibility of obtaining higher prices, whereas 'it is, in the case of a public company, of the greatest 'importance to supervise every item of expenditure, 'to closely compare the cost of production and dis-'tribution with what it was formerly, and to reduce 'it whenever this can be done with safety.' "

Mr. D. H. Macgregor, M.A., notices[1] that the chief difficulty of the German Kartells is to secure reliable directors; and lastly, Professor Hadley writes:[2]—

"Just as in an army there are many who can fill the position of captain, few who can fill that of colonel, and almost none who are competent to be generals in command—so in industrial enterprise there are many men who can manage 1000 dols., few who can manage a million, and next to none who can manage 50,000,000."

[1] *Industrial Combinations* (London, Geo. Bell, 1906), p. 160 *et seq.*
[2] *Scribner's* xxvi. p. 607.

I would only reiterate the point that the capable manager is selected with least social friction by permitting him to prove himself in private industry—the gathering and retaining his own profits, and accepting responsibility for his own losses. The cumbersome system of election is an entirely inadequate method of attaining the result achieved by this "natural selection".

It is indisputable that the transmission of raw material in bulk, and production on a large scale, enable cheaper production than when a lesser quantity is sent to a smaller factory. Yet, against this saving must be balanced the cost of sending the raw material and finished goods from and to distant markets, which expense is saved by a smaller local firm. The latter is also likely to be more sensitive and responsive to the peculiar demands of its own district than is the branch of the great Trust run by a manager. As was previously remarked in the case of the competitive distribution of milk: cheapness is only one factor of domestic happiness: sensitiveness of supply to demand is another important factor—one, moreover, which will increase in importance as the poorer classes become more prosperous and consequently more particular in their tastes. Bagehot states in *Lombard Street* (p. 10 of the 1873 edition):—

> "A country dependent mainly upon great 'merchant princes' will never be so prompt; their commerce perpetually slips more and more into a commerce of routine. A man of large wealth, however intelligent, always thinks, more or less—'I have a great income, 'and I want to keep it. If things go on as they are I 'shall certainly keep it; but if they change I *may* not 'keep it.' Consequently he considers every change of circumstances a 'bore', and thinks of such changes as little as he can. But a new man, who has his way to make in the world, knows that such changes are

his opportunities; he is always on the look-out for them, and always heeds them when he finds them. The rough and vulgar structure of English commerce is the secret of its life; for it contains the propensity to variation, which, in the social as in the animal kingdom, is the principle of progress."

The apologist for the present centralization points out that managers are given stimulus in the shape of commission on their results. I reply that this supports my case for decentralization; since if a manager is induced to be watchful by the stimulus of a commission, the amount of which commission is dependent upon the whim of his employer, he will undoubtedly be more watchful still when, being himself an employer, he can retain a greater proportion of the results of his extra exertions. I will demonstrate later that our present laws actually protect the Trust against smaller competitors, and thus foster monopoly. If this can be proved, the contention that "the natural tendency of competitive industry is towards centralization" remains without sure foundation, and the way is cleared for a reconsideration of the social problem, unfettered by any fixed conviction of the inevitability of State socialism.

CHAPTER III

THE PROBLEM RESTATED

THE social problem has been approached from so many sides that it is but natural that the matter should have been rendered somewhat complex. The modern economist has become sceptical of assertions that the social evil may be cured by simple measures. We hear of the housing problem, insanitary factories, female and child labour, sweating, unemployment, etc., and these are often treated as problems requiring separate solutions. At the risk of incurring the scorn of the orthodox economist, however, I would assert that these evils are mainly the effects of one underlying cause, namely, lack of demand for labour among employers. An increased demand for labour would tend to raise the worker's wages, thus enabling his wife and children to keep out of the factory, and securing better labour conditions for the worker himself. The fundamental problem requiring investigation is the lack of demand for labour among those who are capable of organizing industry to supply the acknowledged want of commodities among the masses of the community.

Lack of demand for labour proves either that every individual is consuming as much as he *cares* to earn, that is, that the productive and consuming powers of the community are stretched as far as is compatible with freedom of action on the part of the individuals composing it; or, that there is a hitch in the distributive process, causing involuntary accumulation of goods in the hands of producers, in spite of demand for the same goods on the part of the rest of the community. That the latter cause of weakness of demand for labour is

the only one which is operative in our midst to-day must be evident upon the most cursory survey of commerce. No student of present social conditions will need to be told that the mass of his fellows are not consuming as much as they desire: under-consumption is the prominent evil of modern industrialism. Furthermore, the prevalence of involuntary idleness among the working classes, and the earnestness with which our technical schools are attended by those who hope to qualify as managers and employers, prove that the productive powers of the community are far from being utilized to their fullest extent.

The prominent feature of modern industry is glut of goods in the hands of producers. Factories are periodically brought to a standstill, or put upon short time, to enable the consuming power of the community to keep pace with its productive power. Hence, in order that the employers' demand for labour may be greater, the consuming power of the community must first be increased. Modern social science has decided that in most cases charity is bad for the receiver, and perpetuates the evil it seeks to remedy. On all sides we hear the protest that it is useless for the State to provide work for the unemployed, since there is even at present lack of effective monetary demand for goods already produced. Further, for the State to undertake production with "unemployed" labour, is to tax the industrious in order to provide wasteful work, or if the State enter into competition, to tax them for the cutting of their own throats. What else remains to be done? We see in our midst numbers of able men who would labour if they had tools, material, food, shelter and clothing—in a word, capital. We see also an accumulation of these commodities in the hands of those who would be only too pleased to dispose of them in exchange for the means of continuing production. Here we begin to trace the hitch in our mechanism of ex-

change. If there are men who want to consume—men who are willing and able to produce goods—some means is required for promoting the flow of goods to them from present producers.

In order to consume more, the worker must receive higher real wages, that is, goods must become cheaper, or monetary wages must rise, the worker in either case being offered greater opportunity for consumption of commodities in return for a definite quantity of labour. Against all schemes to establish a legal minimum wage, however, the protest may with justice be made that certain workers are not worth more to their employers than their present wage. The fundamental problem then appears, namely, how to provide the more capable workers with wages more in proportion to the result of their labour. The answer is: Provide a means whereby capable manufacturers or workers may be credited with cheap capital—an order on the excess product of the community—to enable them to undertake production. Those that feel that they could, with cheaper capital than can be obtained to-day, produce goods at a profit at lower prices than the existing market rate, or those that believe that they could under similar conditions, profitably utilize certain labour, even while paying a higher wage than the market one, will then enter the arena of production.

Now the aim of this book is to demonstrate that we have legally restricted the *means* by which capital is transferred from the quarters where it is in excess to those where it is needed—we have restricted credit. Hence those who are able and willing to consume wealth productively are asked a prohibitive price for credit, while, on the other hand, capital accumulates and deteriorates in the hands of a few producers. The fundamental causes of under-consumption are that existing industry must pay too high a price for the medium of exchange (prices of goods being thus main-

tained at a relatively high level in comparison with the reward which actually falls to labour), and that a large quantity of ability is excluded from production by the prohibitive price which must be paid for the means to establish industry.[1]

If the means of transfer of capital were freed from restriction, productive ability would be brought into closer connection with present producers. The provision of cheaper credit would at once enable a number of manufacturers to purchase goods as material for production of fresh commodities, and the increase in wages caused by this trade activity, together with the cheaper credit, would simultaneously tend to provide a market for goods by extending the purchasing powers of the community. There are few manufacturers who would not assist in supplying that enormous demand which is at present unvoiced and ineffective, if cheaper purchasing power were put into their hands and simultaneously into the hands of those from whom the demand arises. This power would first be exercised in purchasing for consumption, secondly in creating a demand for labour, thus raising wages, and thirdly in the production of cheaper commodities. With every fresh demand for labour, the more capable men would be automatically selected from the unemployed to work at those trades for which they were fitted; their selection would moreover lie, not in the hands of a government department, but with those manufacturers and workers who were experts in their own trades and had proved their ability by actual practice. The wage-earner could also command better conditions of labour; his increased wage would enable him to consume the extra goods produced (consumption being further increased eventually by the reduced price of commodities), to save his

[1] Although no reference is here made to the land question, I freely admit that no equitable social system can be established whilst land monopoly persists. See Appendix I.

wife and children from going into the factory, and to pay for the education of his own children.

To increase the employers' demand for labour by cheapening credit, and thereby enabling the establishment of competing employers if necessary, is thus to provide a complete remedy: the increased volume of goods produced must be sold at cheaper prices, the cheap credit must cause increased purchase on the part of the community at large, wages must rise, and unemployment must dwindle and after a time practically disappear. Thus every extension of industry set up by *cheaper* credit must increase consumption faster than production, which is precisely the fundamental need of our present industrial system (see pp. 41-44 for an elaboration of this statement).

A causal relationship is here to be remarked between wealth, credit, and capital. Adopting the orthodox (Mill's) definition of wealth as "Everything which has power of purchasing", and of capital as "Wealth destined to be consumed in the production of fresh wealth", we see that a credit advance is a *loan* of wealth or purchasing power: it can be used in purchasing commodities and labour power—both of which are forms of wealth. We see also that since a loan is made only on condition of repayment, the borrower is obliged to use the wealth productively, that is, as capital. Hence *Credit transforms Wealth into Capital.* Restriction of credit causes wealth, in commodities or labour power, to accumulate and stagnate in the hands of its possessors, and is thus equivalent to a destruction of capital. An axiom upon which all economists are to-day agreed is that capital limits industry, that is, industry can be carried on only when capital is available. It follows inevitably that *a restriction of credit is equivalent to a restriction of industry.*

Macleod writes:[1]—

[1] *Elements of Banking* (London, Longmans, 1897), p. 143.

"Capital, in its most general sense is not any particular thing, but simply an Economic Quantity, be it Currency or anything else, *employed in reproductive operations*. In its general sense it is the Purchasing Power of the merchant, or it is the moving power at his command to generate a circulation of commodities, out of which he reaps his profits. Credit is also the power he has of drawing the goods from the possession of the manufacturer, and is the pledge of his skill in rendering future services to the community, by discerning their wants and supplying them."

With an elastic supply of cheap credit there is no reason why the reduction of usury and extension of industry should not cause competition and the demand for labour to increase until employers receive the lowest reward capable of attracting them, the most highly paid wage-earner judging the small extra profit which he would receive as an employer insufficient to induce him to undertake the responsibilities of the organiser's position. I would lay stress upon the responsibilities of the employer. Under the influence of the modern protest against the monopolistic power enjoyed by many present employers, and the consequent wave of the "equality of all labour" idea, we are in danger of forgetting how much less anxiety is suffered by the man who, *being assured of employment*, has merely to go daily to perform work that is provided for him, without needing to care whether the product is sold, whether it is being put on the market as cheaply as the competitor's goods, and whether the supply of raw material and the general organization are adequate or not.

It is of course evident that the worker is not assured of regular employment to-day; but the communist reformers, in urging his cause, have followed the old evil habit of partizan exaggeration in contending that the

employee "has a right" to the same remuneration as the employer. It is futile to argue "natural" rights; so long as the ability to organize production is both more in demand and rarer than manual skill, we may assume that the acquirement of the former is more difficult for the average man than the latter, and consequently requires greater incentive. Legal restriction upon the free development of credit, however, gives a certain monopoly of industry to modern employers, since it shields them from the competition of the rest of the organizing ability which the community may contain. Hence, although present employers are legally deprived of a considerable portion of their just returns by those to whom the law gives a virtual monopoly of the exchange medium, the high price of credit tends to prevent ability from securing the means of establishing industry and to this extent places present employers in a privileged position.

There can be no more ideal system for a community *in the present stage of social morality* than one in which every capable employee is being employed at wages rendered as high by competition between employers as organizing returns will permit, and wherein the path to the acquirement of machinery by the capable employee is as easy as possible. Under such conditions no employer will dare to treat his employees unfairly, since the great demand for labour will render the latter considerably more independent than at present, and the closeness of competition between employers will cause the wanton dismissal of a skilled worker to be followed more automatically by a reduction of the unjust employer's profits than is the case to-day. Considering the superior incentive to progress and invention, in the present stage of morality, offered by a system of free competition, we may safely affirm that freedom will assure a far higher degree of comfort to the employee than he would obtain were all industry nationalized.

The protest will doubtless continue to be raised from the employers' side that fresh production is not required, since warehouses are already full of goods which cannot be sold, and that in the majority of cases present profits will not admit of reduction. The old insidious argument of "over-production" will continue to be advanced as an inducement to the worker to submit passively to the frequent periods of short time and unemployment which seem to have become inseparable from our staple industries. But there can scarcely exist real over-production when so many willing workers would consume but cannot. If purchasing power in the shape of credit were cheaper and more accessible, goods would be consumed or put to use as rapidly as they were produced.

The fact is rather that those who would undertake production are compelled to pay too high a rate for the credit by means of which alone they may purchase the capital wherewith to establish industry. Hence we find on the one hand producers with goods in their warehouses which they are willing but unable to sell, and on the other hand able men who would willingly consume these goods in fresh production, but who lack employment. Credit, the third term, the connecting link between productive ability and capital, the arrangement by which capital is transferred to productive ability, has been surrounded with restrictive legislation and rendered artificially dear. The under-consumption set up by this involuntary idleness of productive ability tends to compel employers to sacrifice profits in the sale of commodities in order to avoid glut and deterioration of their wares. It is obvious, however, that the community could consume the total present production of goods, and much more besides, if conditions were favourable. Manufacturers cannot give away their wares except to the individual who can give purchasing power in exchange. Purchasing power is to be obtained only by the individual who can secure credit. Credit, again,

is to be obtained only by the individual who can produce *and sell* goods at a profit. But there already exists glut of commodities. What remains to be done?

The key to the problem lies in the artificial dearness of the means of setting up industry. This it is which prevents men from consuming goods in fresh production, and which thus causes under-consumption and unemployment. It may safely be affirmed that the majority of present manufacturers, and also a considerable number of those who are at present employees, would immediately purchase goods with a view to production if the necessary credit could be obtained at cheaper rates than to-day, since cheaper credit would not only enable cheaper production, but would assist the community to purchase the goods so produced. The initial wave of purchasing power caused by the introduction of cheaper credit would immediately tend to relieve present congestion. Cheaper production would enable the cheaper sale of the product, the community's purchasing power being further enlarged by the increased wages caused by the growth of trade activity; hence the market for the goods—the consuming power of the community—produced by the agency of the cheaper credit would be assured: it would be at once stimulated by cheaper means of purchase, cheaper goods, and increased wages. Finally also, the increased wealth of the community would in part flow into its banks and be used to stimulate still further productive ability.

In the following chapters I will demonstrate that our laws prevent the professional credit purveyor, the banker, from arranging the transfer of capital to productive ability at a low rate. We thus compel ability to beg for long-date loans of the limited number of unprofessional holders of gold, with the result that only the few prominent firms are able to secure capital at a rate low enough to render industry profitable, and even

they must surrender the greater part of the results of their labour to the comparatively idle shareholders and moneylenders whom State interference has permitted to batten thus parasitically upon industry. The profits which would constitute a more than adequate reward for the actual employer, must be paid away to the shareholders. Hence, under present conditions, the employer can rarely sell cheaper when the demand from the underpaid and unemployed comes upon him; if he cannot sell his goods at existing prices as fast as they are produced, he is compelled to shut down his factory until the glut of goods has been reduced.

Every worker who is thus shut out of employment, every man who is thus prevented from entering the employers' ranks with cheap credit to cheapen commodities and increase the wages of labour—every such man tends to reduce consumption and leave our warehouses glutted with unsold goods. Let me repeat that cheaper credit would at once permit present employers to sell their products, by enabling other manufacturers to purchase with a view to cheaper production; and, in employing labour and increasing wages, would create a yet greater market for the cheaper goods thus produced, industrial activity and consumption of goods thus increasing snowball-fashion.

This is the declaration which banking reformers must publish to the world, a declaration which shall bring hope to present sufferers and shall prove how accurate is the new diagnosis of the peculiar disease which now affects the industrial population: "*Cheaper credit stimulates consumption.*"

The introduction of *cheaper* credit into an industrial system first stimulates consuming power, and then tends to use up that productive power of the community which called the credit into existence. Any restriction which hinders the development of credit facilities, and causes the provision of credit to lag behind men's desire

to exchange those goods which are already produced, tends to enhance the price of credit, and simultaneously causes glut of goods in the hands of producers. Artificially dear credit and involuntary retention of products stand in relationship of cause and effect. As long as consuming power is unable to dispose of the results of a community's productive ability, it is a sign that the provision of credit is not cheap or not free enough, owing either to legal restriction or to lack of mutual confidence set up by fear of political unrest. *A supply of credit adequate to the needs of producers enables consumption to keep pace with production.*

The details of the process of cheapening credit will be set forth later; it is sufficient here to have demonstrated, in reply to the contention of "Over-production", that whenever credit can be cheapened, consumption can be stimulated to keep pace with production. Granted a credit system with power of free development, and undisturbed social conditions, consumption will slacken only (1) when the demand for commodities outstrips the supply, and prices rise in consequence; or (2) when productive ability either voluntarily relaxes its activity or reaches the limit of its powers, and hence, in either case, voluntarily reduces its demand for credit. If we consider the numbers of men of ability in our midst to-day who are excluded from possession of the means of production, and how great is the productive capacity of modern machinery, it becomes evident that if the consuming power of the community were increased to the level of its present productive capacity in ability and machinery, industrial activity could be vastly increased without causing over-production.

This view of the social problem leads us to understand the present protest against the insinuation of certain Socialists that the evil is caused by the greed of the capitalist class. Socialists are not to blame for this doctrine. It originated with that opponent of socialism,

Ricardo. In setting up the principle that wages cannot rise without profits falling, Ricardo was certainly responsible for the "class war" which has become so regrettable a feature of modern industrialism. The Ricardian doctrine leaves no doubt in the minds of the working classes that if wages are low the employers must be attacked. This is, however, a fundamental error. Whilst restriction of credit certainly causes present employers to hold a certain monopoly, yet the main cause of the poverty of the working classes is that this legal restriction upon the adequate development of the mechanism of exchange prevents an enormous quantity of productive ability from exercising its powers upon raw material, and consequently renders the whole community considerably poorer than its powers of production warrant. The wealthy classes can point out with justice that if their possessions were divided among the whole community, each individual would receive but a very small increase of his present income. Industry certainly pays an enormous tax to dividend receivers to-day, which tax would be considerably reduced were freedom of development granted to the mechanism of exchange; but the benefit derived from the reduction of dividends would be small compared with the vast increase of real wealth which would result if all machinery were able to work up to the full limits of its powers, and if all productive ability were enabled to exercise its ingenuity to the fullest extent upon raw material. The deep evil is not so much the exploitation of the employee by the capitalist class, as the fact that productive ability is generally denied access to that capital which now stagnates in the hands of those who would be only too glad to dispose of it. This exclusion results from the legally-exaggerated dearness, and risk attending the issue, of our present credit medium. The central problem which faces us, then, is to supply cheaper and safer credit—a cheaper and safer means of setting up industry.

The social problem being reduced to such simple terms, the student who may have wondered previously how so apparently small a thing as banking could affect that vast growth known as the social problem may perhaps be induced to consider more diligently the following chapters, since I propose to show that the difficulty of obtaining cheap credit is chiefly due to governmental restrictions on banking.

Turning now to the actual problem set up at the industrial revolution, I would point out that, although the first mechanical inventions so cheapened production as to drive most of the handworkers into factories, the early employers reaped enormous profits. These employers were usually self-made men who started with one or two machines and sprang from the handworker class. The high profits gained offered every inducement for the more capable among the workers to follow the example of these pioneers. Each worker who entered the employer class would have cheapened the price of goods, enabling increased consumption, and would have created a fresh demand for labour, thus doubly tending to increase real wages. The beneficial effects of the introduction of machinery would thus have been spread over the whole community in the form of cheap goods and high wages.

No explanation has yet been advanced by either Socialist or Anti-Socialist of the circumstance that more workers did not become employers. It would seem as though, if no hindrance had existed, competition among employers must have steadily increased until the profits to organizing labour had become so low and workers' wages so high that it would not have been to the interest of the next most capable worker to turn employer. In such circumstances there could be no exploitation of labour, since both machine (or employee) and organizing (or employer) labour would be obtainable at the lowest possible rate. The employee's wage would then

repurchase his product; *his* product, be it marked, not the entire value received for the goods when sold, which value contains also the labour of the employer in organizing industry, and in finding, and dispatching the goods to, the markets where they are most in demand; the just reward to the employee does not include this latter value as is incorrectly assumed by some Socialists. History shows, however, that for some hitherto unexplained reason, the comparatively few employers at the time of the industrial revolution were left in the enjoyment of huge profits, while the masses of employees competed feverishly against each other for work in the few factories, prices of commodities remaining high in comparison with wages, which latter naturally fell almost to subsistence level. The reduction of purchasing power (as compared with the prices of goods) simultaneously set up a tendency for a certain portion of the goods produced to be unsaleable.

The key to the problem would therefore seem to lie in the cause which prevented the continued conversion of the able worker into an employer. The Socialist says, somewhat vaguely, that exploitation of the worker was due to the monopolization of the means of production by the few. Yet we are impelled to enquire how such monopoly was rendered possible, and the Socialist, upon his assumption that monopoly was due to free competition, cannot explain it except by the dearness of the new machines. This admission, however, immediately introduces the question of credit.

In examining the conditions which prevailed at the time of the introduction of machinery we find that the early factories were for the most part constructed on credit obtained from the banks. Macleod states definitely, and his statement is corroborated by most writers on the banking history of this period, that the first factories were for the most part built upon bankers' credit, and that the great works of canal and road con-

struction accomplished during the latter part of the eighteenth century were carried out on the notes of petty country banks. The question then naturally rises why such credit was not extended to other aspirants for the possession of machinery, since the employers' profits were large enough to form a sufficient inducement. We find that even in our present congested system, numbers of workers are continually raising themselves from the employee into the employer class, and the problem to be solved is why the movement is not sufficiently general to use up all the available labour. The solution of this problem will necessitate an enquiry into the principles of exchange, and deserves a separate chapter.

Certain objections will doubtless already be raised by both Socialists and Anti-Socialists; but, in order to preserve the continuity of the argument at this stage, I have preferred to devote a special chapter at the end of this work to a consideration of the chief objections which I have encountered in the course of many years of lecturing and writing on this subject.

CHAPTER IV

THE PRINCIPLES OF EXCHANGE

ALTHOUGH this chapter is headed: "The Principles of Exchange", it will be found to consist rather of an examination of the principles of credit; for I wish to take every opportunity to point out that a free system of division of labour is impossible without freedom for individuals to co-operate, in whatever manner they see fit, in what we call credit. I have judged it advisable to sketch immediately an ideal system of credit, in order that the reader may have a guide or standard to aid him in the examination of existing credit systems. This fact is mentioned here with the aim of anticipating a possible objection on the part of the reader that the system outlined in this chapter is outside the range of practical politics. Having settled the ultimates of credit theory we shall be better able to judge any practical proposals that are put forward. My own proposals for present action will be found in Chapter XIII. Let us now proceed to theory. I will state the principles of exchange briefly, but I would urge that they be read carefully.

Division of labour or exchange, implies that the individual, A, produces, not for himself, but for another; therefore, if A is to be allowed to undertake specialized production as soon as possible (society benefits most by the *automatic* application of ability to raw material), he will need capital, and therefore credit, in order to sustain life until the sale of his first product. Furthermore, since it is rare that he yields up his product to one who has also produced that which he desires (the double coincidence, in Jevons' phrase), A will need some evidence to show that he has given up his product to B

but has not yet received an equivalent; in other words, A is to be credited with purchasing power to the worth of the goods which he has given up. This latter result is usually attained by B transferring to A some token of his own (B's) credit — some token of his ability to produce a future profit. Here, then, in the two most fundamental operations of exchange—the undertaking of production, and the disposal of the result—credit is found to play a most important part. It therefore becomes imperative to examine the principles of credit.

Throughout his works, Macleod, the standard writer on banking theory, defines credit as that which brings into commerce the present value of a future profit.

Among the many hazy and sometimes half metaphysical definitions of credit by orthodox economists I know none that describes so clearly the essentials of the process as this one of Macleod's. It will be seen that it covers both the operations above referred to, since to obtain capital wherewith to undertake production, and to purchase previous to sale of one's own product, are alike methods of bringing into commerce the present worth of a future profit. Macleod states:[1]—

> "The true Limits of Credit may be seen from the etymology of the word. Because all Credit is a *Promise to pay something in future.* And that 'something', whatever it may be, is the Value of the promise. That *something* need not be money. It may be something else. The practice of interest, or usury, was in force before the invention of money. It may be a promise to do anything. As an example of this we may take a postage stamp, which is a promise by the State to carry a letter. And this service is the value of the stamp. Now everyone knows that a

[1] p. 110 of work previously quoted.

postage stamp is a valuable thing. It passes currently as small change. People take postage stamps as equivalent to pence because they often wish to send letters by post. Postage stamps are Credit."

We may now realize how important to any exchange system it is that the provision of credit should proceed smoothly and automatically. For, if productive ability be not assisted by credit to the possession of the capital which society has already produced and which awaits consumption, production will not be in such capable hands as it might be, and the whole community suffers accordingly. Secondly, if, in the example before us, A has produced goods, has found a purchaser B, and yet be unable to obtain evidence of the proposed exchange, he cannot dispose of his product; he must cease production, goods will remain on his hands, and B, who may also have produced saleable goods, or be perfectly capable of producing a future profit, yet cannot obtain credit evidence thereof, is prevented from purchasing and must also remain idle. Hence idleness of two individuals, "over-production" and "under-consumption" as a result of one hitch in the provision of credit. Is it not evident that I have here given simple instances of the great problems that affect us to-day? We have seen low wages result from lack of demand for labour among employers. Machinery, however, is essentially the embodiment of the hopes of a future profit. Failure of credit may therefore have been responsible for the present monopoly of the possession of machinery. Orthodox economists have said that the fundamental evil to-day is rash trading and "over-production"; but the orthodox economists would also have said that, in the above instance, A was guilty of over-production since his goods remain unsold, whereas we find the more fundamental cause to have been the failure of credit.

Credit is that which brings into commerce the present worth of a future profit. The credit token might be called a certificate of merit since it translates into purchasing power the individual's desire to consume, whenever, in the opinion of the issuer of that credit, such consumption will result in the production of fresh wealth. Let us here clear our minds of preconceived notions. Whatever effectively announces to the community the desire and ability of the individual to produce a future profit within a given period is a sound credit token, irrespective of what material it may be made, or by whom issued. I would like to emphasize this statement. An ability to apply it promptly to controversial points is essential to a clear conception of the subject of credit to-day. We have previously remarked that credit is called into existence only to prevent overproduction, deterioration of goods, and involuntary idleness of productive ability. The individual who applies for credit has surveyed the market and decided that there exists *saleable or unconsumed* wealth which he can purchase and utilize as capital. As long as these conditions exist, the demand for credit will persist and should be supplied.

Credit is not in itself wealth—it is not a material object. Credit is the means of transforming wealth which already exists (in the form of commodities offered for sale, and willing ability to labour) into capital. Whatever effectively unites *saleable* wealth—that which has been produced in excess of personal need—and productive ability, is a sound credit token, whether it be made of gold, silver, wampum, or paper. The one and only function of a credit token is effectively to announce to a community *wherein superfluous wealth already exists and is offered for sale*, the commercial capacity and reliability of the individual.

To this first principle it follows as a corollary that the credit tokens should be obtainable as cheaply as possible.

Let me again insist on this point. The frequency with which these principles are disregarded by orthodox economists renders it difficult for me to avoid the temptation to besprinkle this chapter with italicized passages far more thickly than is already the case. In all objects that minister to human needs, other things being equal, cheapness is an advantage. Consequently, if two tokens equally effectively publish the credit of an individual, the cheaper token is to be preferred. Let it not be thought that I am exaggerating petty details; these details have formed the subject of volumes written by currency theorists. With the confidence born of long training in a bygone school of paternalistic political economy, the orthodox economist frequently opposes the cheapening of credit to-day on the ground that cheap credit tempts the unwise into over-trading. On similar grounds it might be argued that cheap bread causes over-eating, and that its production should accordingly be legally discouraged! The economist who has put the reply to this contention respecting the issue of credit most clearly is John Stuart Mill,[1] and, as Bagehot remarks somewhere, "When a prominent man "has said a thing which you wish to say so much better "than you could yourself, it were stupid not to quote "him." Mill writes:—

> "Although the inclination to borrow has no *fixed* or *necessary* limit except the power of giving security, yet it always, in point of fact, stops short of this; from the uncertainty of the prospects of any individual producer, which generally indisposes him to involve himself to the full extent of his means of payment. There is never any permanent want of market for things in general; but there may be so for the commodity which any one individual is producing; and

[1] *Essays on some Unsettled Questions of Political Economy* (London, J. W. Parker, 1844), p. 111.

> even if there is a demand for the commodity, people may not buy it of him but of some other. There are, consequently, never more than a portion of the producers, the state of whose business encourages them to add to their capital by borrowing; and even these are disposed to borrow only as much as they see an *immediate* prospect of profitably employing. There is, therefore, a practical limit to the demands of borrowers at any given instant; and when these demands are well satisfied, any additional capital offered on loan can find an investment only by a reduction of the rate of interest."

Obviously then the demand for loans depends largely upon the price of the loan. *If the price of the credit token be increased, certain forms of genuine productive ability must be excluded from the cherishing effect of credit*, for the same reason that dear clothes compel industrious but poorer people to go ill-clad. If, therefore, as I shall hereafter prove to be the case, the excessive price of our present credit token and the risk attending its issue prevent the monetization of a large quantity of sound commercial ability, consumption of capital being thereby prevented, demand for labour checked, wages kept low and prices relatively high, the importance of a cheap provision of credit can scarcely be exaggerated.

Socialists have insisted that the central evil of our present system is that the producer is unable to repurchase his product. I will demonstrate that the cause of this evil is undoubtedly the excessive price which must be paid for credit, or for the permission to use machinery. This it is that reduces the purchasing power of the producing classes, and keeps wages low in proportion to the price of goods.

The credit token is essentially a certificate of merit, that is, it represents the publication of an abstract quality. The cheapest method of performing such an

operation is by means of a paper document, the ordinary safeguards against forgery to be taken. This statement requires no demonstration.

The question now arises—by whom shall the credit token be issued? Our aim is to provide a means whereby those who have produced wealth for exchange shall be able to transfer it to those who can use it in fresh production. In primitive communities, loans of actual commodities are doubtless made by producers direct to the users. Division of labour, however, creates a class of men who specialize upon the profession of judging the commercial integrity and ability of those who would borrow. The producer still actually lends his wealth but he now lends it to the professional integrity valuer, receiving in its place a token which enables him to purchase immediately. The process is that the valuer lends to the borrower his tokens of guarantee of the latter's productive ability, which tokens the borrower conveys to the producer in exchange for the latter's wealth. It is obvious that when the producer entrusts his lending to a third person, he usually runs more risk than if he himself lends to those only of whom he has personal knowledge. But in return for the risk undertaken by trusting the valuer, he obtains, firstly, immediate purchasing power, and, secondly, access to a wider circle of traders than would have been possible by his own unaided efforts. Hence in our imaginary community we will require judges of productive ability, and certain men must specialize in this profession. But the determination of productive ability is essentially a speculative matter. The ability of an individual which one judge might be willing to guarantee might be rejected by another. We will therefore do well to permit competition between various judges of commercial ability, for the same reason that we permit competition among manufacturers and find that the really useful invention stands thereby the best chance of being

accepted. That judge whose decisions are most accurate, and who is most discerning of the various forms of productive ability, will be favoured by the community. Obviously, certain indiscreet members of the community are likely to be deceived by fraudulent or incapable judges of credit. But the only alternative to a system of competing judges is that one or more integrity valuers shall be selected by majority vote to appraise all types of productive ability. Experience proves that all such elected boards tend to become stereotyped in action and to produce social friction.

We are here faced with the old contest between freedom and protection. Under freedom we permit the individual to experiment with different methods and to receive the full reward of his discoveries and inventions; at the same time however, the unwise are liable to be deceived. Under protection of any sort we shelter the fool from the results of his folly, while simultaneously hampering the capable individuals. All social science teaches us that this is an unsound policy for an industrial stage of society. Progress is only assured by gradually weeding out such persons as cannot adapt themselves to conditions which favour more socially useful types; and, since no man or body of men can be certain what types the future may need, selection is best left in the hands of every individual in the community. Moreover, in the particular matter under discussion, that of credit valuers, history shows that in Scotland, where for a time more freedom of choice between professional valuers was permitted than in any other country, better results were obtained than elsewhere.

An interesting example of the benefits derived from permitting freedom of choice in the selection of bankers is shown in the division of labour which is practised to-day in the acceptance and discount of bills. In the great mercantile centres our present over-centralized banks have found it impossible to know the worth and

standing of all the firms which require credit advances. The practice has therefore arisen for the older-established firms in each branch of trade to "accept" (which virtually amounts to endorsing or guaranteeing) the bills of certain of their less known brethren. The banker thus has dealings only with the prominent men. Of course, with the lapse of time, the reputation of the smaller firms is also established and they also come within the inner circle of the banker's area of advances. In the great financial centres, however, the merchant rarely comes into actual contact as borrower with the banker at all: a further subdivision of labour has created a class of bill brokers who specialize on the discount of commercial bills, and get their funds from the banks. The flexibility of the system which produced "Accepting houses" and bill brokers is a quality which should not be lightly regarded when we are considering the establishment of a new banking system.

An example of the contrary principle comes from France. The late Benj. Rampal left a fund of 2,000,000 francs to be employed in giving assistance by loan at the rate of 3 per cent. per annum to productive co-operative societies, leaving the administration of the fund to a committee to be appointed by the Municipal Council of Paris. Mr. Wolff states in his *People's Banks* that the *Legs Rampal* is going downhill:—

> "Under the influence of technical rules applicants obtain help who are not entitled to it, and who waste it, whereas other claimants, who have indeed a good case, but cannot put it into the shape required by red tape regulations, are sent empty-handed away. In 1887, of 437,000 francs lent out, 100,000 francs were reported irrecoverable. In 1889, out of forty-nine associations lent to, eighteen were found to be bankrupt, eighteen more in course of liquidation, and three suspiciously in arrear."

Bagehot states:[1]—

"A single monopolist issuer, like the Bank of France, works its way with difficulty through a country, and advertises banking very slowly. Even now the Bank of France, which, I believe, by law ought to have a branch in each Department, has only branches in sixty out of eighty-six. . . . The reason is that a central bank, which is governed in the capital and descends on a country district, has much fewer modes of lending money safely than a bank of which the partners belong to that district, and know the men and things in it. A note issue is mainly begun by loans: there are then no deposits to be paid. But the mass of loans in a rural district are of small amount; the bills to be discounted are trifling; the persons borrowing are of small means and only local repute; the value of any property they wish to pledge depends on local changes and local circumstances. A banker who lives in the district, who has always lived there, whose whole mind is a history of the district and its changes, is easily able to lend money safely there. But a manager deputed by a single central establishment does so with difficulty. The worst people will come to him and ask for loans. His ignorance is a mark for all the shrewd and crafty people thereabouts. He will have endless difficulties in establishing the circulation of the distant bank, because he has not the local knowledge which alone can teach him how to issue that circulation with safety."

It will be seen that the essential function of a credit valuer is to give certain individuals an order for goods upon the general community. The objection will doubtless immediately arise that to permit thus a man to consume who has not produced must cause an increase

[1] *Lombard Street* (London, H. S. King & Co., 1873), p. 89.

of prices. I will defer the full discussion of this contention to Chapter XIII., merely treating here the theoretical side. Let us examine the origin of exchange. In a primitive state of society the individual, A, produces exclusively for his own use. *Exchange and the demand for credit will arise only when certain members of the community have produced more goods than they need for personal consumption*, and this is emphatically the case in our present industrial system. When A has produced in excess of his needs goods required by B, one of two things must happen: either he must wait until B has similarly produced goods which he (A) desires; or, B may be permitted to purchase immediately, giving A in exchange a token, a duly attested promise to pay, which the latter may use at his leisure in purchasing such goods as others have likewise produced in excess of their needs. The former system is simple barter, and is the system which obtained in most of the primitive communities. Its disadvantages are obvious. The surplus goods produced by A and desired by B are most frequently perishable and bulky, requiring storage. Their undue retention by A consequently entails risk of deterioration and expense of storage; whereas if he yield them to B immediately in exchange for a credit token, he obtains, in place of goods desired by probably only a few persons in the community, general purchasing power—an order upon the whole community. It is therefore to A's advantage to dispose of his goods speedily, and, so far from the issue of credit to B causing an increase of prices, if credit be withheld A will be compelled to dispose of his goods for less than their equivalent, in order to avoid the risk of deterioration of the goods and the expense of storage. The bearing of these facts upon the hoary problem of usury is interesting and is dealt with in Chapter XV.

It is conceivable that when the credit medium is intrinsically worthless, B may be provided by an

unscrupulous integrity valuer with such a quantity of exchange medium as will cause A to raise his prices unduly; on the other hand it is certain that if credit be withheld from B, A's prices must fall unduly. The problem is to devise a method whereby the issue of intrinsically worthless exchange medium may be kept within proper limits. The chief aim of this book is to show that the method which was being evolved in freedom, previous to governmental interference, was perfectly capable of attaining this end. This will be evident when we come to examine the history of exchange in the next chapter.

Certain critics urge that credit should be issued to B only when he has actually produced saleable goods. I would, however, point out that even credit issued in this manner represents no more than the present worth of a *future* profit, and equally entails the risk of loss, since there can exist no absolute certainty that B's goods will eventually be sold, and be sold at a profit. A certain period must elapse between the issue of credit to B and the redemption of the debt, which period may be occupied either in finding customers for goods already produced, or in the production and sale of fresh goods, according to the arrangement between B and the credit valuer. The chief advantage of the introduction of an exchange medium was that it enabled the period which must elapse between production and sale to be usefully occupied, and while providing a more ready satisfaction of desire to all producers, avoided the risk of deterioration of goods. The total wealth of the community was thereby increased, and the streams of exchange quickened. Every subsequent improvement in exchange lay in the direction of the more automatic disposal of goods on the part of the producer.

We are thus enabled also to point out the error of those who have criticized modern banking on the grounds that a single consignment of goods, in passing

through the hands of the various middlemen on its way to the consumer, may give rise to several bills of exchange and several issues of credit by different bankers, resulting in a considerable creation of credit on the security of only one parcel of actual goods. The reply is that the real security for this credit rests upon the reputation and honour of those who have borrowed: the material security of the consignment of goods is merely an additional guarantee. Each person who handles the goods and borrows on them, promises to produce wealth within a given time, and under normal conditions these promises are quite legitimately converted into present purchasing power by the banks.

We may now sketch an ideal system of exchange, omitting details of organization. Let the individual who desires to purchase wealth which is offered for sale, apply to a professional integrity valuer or banker of established reputation. The latter, if he be convinced of the applicant's ability to produce a future profit, will give him credit tokens made out in terms of whatever value-measurer the community choose to adopt, authorizing him to purchase up to a certain amount, and charging him a certain sum for the service. These tokens or notes will be used in purchase by the person to whom they are issued, and will circulate through the community on the certainty that they truly represent the present worth of a future profit. When the original debtor has obtained his anticipated return he will repay to the guarantor credit tokens to the amount originally agreed upon, and the transaction will be closed.

I have called this an ideal system since I assume that the ability of the credit valuer is sound and is generally recognized in the community wherein he labours; that the credit token is intrinsically worthless; that it is circulated by reason of the reputation of the issuer alone, i.e., not by reason of its convertibility into gold at the bank of issue; and that the advance is duly repaid. I

have assumed these ideal conditions in order to obtain a standard against which to measure our existing system, and it remains an ideal though it be nowhere realized in practice. In subsequent chapters I hope to show that previous to governmental interference with the free development of banking, this ideal was in process of realization, and that the shortcomings of our existing credit system, measured against this ideal, are sufficient to account for a large portion of the evils which beset industrialism in our present society.

A final point which I wish to emphasize is the relationship between credit and money. The fact that nowadays we use valuable tokens for the latter has obscured its essential function. Credit is that which brings into commerce the present value of a future profit. Money is the token by which this act is performed. *That token is money through the medium of which the community is willing to exchange wealth.* Hence, while credit is the arrangement between lender and borrower by which the realization of the present worth of a future profit is agreed upon, money essentially represents the present worth of that future profit. In primitive social systems the community accepts the banker's guarantee of the ability of the borrower only when it is issued in the shape of an intrinsically precious token. The process of improvement in exchange expedients has consisted in the gradual substitution of paper promises for the scarcer and more intrinsically precious metal token. If only I could take the reader with me through the volumes which have been written in latter days, wherein the author, harking back to the needs of a more primitive condition of society, bases his entire system on the principle that "true money" is that only which is itself an article of intrinsic worth, and comes quite naturally to the conclusion that paper money is a delusion and a snare—if only the reader knew how much confusion has been set up by such conceptions of the principles of

money, and, graver still, how much social misery has resulted therefrom, he would not wonder at my reluctance to leave this part of my subject without driving the points thoroughly home.

In subsequent chapters I will show that the view that money must itself necessarily be of worth, mirrored a primitive state of society, for, although money may be safer when it is in itself precious and consists of goods produced, yet its essential function is purchasing power. In an advanced state of society, increasing use is made of contract and promise in all human relationships: men begin to rely less on individual methods of self-defence and more upon public opinion and the arm of the law. The process is one of gradual specialization and division of labour. Accordingly, with increasing civilization, the transfer of intrinsically precious money is replaced by the transfer of documentary promises, and when once men begin to rely upon such an exchange medium, and regulate their production of commodities accordingly, exchange can proceed smoothly only if *all* individuals who either have produced, *or can produce* value within a given space of time, be given purchasing power. The fulfilment of these conditions necessitates the use of a money which is intrinsically worthless. Macleod again states,[1] and supports the statement by quoting many economists from Aristotle down to Adam Smith and John Stuart Mill: "The true nature of money is to be a "Right, or Title to demand something from others." I will show indeed that the medium of purchasing power is in a truer sense "money" when it is not in itself precious, since it then more fully represents goods. A valuable money represents the goods *minus the cost of obtaining the money* (apart from the banker's labour). It is only when the price of money falls to the cost of the banker's labour in valuing ordinarily safe security that the benefits of credit may be extended to the widest

[1] p. 15 of work previously quoted.

range of security—it is only then that money becomes the servant of goods instead of their master—that it becomes a thoroughly popular instrument.

Whereas in a primitive state of society only that is purchasing power or capital which has intrinsic worth; as society advances, and men's promises may be more relied upon, a man's mere promise to produce a future profit, endorsed by majority opinion in the community wherein he dwells, through its mouthpiece the judge of integrity, becomes equally valid purchasing power and capital. Any obstacle which prevents the community from thus evincing its trust in the individual's promise to produce a future profit actually prevents the growth of capital, and consequently prevents the growth of industry. Money is the token of credit. We have seen that credit is not capital but the means of transforming wealth which is offered for sale into capital. Credit is an act, an arrangement—not a material object. Money is the evidence that the act of credit has been performed. Whatever may have been the case in primitive days, people who sell commodities for gold at the present time, have, for the most part, no use for the gold as such. A gold coin is to them merely a token which others will accept in exchange for a certain value of commodities, "a right or title to demand something from others."

Let it not be thought, however, that I necessarily favour an exclusively paper currency, as some of my critics have supposed. Small change which circulates rapidly and receives much wear will probably always be most economically represented by cheap metal tokens. Yet it should not be thought that the greater safety (implying intrinsic worth) of this money token necessarily implies a more "honest" money. An honest money is one which will obtain in exchange precisely the worth of commodities which was given for it. A paper token may perform this function as satisfactorily as the most

valuable money: it depends entirely on the method of issue of the paper token and upon the safeguards adopted by the community to protect itself against fraud.

I have treated this problem of exchange simply, but the matter is highly important. The battle of the future will be fought around the question of whether the introduction of a *commodity* medium is necessary to the exchange of goods. I trust to have shown that, ideally, the exchange of goods requires nothing but the balancing of figures—that it is a simple matter of book-keeping. Men will protest that the introduction of paper will "drive loanable capital abroad"—we must be able to prove that the home exchange of goods can proceed as long as the printing press can issue duly attested paper tokens of men's confidence in each other, and that foreign exchange will persist as long as we possess goods of a sort required abroad to give in exchange for those we import.

CHAPTER V

THE HISTORY OF EXCHANGE

THE credit system described in the previous chapter was an *a priori* one, deduced from a knowledge of the needs of commerce. I will now endeavour to demonstrate inductively that the ideal system described represents the fulfilment of the historical strivings of men towards improvement of the exchange system, and that the inequity of our present social relationships is for the most part due to the deflection of the previous course of progress by unwarrantable State interference.

The way from production for exclusively individual use towards the modern system of exchange lay through barter. In barter obviously there was an entire absence of mutual trust and consequently of credit. The individual gave up his product only when he received immediately the actual goods he desired. With the growth of exchange, however, it was not always possible to find such a convenient purchaser, and the need was felt for some commonly recognized medium of exchange which would enable the holder thereof to purchase of some person other than the one to whom he had given up his own product. Different tokens were chosen by different communities, but in most civilized countries a valuable metal was chosen as the medium of exchange; in this country the choice eventually fell upon gold. As a matter of historical fact, gold and silver were chosen in most countries, but we will avoid the bi-metallic controversy at present by speaking of gold only.

This choice of a medium of exchange is interesting and deserves some examination. The substitution of a gold exchange medium for the system of commodity

barter represented in effect the introduction of mutual trust and a form of credit, in that it recognized the need of such a token of the individual's purchasing power as would be accepted by the community at large, and depended for its efficacy upon the individual's trust that the community would receive gold in place of ordinary commodities. Yet it was a system which reflected the conditions of the age in which it was introduced—a perfect example of the principle that when individuals are left free to supply each other's needs without *directive* governmental interference, precisely that system which suits the majority will be chosen. Justice was not yet sufficiently secure in the detection of crime, and social morality not yet sufficiently developed, to admit of reliance being placed on a purely documentary guarantee of the individual's credit; there was accordingly evolved a token which, while commonly recognized, was in itself of worth and thus evaded the necessity of any advanced form of mutual trust for which the community was as yet unprepared.

Gold became in this wise at once the medium of exchange and, by reason of its qualities of comparative stability of value, etc., the standard of value. Books have been written to prove that the only true money is that which is at once the standard of value and the exchange medium. But these two functions are in reality quite distinct and separable. In the middle ages, when coin clipping was frequently practised, and debased coin was common, it became impossible to calculate values with certainty in any national coin, and the old Bank of Hamburg introduced a value-measure which was never coined. This was the Mark Banco, the name given to a certain weight of fine silver. Deposits were received in silver and gold coins of every nation, of all descriptions and alloy—all deposits were valued in Mark Banco, and credited in that imaginary coin to the depositors' accounts. Certain tribes of North American Indians

value their goods for exchange purposes in fox-skins, yet the skins are rarely present at the transaction, and are themselves of fluctuating value. A single fox-skin for instance, may be priced at a fox-skin and a half.

Whilst, however, the gold credit token was admirably suited to the times in which it appeared, it was precisely its worth which unfitted it to serve as exchange medium in a more advanced community. Worth is partly dependent upon scarcity, and although gold sufficed for the commerce of primitive society, its scarcity inevitably rendered it unfit to effect the volume of exchanges in a more advanced commercial state. Moreover, the natural scarcity of gold coin has always been aggravated by human agency. Del Mar has shown that the issue of gold coin has from early days been the exclusive monopoly of kings. Indeed, in ancient Persia and other eastern countries, a monarch was not considered to have fully assumed his regal power until he had stamped and issued money. The privilege of coining even came to have a sacred significance, and we find that from the time of Julius Cæsar to the fall of the Roman Empire gold coinage was considered throughout the Roman Empire to be a sacerdotal privilege of the Basileus at Rome. Monopoly of the issue of coinage or purchasing power was doubtless originally assumed by rulers on account of the value of the privilege. Legal tender laws, compelling the use of official coins, were introduced when impecunious monarchs conceived the idea of replenishing their coffers by the issue of debased currency.

Governmental monopoly of the issue of money has been defended by later supporters of orthodoxy on the grounds that it would be vexatious to commerce if persons were obliged to discriminate between the money of various private issuers. We observe, however, that in Scotland the private paper money of the issuing banks is preferred to the gold coins issued by the government:

experience has demonstrated to the Scottish people that forgeries of the paper of its private banks are rarer than counterfeit sovereigns: the issuers of the paper are on the spot, and are interested in preventing forgeries of their own notes; whereas the government acts slowly and ponderously from a distance. Moreover, it will be demonstrated later, in dealing with the history of Scottish banking, that the confidence at present enjoyed by Scottish banks is precisely due to the comparative absence of State interference in the days of the establishment of banking in that country.

Let us return to the general history of currency. With the gradual increase in the volume of exchanges, the hunger for exchange medium increased, and was met by no fresh gold discoveries. Hence arose the high profits of usurers. The usurer collected gold from those who had no immediate use for it, and loaned it to those who desired purchasing power. He resembled our ideal guarantor in that he judged the individual's credit, and, by an extension of mutual trust between himself, the borrower, and the community, translated private credit into a form recognized by the latter. Yet, since his credit tokens were themselves scarce and valuable, and the times were troubled politically, he was able to charge a high price for his advances. The safety of the token was secured at the expense of its cheapness. The usurer frequently lost both principal and interest in times of political unrest. Hence to the interest charged for the use of scarce tokens he added a risk charge, the double charge constituting a burden which rendered the establishment of industry upon borrowed capital virtually impossible. The only persons who approached the usurer were those who, like Antonio in *The Merchant of Venice*, stood in urgent need of money to avoid calamity. Ordinary industry, being thus limited to the capital which the craftsman or merchant could accumulate by personal thrift, was exceedingly restricted, and the

whole community suffered in high prices of goods and frequent periods of famine. Brutus lent at 48 per cent. in Cyprus; Seneca levied enormous interest in Brittany. The community groaned under the extortionate demands of the usurer, and the government interfered. But the science of credit was not yet sufficiently understood to admit of the perception and application of a rational cure. The government merely prohibited the levy of interest; but, since no cheaper credit token was provided, the prohibition was worse than useless, for it prevented honest men from obtaining credit, even at any price, and compelled resort to illegal contracts. From prohibition of usury the government was forced by the needs of commerce to pass to regulation. From 10 per cent., the maximum rate which might be exacted was successively reduced to 8, 6, and 5 per cent., and the limitation actually persisted in England, to the great hindrance of commerce, until the Act of 1854, when it was removed, economists having at last decided that the institution of a legal maximum acted in restraint of trade.

It is surprising to us to-day that the fact should have been for so long overlooked or disregarded that when a man desires to undertake risky enterprise on borrowed capital he should compensate the lender of the capital in proportion to the risk involved, and that to prohibit high interest is to proscribe certain loans which might promote enterprise in a thoroughly beneficial manner. But the century-long prohibition of high interest is explicable when we remember that the limited issue of exchange medium, together with the general absence of social security, compelled the payment of high interest on *all* borrowing transactions—even on the safest. Hence the usurer tended to absorb the greater part of the wealth produced by industry, causing those periodical revolutions when the industrial class in desperation repudiated its crushing weight of debt and murdered

the usurers. Public sympathy was with the debtor class. The government, overlooking the true causes of excessive usury, which lay in its own inability to preserve peace and order, and in its restrictions upon the supply of exchange medium, fell back upon that device which seems always so temptingly easy to a certain class of politicians, namely, legal regulation of the rate of interest. In a later chapter I will point out a parallel example in the case of our own Factory Acts. The peculiarly harmful effect of the Usury Laws in preventing the extension of credit at the time of the industrial revolution will be demonstrated in treating the history of that period.

In 1099 began the crusades and relations with the East. There resulted considerable commerce with Aleppo, Damascus, Bagdad and Cairo. Brooks Adams gives an interesting, if partizan, account of the currency history of this period in his *Gold Standard*. The currency felt the strain of the increased volume of exchanges, and the Venetian and Florentine bankers revived the old Roman Bills of Exchange, by which alone the growing Levantine commerce was rendered possible. In Bills of Exchange we see a most important step in the evolution of the ideal credit system. The greater part of the commerce between Europe and the East was henceforth transacted without the transmission of gold by means of a simple balancing of debts in ledgers. The Marseilles merchant who had purchased in Jaffa, for instance, received a request for payment on a specified date. This document he endorsed with his promise to pay and returned to the vendor, who sold it to his local banker for a less amount of cash. The Marseilles banker likewise collected Bills of debts due to his own customers. The two bankers exchanged the paper, and each collected the debts from his own customers when due, either in cash or fresh paper. This system was rendered possible only by the bankers' and merchants' guarantee

of the integrity of their customers. Its importance lay in the economy thereby effected in the use of gold. It fell short of the ideal credit system in that the private nature of the document and the imperfect administration of justice did not permit the extension of the system to all classes of society. Bills of Exchange remained, therefore, for the most part, an aid to exchange for wealthy merchants only: they have never performed that essential function of a true substitute for gold, namely, circulation through all classes of society. Banks similar to the Venetian were set up at Amsterdam, Hamburg and other places, and were mainly instrumental in aiding that blossoming of art and commerce which characterized the Renaissance period.

For subsequent improvements in credit systems we may turn to the history of our own country. The successive steps by which the community was led to the adoption of banking as we now know it form one of the most interesting chapters in the history of commerce.

A general survey of the industrial history of mediaeval England shows the producing class almost continually suffering under grave disabilities. We notice first the various gilds, established in turbulent times to protect the craftsman against unruly barons (protection which the State was unable to afford) but rapidly becoming exclusive organizations animated with the sole desire of preserving a monopoly of industry for their members.[1] For many generations, wave after wave of industrial discontent threw itself against the gilds, until they finally gave way in comparatively modern times to a less restricted condition of industry. We shall fail to understand the spirit of mediaeval industry if we look upon it through the spectacles of modern political ideas. Ours is an age of industrialism. Let us remember that we are considering an age of militarism. We honour the man of

[1] See J. M. Robertson, *The Evolution of States* (London, Watts & Co., 1912), p. 393.

industrial ability or learning. They honoured chiefly the warrior, and rightly so, for the times rendered the warrior more important than the craftsman or scholar to national life. Hence the mediaeval government regulates the whole life of the individual with a view to the production of the most efficient warrior. There is little doubt that the famous Mercantile Theory, which for so long dominated politics, needing the genius of an Adam Smith to overthrow it, was partly a product of the military age in which it was conceived. The rulers saw that it was necessary to maintain a large national stock of bullion for the ever-impending possibility of war. It was noticed that purchase abroad tended to drive the bullion abroad. What more natural, then, than that rulers should prohibit import of foreign commodities, and "cherish" home industries with bounties; and that statesmen and people should acquiesce in this (from the point of view of a later industrial stage of society) monstrous policy? In the primitive community the king is the absolute ruler. Liberty to engage in industry is a privilege to be begged from him, a privilege which is granted to his favourites, or, when he becomes needy, sold to the highest bidder. Thus the gilds are established. But the gilds merely replace one monopoly by another. Contemporary political economy knows no right of the individual to labour freely for and receive remuneration from another. He who would labour in any of the various crafts must pay his dues to the particular gild which monopolizes that industry, and must comply with its various regulations. We must thoroughly understand the submissive spirit of the ordinary people of those ages before we express surprise at the shameless manner in which monopolies were granted to certain corporations.

In addition to this obstacle to prosperity of the craftsman there was, on the other hand, the deeper disease of usury. Throughout historical times we find the recorded

protests of reformers against excessive usury. Little reference is made to the two main causes of excessive usury, namely, social insecurity, and legal restriction of the exchange medium. On the contrary, we find frequent appeals to the conscience of the usurer and to legal prohibition, the former appeals being as fruitless then as to-day, and the results of the latter more evil than the disease which they sought to cure. The prominent tendency of industry in all ages has been to outgrow the means of exchanging its products. This tendency will appear the more inevitable when we remember that the invention of a machine which may displace a considerable quantity of labour depends upon a single individual; whereas the development of credit to provide means for the establishment of the new machine depends upon the general order and security of society. Already in 1555 we find, as Professor Milnes points out, the beginnings of Factory legislation in the Weavers Act, which sought to prevent the outside individual from establishing more than one loom in his house and thus undercutting gild prices. Under conditions of political security, industrial freedom, and a rational credit system, it would have been easy to establish a sufficient quantity of the new machines to use up all the labour which they displaced, and the whole community would have profited by cheap production. But, plundered by greedy monarchs, barons, and the robbers who roamed about unrestrainedly; oppressed by the powerful gilds and the usurer; suffering acutely from the periods of unemployment induced by every introduction of machinery and every political crisis, the condition of the industrial classes throughout the middle ages was generally precarious in the extreme.

Progress towards the reduction of usury was instituted by the London goldsmiths. It had been the habit of wealthy persons to deposit their gold and valuables in the Tower of London for safe keeping. On two occasions, however, the Stuart monarchs seized these

deposits and announced the seizure as a loan, previous application in the open market for a loan having failed to secure a response. The merchants henceforward prudently deposited their gold with the goldsmiths, whose huge strong-rooms offered a better guarantee of safety than the honour of princes. The goldsmith, on receiving such a deposit, gave a receipt for it. When the merchant wished to pay a large debt he prepared a document directing the goldsmith to pay a certain quantity of gold to a particular person, which document he forwarded to the payee instead of gold. This type of instrument has been preserved to us in the cheque. It doubtless, however, frequently happened that the merchant's signature to a cheque was insufficient to convey a sense of security to the recipient of the document, and the practice arose of circulating the goldsmith's receipt itself, the goldsmith's signature being more widely known than that of any individual merchant. The goldsmith then began to give receipts, divided up into convenient amounts, for each sum deposited with him, and wherever his reputation extended, a receipt signed by him was accepted as satisfactory payment. This innovation marked an improvement on the primitive cheque system, and was due to a further extension of mutual trust. Experience gradually taught the goldsmith that the more his reputation became established the less often were his receipts returned to him for redemption in coin. He thereupon conceived the idea of lending to applicants for credit advances his receipts, or promises to pay gold to bearer on demand, instead of his gold. He charged interest on these receipts as though he were lending the gold itself, and circulated quantities of them on the pure chance that no considerable number would ever be returned to him simultaneously for redemption in coin. When repayment of the loan became due, his client returned either receipts or gold, and the transaction was closed.

This system marks an important step. The goldsmith, or banker, as he came to be called, was by this means enabled to monetize a quantity of credit far beyond the limits of his gold store. People began to lend the banker their gold at interest, and, although he could pay interest only if he were permitted to use the gold in his own operations, they had faith that if they needed their gold it would be forthcoming. Their experience of the business reputation of the banker gave them confidence that he would lend only to those who were capable of repaying the debt, and that their gold was therefore safe in his hands. The community circulated the banker's promises to pay gold to bearer on demand, well knowing that he could never redeem simultaneously all the promises he had issued. Experience taught the banker to keep sufficient gold by him to satisfy actual demands. The banker knew, moreover, that numbers of his notes were continually being paid into other banks in the ordinary course of business. These notes were returned upon him immediately by those banks, and, if unbalanced by corresponding repayments to him by his borrowers, would have to be met in gold. This way led to bankruptcy. Accordingly, if his business acumen did not lead him to avoid issues to incapable producers, his dwindling gold reserve would gradually bring him to his senses. It became, therefore, the more important to him that his notes should not be returned for redemption owing to lack of confidence in him; and it was to his interest to afford adequate guarantees of the soundness of his operations. By this delicate mechanism of mutual trust the community was led along the path towards the ideal credit system—that system in which productive ability is freely translatable into purchasing power; and by this means alone was enabled the transaction of the growing commerce of the community. As mutual confidence increased, there was set up a double movement towards increased facility of credit: the com-

munity brought its superfluous gold to the banker, and the banker was able to issue a gradually increasing quantity of credit on the wealth thus entrusted to him. Competition tended to evolve the banker with the soundest reputation and whose charges for providing exchange medium were lowest. The community reaped the advantage of being able to obtain a cheap medium of exchange.

Economists of all shades of opinion have justly laid great emphasis upon the importance of the accumulation of a country's wealth in the hands of its professional lenders. It needs but little insight to see how great an advantage that country obtains whose superfluous wealth is accumulated and directed to those quarters where it may best be used to stimulate fresh industry. At any given time, two countries may be equally wealthy; but if the merchants of the one country follow the oft-quoted example of Pope's father who, moving into the country, carried his gold with him in strong boxes, whilst the second community confides its gold to its bankers to be used in stimulating fresh productive ability, there is very little doubt as to which country will show the greatest prosperity in the course of the next generation.

Most of the orthodox economists, however, have been guilty of a serious oversight in their examination of this subject. They have emphasized solely the importance of the economization of *gold* in the hands of the banker, omitting to give due prominence to that far more important movement, the issue of paper *substitutes* for gold by the banker. The banker has been looked upon as a lender of gold, instead of a distributor among possessors of productive ability of all forms of wealth produced for exchange. It is for this reason that I have adopted a different plan in this book, and have prefaced my history of the evolution of the banker by a sketch of an ideal system, setting forth my conception of the goal

towards which developments in banking were tending prior to governmental interference. Others have been satisfied to point out the part played by the banker in accumulating and distributing *gold*; whereas I seek to show in this circumstance merely a step in the evolution of the ideal system. In this country we have never been producers of gold, hence if the banker confine himself to the collection and distribution of this metal, he can collect the wealth of those only who are able to exchange their actual products for this metal, and if the production of ordinary commodities be greatly in excess of the available amount of gold, there results inevitably a glut of wealth in the hands of producers, side by side with unemployment and starvation on the part of a considerable section of the community. The banker can attain the utmost efficiency in the distribution of the *whole* wealth produced for exchange only if he can collect, or, what amounts to the same thing, issue orders upon, the whole wealth so produced.

Note the evolution of the system. In the beginning the banker collects and distributes only the gold. The first circulating paper substitute which he is able to issue over and above his gold store is equivalent to the deposit of an equal amount of other wealth than gold in his care, and its transfer to one who intends to use it in fresh production, since the paper note is issued only to one who may be relied upon to repay the loan, and represents an order upon the existing wealth of ordinary commodities produced for exchange. The greater the quantity of wealth produced for exchange, the more must the banker be able to extend his issue of orders upon that wealth. Evidently, then, the ideal banker must not be limited in his issue of orders upon the wealth produced for exchange by the available quantity of a scarce metal, which metal may be withdrawn precisely when the desire of the community to exchange other forms of wealth is at its greatest. For this reason

I have shown the ideal banker issuing intrinsically worthless tokens; which tokens are accepted and circulated by the producers of the community in exchange for their goods in virtue of their confidence that the banker issues these tokens to those only who may be relied upon to produce equivalent wealth within a given time. As we pursue the history of the development of banking, this ideal will constantly provide us with a key to the mazes which grew around the theory of banking during the violent controversies of the early part of last century.

To resume, let it here be noted that the early note-issuing banker had improved upon the usurer, and approached still closer to the banker of our ideal, in that, under division of labour, he had extended the profession of judging the commercial integrity of applicants for credit by economizing the use of gold as a credit instrument. In his advances he began to look chiefly to the applicant's power of employing capital to advantage. A circle of small traders who could be relied upon to pay their debts, but who required advances at a low interest, was more profitable to the banker than the rakish young blood who was willing to pay a high rate of interest for a loan the repayment of which was doubtful. The banker lent, not gold, but paper promises to pay gold on demand, that is, intrinsically worthless tokens. He could prosper only when the community had sufficient confidence in the reliability of his judgment to circulate these tokens without demanding their redemption in coin. Hence his chief aim was to avoid risky loans, just as it was the moneylender's, on the contrary, to seek them. The banker's aim was to cherish his reputation; the moneylender, on the contrary, was not dependent upon his reputation: he lent, not paper, but gold, and his one aim was to secure high interest. The banker's limitation lay in that he was still compelled to restrict his credit advances to a proportionate

relation to his gold store, on account of the lingering suspicions of the community, and the danger of political unrest with its accompanying destruction of credit. Yet, every receipt or "bank note", as it came to be called, which circulated, and was finally paid back into the bank by one of the banker's clients without its redemption in gold having been demanded, was a step towards the ideal system, since it was a sign that the community was using some other check on the banker's reliability than that of desiring actual gold in the hand. The note system performed most of the exchange functions of gold, and possessed this fundamental superiority over gold, that it was capable of extension with the growing exchange needs of the community.

Here, then, the way was prepared to the ideal system of credit. As social security and public confidence in the bank increased, the bank note would circulate more freely, and calls for its redemption in coin would become more rare. The banker would then be able to circulate a gradually increasing quantity of notes on a given gold basis, and be able to monetize greater quantities of productive ability. As commerce and the demand for credit increased, and the possibility of converting the mass of circulating credit tokens into gold became more remote, it is probable that, just as necessity had produced the bank note itself, so the public would have come to see that the sole essential of a note is that it should have been issued to a reliable person—to one who would in due time redeem his debt; possibly also, people would have come to see that credit could become cheaper in proportion as the demands for gold on the banks became fewer (the clients of the old Scottish banks helped their banker by circulating his notes as long as possible). Human ingenuity and freedom for experiment, would, as in countless other cases, have invented improved methods. Other means than the gold check of ascertaining the reliability of the banker would have been in-

vented: probably the method of checking the banker's issues by examination of his accounts would have been adopted. Gold would then have been deposed from its position as exchange medium and relegated to the mere position of a standard of value. The way would thus have been thrown open to a cheap monetization of all forms of productive ability.

It is important to notice that the interest of both the banker and his customers lay in the direction of the reduction of calls upon the former for gold. The fewer the demands for gold, the more the banker could extend his issues, which extension meant more profit to him and increased accommodation for his customers. Hence it was to the interest of the banker to invent other means than the gold check of assuring the confidence of his customers in his issues; and it was equally to the interest of his customers to use these other checks. The employers, who knew that they could get the cheaper money only when its redemption in gold was not demanded, used every means in their power to spread a good opinion of the bank's reputation, and, when certain employees were still suspicious of the paper, either made it a condition of employment that notes should be accepted for wages in place of gold, or, when the demand for labour was so great that they were unable to make such conditions, offered higher wages to those workmen who would accept notes and endeavour to circulate them. The same motives compelled the acceptance of the paper by local tradesmen: they must either accept the paper or lose custom; moreover, the local tradesmen themselves were frequently debtors to the bank and were therefore only too willing to accept the notes.

The efforts of the bankers to invent methods for reducing the number of demands upon them for gold are interesting and of high importance. In Scotland, where, in the early eighteenth century considerable free-

dom for banking experiment was permitted, the danger to home credit which sprang from a sudden conversion of a considerable quantity of notes was early noticed. The danger lay in the suddenness of the demand: the banks could have obtained gold had they been apprised some time previously. The demand was usually quite unconnected with any decrease of confidence in the stability of the bank thus attacked. In the experience of Scotland the demand was usually either from another Scottish bank which wished to ruin a competitor, or caused by bank failures in England, failures chiefly due, as will subsequently be demonstrated, to vicious governmental interference with banking in that country. In both cases, however, the demand was sudden and usually quite unforeseen. Accordingly, the early Scottish bankers introduced the note with the option clause. This was a note redeemable in gold at the bank of issue, not on demand, but, at the option of the banker, within a period of from three to six months after demand, according to the terms specified on the note itself, interest to be paid for the time during which payment was deferred. These notes were introduced by the foremost bank in Scotland and were rapidly copied by all the other Scottish banks. The bankers publicly announced the reason for the innovation; and, as soon as their customers saw that no reckless issues were made, they accepted these notes at par, thus following the path of progress to the theoretical ideal which I have previously outlined. In accepting these notes at par, producers showed that they did not require gold in order to effect exchanges. They relied upon the banker's care for his reputation to induce him to confine his issues to such persons as were capable of producing a future profit, and they compelled the banker to be careful by maintaining a close survey of the commercial career of the persons to whom he had made large loans. The bank then ceased to be regarded as a storehouse whence gold

could be withdrawn for export abroad, and the banker increasingly assumed the function of integrity valuer pure and simple, the demand for gold being directed to the professional goldsmith.

The fate of the option-clause note will be recounted later on; I have merely referred to it here in order to show that my description of the probable course of progress in the science of banking under untrammelled conditions is not unsupported by facts. It will be seen that the option-clause note system was capable, in the first place, of gradually weaning ordinary producers from their reliance on gold as the only sound exchange medium, and consequently of enabling the gradual extension of credit beyond the limits of the gold basis and up to the demands of commerce itself. In the second place, the system protected the home credit structure against attack from abroad: a most important consideration, as we shall see later. The demand for gold from abroad was invariably for immediate payment. The postponement of payment for six months by the bank compelled the financier to transfer his demand to the goldsmith, who set a price upon his bullion calculated according to the demand and supply conditions of the market. Gold thus tended to fluctuate in price, and consequently to become unfit to serve as a standard of value. This very fact, however, as will be shown later, stimulated human ingenuity to the discovery of a better theory of value.

This is perhaps the most important contention which I have to lay before the student of the social problem, namely, *that freedom for experiment would have resulted in the evolution of a banking system adequate to the demands of commerce.* The remaining portion of this book will be devoted to proving, in the first place, that the reasons advanced by economists, past and present, for the legal restriction of freedom of banking are in the main unsound; and, in the second place, that such social in-

equity as exists in our modern industrial system is largely due to the restriction of freedom of exchange set up by these legal hindrances to the lending of capital.

It was not to be expected that so valuable a power as the issue of paper money would long escape the cupidity of monarchs. Indeed, nothing seems more natural than that the impecunious government should reason that since people are willing to accept paper instead of gold in payment of debts, it could thus cheaply discharge its own liabilities. From the period of the invention of banking down to our own time there is no commercial operation which has been subject to more restrictive interference and governmental monopoly than banking, with the natural result that we find everywhere current the opinion that banking is essentially an operation *needing* governmental supervision. Here again we discover the old protectionist principle. If we bind a child's legs from birth it is but natural that at maturity it will be unable to walk without assistance. It is also natural that people who have forgotten or overlooked the original restriction will assert that it is inherently impossible for the child to walk without supervision. It is only my desire to avoid the too frequent irony of inverted commas which restrains me from continually referring to this principle as "Protection".

We will now proceed to the examination of the later history of banking in this country. Governmental interference with the medium of exchange was far more frequent abroad than in Great Britain; for circumstances early combined here to throw power into the hands of the people rather than into those of monarchs, with the result that our merchants were better able to prevent undue State interference with their operations than was the case abroad. It will suffice, therefore, to show the disastrous results of such interference as took place in England and Scotland, since we may be assured that the rest of Europe suffered even more.

CHAPTER VI

THE BANK OF ENGLAND

In 1694 the Bank of England was founded and set up in the midst of the goldsmith-banker system described in the last chapter. The circumstances of its establishment are noteworthy. William III. was in urgent need of money for the prosecution of continental wars. The conspiracies of the Stuart faction, however, rendered his throne unstable, and merchants were unwilling to risk their gold in loans to him. At length a body of London merchants and others were induced to make a loan to him at a certain interest on condition that he permitted them to issue notes to the amount of the loan. Further loans followed and the company was eventually rewarded with permission to issue notes to any amount, provided that the notes were redeemable in coin on demand. In thoroughly royal fashion the company was given a monopoly of note issue. There were suggestions at the time that the notes should be given a forced currency, that is, that people should be compelled to accept them as legal tender in payment of debt, but the proposal was rejected by the company itself. It was seen that confidence lay at the root of the note system. Credit represented the very blossom of mutual trust in commercial circles, and it was held that no State decree could compel such confidence.

Let it here be noted that the Bank of England was not established to supply the community with credit but was modelled with an aim similar to that of the early Italian banks, namely, to provide the government with funds. This single circumstance has determined the whole development of banking in England, and indeed,

throughout the world, since the later banking systems of the world are largely modelled on that of England. The subsequent history of banking in this country may be termed the record of the struggle between the Bank of England on the one hand, using every means in its power to maintain its monopoly, and the people on the other, whose growing commerce cried aloud for a more elastic credit medium. The bank, being the mainstay of the government, was usually the victor in the contest. Time after time the government pounced upon the stores of the Bank of England, and usually gave it some compensatory privilege. I do not propose to make this a detailed history of the Bank of England, but merely desire to show the genesis of current misconceptions on the subject of banking. It is therefore unnecessary for me to detail the various acts of restriction of private banking, or the political jobbery by which they were obtained. These details can be obtained from any history of the Bank of England.

With the extension of commerce the value of the note monopoly naturally increased and, in response to clamour, concession was made in 1709 to a class too powerful to be resisted: companies consisting of not more than six partners were permitted to issue notes, the profession of banking being thus restricted to the wealthy members of the community. It is evident that notes would be accepted by the general public only when there existed confidence in the issuer of the notes. Such confidence must repose either on the personal reputation of the issuer (e.g. a man that had established his reputation in other industry might, and frequently did, begin to issue notes), or on the quantity of capital known to be sunk in the bank. The partnership restriction law hindered the establishment of fresh banks founded on the latter type of assurance since it limited the number of people that might pool their capital to start a bank. It is evidently more difficult to collect a

given amount of capital from a small than a large number of people. Moreover, as the writer (Sir John R. Paget) of the article on banking in the *Encyclopædia Britannica* (Eleventh Edition) remarks of this law:—

> "When a partner [of such a joint-stock bank] died, his capital not infrequently went out of the business; then a fresh partner with sufficient means had to be found. Constant change was the result; and confidence, 'a plant of slow growth', could not thrive, except in those instances when a son or a relative filled the vacancy."

In 1765 the government's attention was drawn to the option-clause notes previously referred to. These notes had become an institution in Scottish banking, although they had obtained only slight vogue in England. As is the case with most of such inventions, the option-clause note system involved trouble for the unwary, since the absence of the redemption on demand check enabled unreliable persons to set up as bankers. Here the government was faced with the problem that has constantly confronted ruling bodies: Shall the fools be protected at the expense of the wise? The government of the eighteenth century knew nothing of natural selection—knew nothing of that law of progress which decrees the constant elimination of those who are unable to adapt themselves to conditions which are beneficial to the normally prudent members of society. Any student who searches the economic literature of this period will be chiefly struck by the prevalence of the protective spirit. The duty of the statesmen to protect the foolish from their own stupidity is constantly insisted upon. Society is in its military stage, and statesmen are chiefly concerned to preserve a sufficient number of physically healthy subjects to serve as soldiers. Whether those men live as slaves, with only the barest necessities of life, whether inventive ingenuity and industrial science are stimulated

or not, seems to be of less importance to the statesman. The establishment of industry is a privilege to be begged from the State, to be accorded only if the conditions thereof are perfectly "safe" for the simpletons. If a man accept an option-clause note and suddenly find that he requires gold, the banker "defrauds him of his natural right" if he postpone redemption of the note; although there is no reason why the individual should not take the note to the goldsmith and purchase gold at the market price as he would any other commodity.

With statecraft based upon such principles it is not surprising to find that the government, confronted by this problem in finance, protected the fool in his folly, and, in 1765, prohibited the option-clause notes both in England and Scotland. An invention which we now see to have been in the direct line of progress was thereby smothered, and both the education of the people in the principles of credit, and the evolution of a more perfect credit system, were stopped. The government laid it down as a law, on purely protective grounds, and has ever since maintained and defended its decision on the same grounds, that no notes should be issued promising the payment of money to bearer unless redeemable in gold on demand. It will be seen later that the "free" gold market is a direct result of this law, and that the evils which this institution entails caused much social suffering, together with bickering and discussion between economists and politicians during the nineteenth century. The path of experience towards the national recognition of the folly of protective legislation in an industrial stage of society is indeed a long and painful one.

Yet another restriction obtained. In 1765, notes of less value than one pound were prohibited in Scotland, and in 1775 in England. The government, strong in its "protective" principles, contended that small notes tempted unreliable persons to set up as bankers, since

the issue of these notes did not necessitate the possession of such large quantities of gold. Simpletons were thus protected against possible fraud from unstable bankers. But competition between bankers was thereby hindered and credit maintained at a higher price: the establishment of a bank being comparatively easy when the issue was confined to a limited amount of small notes. In his evidence before the Select Committee on Banks of Issue (1875), Bagehot referred to the Bank of Dundee, which had been able to grow from insignificance to prosperity by means of its small note circulation. He proceeded:—

> "So it was in Somersetshire and all over England, and if the Committee will consider, that is the only way in which a deposit system can be introduced, because if, for instance, a bank like the National Provincial Bank were to go and put itself down in any small town in France at this moment it would find that it would not be trusted at all; nobody would come near it, or bring it any money. The easiest way to develop credit is to issue notes; then these notes get about into the hands of people, and the people gradually find, having these notes, that they are trusting the bank, and that they will run no further risk if they bring them to the bank (in deposit). The system of deposits gradually grows out of a note issue, because there is no increase of confidence required. It is in that way that at first the note issue created the system of deposit banking, and that the system of deposit banking created that further superfluity of money which we have now in London. Therefore I should say that in past times the country issuer was a vital element in our banking system, although he is so small an element to-day."

The poorer the district, and the smaller the tradesman or manufacturer to whom credit is issued, the

smaller must be the denomination of the note, since the notes are usually put into circulation in payment of wages and other local debts. The prohibition of the small note, therefore, again tended to handicap the small manufacturer; and in England, where, in 1777, all notes of less than five pounds in value were prohibited, the handicap was still more severe. Competition between employers was thus hindered, and, since gold had to be used wherever its substitution by paper was prohibited, the whole industrial community was compelled by the prohibition to use a more expensive exchange medium. Moreover, the poorer classes were thereby prevented from becoming familiar with paper money. The proscription of small notes was withdrawn during the stringency that preceded the passing of the Bank Restriction Act in 1797, only to be again imposed on English banks in 1826, and the issue of small notes in England has since been absolutely prohibited.

It has been calculated[1] in recent years that the average time during which each Bank of England note stays in circulation is: 70 days for £5 notes; 58 days for £10 notes; 27 days for £20, £50, and £100 notes; 9 days for £200, £300, and £500 notes; and 7 days only for £1000 notes. These figures clearly demonstrate how much greater is the demand for small than for large notes. The greater part of ordinary domestic purchases are made with sums of £1, 10s., 5s., or less. Of the £7,611,211 total note issues of the Scottish banks for the four weeks ended November 11, 1911, £2,331,861 was the amount of notes of £5 and over, and £5,279,350 of under £5. Conant quotes a letter[2] written by an agent of the Renfrewshire Bank at Greenock to the manager, which sets forth in a striking manner the paralysis which

[1] Andréadès, *History of the Bank of England* (P. S. King, London, 1909), p. 298.

[2] *History of Modern Banks of Issue*, 4th ed. (New York, G. P. Putnam's Sons, 1909), p. 162.

falls upon many transactions by the abolition of notes under £5. Cattle dealers in the country markets, he pointed out, often purchased two or three hundred beasts, reaching an aggregate worth of several hundred pounds, but they purchased them by the single animal, at a price ranging from £2 to £4, from the farmers who brought them to market. It would be necessary, if £1 notes were abolished, for the dealers to come to market loaded with gold and silver, and the difficulty of obtaining it from the banks would be increased by the fact that the banks derived no profit from its circulation. Grain was bought up, it was pointed out, in much the same manner, and the proceeds of the herring fisheries, which often amounted at Loch Fyne alone to the value of £40,000 in a single season, were brought in by a thousand boats, whose catch for a night was generally under £5 per boat.

> "If small notes are superseded, and gold substituted [continued the letter], it is not easy to see how the supply of gold is to be kept up to carry on the business and transactions of the country. . . . A person having to pay small sums will on every such occasion be obliged to send his large notes to the bank that issued them, to receive gold and silver in their place, to answer his purpose."

The general effect of these various restrictions is now to be noted. England was rapidly approaching the period of the industrial revolution. In 1769 Watt patented his steam engine; between 1770 and 1780 Arkwright, Hargreaves, and Crompton perfected the spinning-jenny and the mule; while in 1785 the power loom was invented. Machines which in some cases increased production a hundredfold were invented, and the increase in the volume of commodities requiring exchange was consequently enormous. Most of the early factories were built upon such credit as the banks could

afford, and there arose a great demand for more credit. Now, under freedom, the usual effect of increased demand on any industry is to attract fresh competition. This should have occurred in banking; but the partnership restriction, which limited the number of partners to six, together with the proscription of small notes, prevented any but rich men from setting up stable banks. The rate of interest on advances was also legally restricted to 5 per cent. by the Usury Laws, the consequence being that even the few bankers whom the law permitted to trade were compelled to avoid risk and to exact very safe security from the few clients to whom they did actually grant credit. Therefore, while the first manufacturers were easily able to undersell the handworkers, the more capable among the latter were prevented from entering into competition with the former and using up the labour which had been displaced by machinery. Had a rational banking system existed, the sole result of the industrial revolution would have been to enable increased consumption of commodities on the part of the whole community, since the freer competition among employers, resulting from cheap capital, would have rapidly reduced prices to their lowest while increasing wages to the highest limit that the employers' returns could afford.

The actual results were, however, very different. The masses of displaced handicraft workers crowded into the few available factories, and wages fell to an incredible point — the result of excess of labour supply over demand. The inability of wage-earners to find permanent employment, or to secure fair wages, has ever since been the prominent feature of industrialism. There can be no doubt that while the political unrest of this period was a contributory cause, the evil of monopoly of the possession of machinery at the industrial revolution was mainly due to the legal restrictions which prevented that increase of loans which was required to

put the more capable handicraftsmen in possession of the expensive steam-driven machines. Political unrest in itself is insufficient to account for the permanency of unemployment which was exhibited after the introduction of machinery. Adam Smith demonstrates the greater flexibility of the social system when tools were cheap in Book IV. ch. ii. of *The Wealth of Nations*. He points out that at the close of the wars with France by the Peace of 1763, when more than 100,000 men accustomed to war were thrown upon the country and had to find work or else be supported in some way or other, "not only "no great convulsion, but no sensible disorder arose". Previous to the invention of expensive steam-driven machinery, the handicraftsman's tools were cheap, and, with quantities of vacant land available, it was comparatively easy for a large body of men to begin to work to supply each other's needs. When tools are dear, however, the majority of men will only be able to set up industry by means of borrowed capital, requiring therefore a considerable flexibility and perfection of the credit system. The development of such a credit system was rendered impossible by the laws which restricted the issue of credit medium at the industrial revolution. To add to the hardships of the workers, prices of goods remained high by reason of lack of competition among employers. I need not dwell upon the miseries of this period: the ever-increasing mass of socialist literature has sufficiently dealt with the matter.

It may, however, serve some purpose to postpone for a while further examination of events in the banking world, and note the effects upon later social science of the misery set up by credit restrictions at this period. The evil of unmerited poverty became at length so great that the social sympathies of the community were aroused and a cure was sought. Those were the primitive days of political economy, and it is not surprising that society should deal with effects while overlooking

the cause. The major cause of the industrial evil was legal restriction upon the lending of capital; but the reformers of the day merely saw that employers were not giving fair terms to their workers. The first cure which would occur to the simple mind would be to compel the employers to give better terms, and we accordingly see the initiation of that long list of governmental interferences with freedom of contract. How often have we seen in history that one bungling act of legislative interference necessitates a string of fresh legal restrictions to remove evils which were actually set up by the original legal enactment! Spencer has said that any interference with freedom of contract, while on the surface it may appear to benefit society, actually produces more evil than good in an industrial stage of society. The truth of this principle was proved in the case of the Factory and other Acts of industrial restriction. The fundamental evil was the excess of labour supply over demand. Any governmental decrees that simply compelled employers to provide more expensive factories, prevented fresh competition with existing employers. Men who might have started machine production under cheap, even if insanitary, conditions were thus prevented from increasing the demand for labour. Hence the normal process of conversion of the able wage-earner into an employer was hindered; unemployment increased; and the wages of the employed were reduced by the competition of those who were thus pushed closer to the starvation line.

Furthermore, as long as the excess of labour supply persisted, employers were able to impose onerous conditions upon their employees, and we find that the further evil result of interfering Factory Acts has been to cause an increase in the standard of ability and speed required of the worker. A man may work only eight hours a day in an admirably ventilated factory, but may be worn out at forty by reason of the nervous strain

induced by the speed at which he is compelled to work, owing to excessive competition from other workers. With an increase in the demand for labour the workers could have obtained for themselves better wages and conditions *in proportion to their ability* (note the discriminating effect of rewards obtained under freedom as compared with those awarded by governmental acts). An increase in the demand for labour would also have obviated the necessity for female and child labour: it is inconceivable that the average man would have sent his wife and children into the factory had he been able to support them at home. But the public conscience was satisfied by the disappearance of the insanitary factory; and the subsequent low wages, increased strain, and unemployment were in no way ascribed to these restrictive Acts.

Let us now return to events in the banking world. There was a second important result of the bank partnership restriction rule. The hunger for credit persisted, and, since banking companies of more than six partners were prohibited, and a low rate of interest legally fixed, reliable aggregations of capital from among more than six moderately wealthy persons were impossible. The consequence was that petty shopkeepers and tradesmen set up everywhere as bankers to supply the demand for credit. In many cases employers themselves issued their own notes to their workpeople. Every person who issued notes had to obtain a licence for that purpose, and was registered as a private banker. Burke says that when he came to London in 1759 there were not twelve bankers out of London; in 1793 there were nearly four hundred: such was the demand set up by the sudden blossoming of industry. Those were the early days of banking, when people were still suspicious of bank notes. From the middle of the eighteenth century to the beginning of the nineteenth was probably the most disturbed period politically of any in our national history. With every

threat of a Stuart rising or a foreign invasion the more timid people rushed to the banks to exchange their notes for gold. Only the wealthy banks could stand such runs, and the petty shopkeeping banks failed on all such occasions in scores, dragging down with them their clients—precisely those smaller manufacturers who were struggling into competition with the more wealthy employers. In subsequent days when private banking was standing its trial, all such failures of shop-keeper banks were counted against the principle of free competition in banking!

Moreover, the frequent failures of banks at such times of stress tended to discourage the investment of capital in banking businesses, especially since banks were prohibited from charging more than 5 per cent. on advances. Competition among reliable bankers was thereby further restricted and the establishment of factories rendered yet more difficult. It was to remedy this evil of the establishment of unreliable banks that the government prohibited the small note! In 1709 the government set up regulations which, as is admitted by every modern writer on the subject, actually compelled the community to deal with unreliable banks—and in 1775 it must "protect" its subjects from unreliable banks by absolutely proscribing the means of establishing banking from small beginnings. Previous to legal restriction it had been customary for the prosperous trader to endeavour to supply the much-needed banking accommodation by a limited issue of small notes. If the issue commanded public confidence, it was increased up to the point where it became profitable for the trader to relinquish his ordinary business and confine himself to banking. Thus the issue of small notes at any rate tended to preserve a certain degree of healthy competition among bankers, although of course, as previously stated, the partnership restriction prevented these small banks from accumulating sufficient capital

to enable them to weather the frequent crises of those days.

In Scotland, by contrast, where freedom in banking was for a time permitted, banks were established wherever the needs of commerce demanded; the people favoured only reliable banks, and during the hundred turbulent years 1745–1845 only twenty-three Scottish banks failed, many of these even paying their creditors in full subsequently. In England in one year of crisis, 1793, nearly a hundred "banks" failed. In the course of his essays on currency, Mill can make the astonishing statement that freedom in banking is very good north of the Tweed, but very bad south of it.

Later apologists for restrictive Bank Acts in England have declared that free banking may be practicable among a people so cautious as the Scots, but would be disastrous to a nation so prone to enterprise as the English. Professor Jevons dismisses the question of the reason for the superior stability of Scottish banks as compared with the English with the remark[1] that if we were all Scotsmen, the unlimited issue of one-pound notes would be an excellent measure! The vicious effect of State interference (in causing the instability of English banks) has been overlooked by these economists: accordingly "Scottish caution" must be made to do duty as an explanation. The cautious Scot! Have we so soon forgotten that it was a Scotsman, namely, William Paterson, who had enterprise enough to set on foot the scheme for the Bank of England itself, and subsequently the Darien colonization scheme? Have we forgotten that John Law (whose visions of prosperity to be created out of paper money first so greatly helped and then so nearly wrecked France) was a Scotsman? Do we forget the Scottish merchant shippers and engineers whose bold enterprise is world-famous?

A still graver result of the prohibition of reliable

[1] *Money and the Mechanism of Exchange*, p. 319.

banking was that, whereas in Scotland the people came to prefer the private bank note, even to gold (since they could not be sure of the sovereign, whereas their own banker kept a sharp watch for forgeries of his notes), in England the frequent failure of "private banks" produced a deep distrust of bank notes. The English tradesman always felt safer when he had gold in his till than when it was filled with notes. On all possible occasions therefore he returned notes to the banker for conversion into gold, and the primitive reliance on gold as the only sound exchange medium was fostered. It is evident, for instance, that if the State had imposed such restrictions upon the production of matches as resulted in the manufacture of an unreliable type of match only, distrust of matches as fire producers would have lasted longer than it actually did. Popular distrust of his notes compels the banker to back them by a larger quantity of gold than he otherwise would, and consequently increases the cost and risk of credit advances. In Chapter IV. it has been shown that when the banker is compelled to use a more expensive credit token, he is unable to monetize such quantities of productive ability (latent purchasing power) as he otherwise might, and he therefore rejects the less safe forms of security.

The reason is now apparent why, at the introduction of machinery, possession of the means of production gradually fell into the hands of a few. The use of machinery increased the volume of exchanges enormously, and the credit system was unable to keep pace with the increase. The consequence was that, whereas the early manufacturers were able to start from small beginnings, the very cheapening of production, with the consequent increase in the volume of exchanges and strain on the medium of exchange, closed the avenue of credit to those who would have followed, and frequently caused in addition widespread ruin among those who were actually established. Thenceforth the possession of

capital became a matter of luck instead of a reward for integrity and ability. The prize was to the man who was able to obtain capital by inheritance or speculation, rather than to the man who had shown capacity and character. Even when established, the trader's position was rendered precarious by State interference with the growth of credit. We shall see that this "natural selection" resulted in the survival, not of the man who could best serve society, but of the one who simply happened to start business when credit conditions proceeded smoothly, and happened furthermore to survive legally created credit stringencies.

CHAPTER VII

THE WAR OF PAMPHLETS

It was with her banking system in such a perilous state that England entered upon the troubled period of the war with revolutionary France. The evil results of contemporary ignorance of the principles of credit now became thoroughly apparent. A number of circumstances combined to bring disaster upon the banking system. The continental war necessitated immense payments abroad, which could of course only be made in gold. Tooke shows that a series of bad harvests in England caused extra purchases of food supplies abroad, entailing a further drain of gold from this country. Finally, the general insecurity and continued threats of invasion gave rise to the hoarding of gold in this country. The store of gold in the banks became steadily lower. As William Graham, member of the Institute of Bankers in Scotland, says:[1]—

> "The Bank of England now began to feel to the full the dubious privilege of being the only bank worthy of the name in England. The impoverished government, the hosts of petty country banks, the London merchants, all clung to it as to the one strong man in a sinking ship."

It may with truth be said that Napoleon never would have been conquered except through the assistance of the Bank's loans to the government. In consideration of the frequent advances made, and the danger that

[1] *The One Pound Note in the History of Scotland* (Edinburgh, 2nd ed., 1911), p. 131.

the withdrawal of gold might destroy English commerce more effectually than could many Berlin Decrees, Pitt permitted the Bank of England to suspend payment of its notes in gold by the Restriction Act of 1797. But the export of gold went on, and since there was no proportionate reduction in the issue of bank notes, the price of gold reckoned in bank notes gradually rose. The war fever and consequent interruption of commerce, together with a series of bad harvests, caused a rise of prices, and complaints arose all over the country. A perfect hail of pamphlets ensued, attributing the high prices and "depreciated notes" to the suspension of specie payments, to excessive note issues from the Bank, to the unrestricted issues from the country banks, and to numerous other causes.

The high prices of commodities, together with the impossibility of obtaining gold wherewith to buy goods abroad, naturally caused clamour amongst those who were unable to see that when a nation has been drained of its wealth to carry on a foreign war, prices of necessaries must rise. The Bank of England had certainly made immense advances to Pitt to enable the war to be carried on; but these loans had not inflated the home currency since they were for the most part used abroad. The causes of the high prices were undoubtedly the bad harvests at home, and the drain on the country's resources to carry on the war with France. A nation which engages in an expensive war is in precisely the position of an individual who consumes without producing. When his resources run low such an individual must be content to restrict his consumption until he has again built up his fortune. Be it remarked that restriction of *consumption* is required, not restriction of production. On the contrary, under such conditions it is in the highest degree desirable that production should be encouraged to the utmost. Now the normal economic method, namely, to raise prices as soon as

commodities become scarce, is fortunately the most effective means of discouraging consumption and encouraging production simultaneously. In the case of the nation, however, the problem was complicated by the presence of one commodity, gold, which was prevented (by reason of its function as standard of value) from sharing in the general rise of commodity prices; and the financiers were unable to see why they should be prevented from exporting this one cheap commodity in exchange for low-priced foreign goods. A calm survey of the situation reveals the fact to us that the policy of exporting artificially cheapened gold instead of ordinary commodities in exchange for foreign goods in times of scarcity at home in order to prevent ordinary commodity prices from rising, was a short-sighted and vicious measure which, if persisted in, must eventually have drained the country of the very means of producing and exchanging goods at home. As supporter of mutual trust and credit, gold still played its part in commerce. The financiers, however, clamoured because the Bank Restriction Act prevented them from making a profit from the export of the support of the country's credit. In 1800, when their complaints grew very loud, Addington, the Chancellor of the Exchequer, strongly opposed the return to cash payments, saying that "for "several months past there has been a trade carried on "for purchase of guineas with a view to exportation." These financier "patriots" who could talk so eloquently of England's dishonour in refusing to permit the Bank of England to redeem its notes in gold on demand, had actually set up booths where they paid a small premium to those who were willing to sell guineas. The prominent merchants, however (to do them justice), set their faces strongly against these proceedings, and at meetings organized to consider the situation, expressed their willingness to receive the Bank's notes at their face worth in payment of debt; and throughout the country

it was counted unpatriotic for anyone to demand gold in the liquidation of debt.

The confusion and popular clamour became at length so great that, with the market price of gold standing at £4:10s. instead of £3:17:6 per oz., Parliament was compelled to appoint a committee to enquire into the reason for the high price of bullion. This was the famous Bullion Committee, whose deliberations have so often formed the theme of discussion by later economists. The witnesses were divided almost equally into two hostile classes. There were those like Mr. Chambers, a well-known merchant, who, viewing only the immediate needs of commerce, declared that the Bank of England notes could not be depreciated since people freely accepted them at their face value in exchange for ordinary goods. He attributed the high price of bullion simply to the demand for specie for purposes of export abroad. Ranged on the opposite side, however, were those who insisted on the letter of the law. A £5 bank note was a promise to pay a certain weight of gold. If this quantity of gold could not be obtained for a note, the paper was depreciated. Mr. Chambers protested mildly that he could not conceive gold to be a fairer standard for Bank of England notes than indigo or broadcloth, implying of course that the value of the paper in relation to indigo and broadcloth was unchanged; but the Committee placed itself decidedly on the side of the stricter view.

The Bullion Report of 1810 laid down in no uncertain terms that the Bank of England notes had suffered depreciation owing to excessive issue by the Bank. The test of the Bank's issues, it asserted, should be the state of the gold reserve—not the demands of commerce. The return to specie payment of notes within two years from the date of the Report was recommended. Yet, in spite of the emphatic recommendations of the Committee members, Parliament

was moved by practical considerations to reject their proposals. It adopted instead certain resolutions (proposed by Mr. Vansittart), which declared that bank notes were not depreciated, but that the price of gold was enhanced, and that the political and commercial relations of Great Britain with foreign States were sufficient to account for the unfavourable state of the exchanges and the high price of bullion. To have returned to specie payments would, as Lord Castlereagh objected, have afforded Napoleon just the lever he was seeking to enable him to overthrow British commerce, since the immediate effect of resumption of cash payments would have been the depletion of the country's gold store—the basis of its credit—and the consequent collapse of commerce. The Committee said in effect: "You have promised to pay gold; redeem your promise honourably". Parliament replied: "Where is the gold to come from? And why should we pay gold when nobody at home wants gold?" Later critics have regularly ranged themselves into the two opposite camps. Macleod and Dr. Andréadès are emphatically on the side of the Bullion Report.

Looking back over all the circumstances of the case, I am obliged to echo the words of that temperate economist, Prof. Foxwell, who, in his preface to Dr. Andréadès' *History of the Bank of England*, says:—

> "I doubt whether the crowd of critics who have repeated Ricardo's censures of the Bank have sufficiently distinguished between the speculative views and the practical measures of the Directors. I think it will appear, the more the circumstances are examined, that their actual policy during the Restriction was generally guided by a sound instinct. It would be impossible to defend some of their arguments; but they were not there to argue. As so often happens with men of affairs their policy was much better than

the reasons they gave for it. The fact remains that where there was about an even chance of failure, the Bank succeeded: we may well be grateful to it for steering the country safely through the most critical period in the whole history of its banking and credit system. No doubt the Bank had the defects of its qualities; it may have laid rather too much stress upon the urgency of accommodating the trade of the country: but if so, its vices leaned to virtue's side. Its principal difficulties were due to its unwavering loyalty to the State; and to its endeavour, so far as lay in its power, to avert undue pressure on the commercial community."

It has never been satisfactorily proved that the Bank made undue use of the power granted to it by the 1797 Restriction Act of extending its note issues indefinitely.[1] Opponents of free banking have declared that freedom of issue is an unavoidable temptation to over-issue; but here was a bank that was even spared *by law* the necessity of redeeming its issues in gold, that was submitted to no systematic examination of its issues by Parliament or by its own customers, and was yet withheld by simple regard for its reputation from making undue advances to speculators.

During the debate on the Report of the Bullion Committee a portion of a speech made by Mr. Rose deserves quoting on account of the accuracy with which it foretold coming events. He said:—

"If the Bank directors, on the advice of the Committee, should govern the amount of their issues by the state of the foreign exchanges, I will venture to say the inevitable consequence would be most mischievous; for instead of the decree remaining in

[1] Compare Mill, *Political Economy*, 1852 ed., on "Inconvertible paper currency" (vol. ii. pp. 87-8).

> gentlemen acting under severe responsibility, and who have no personal interests to sway their judgment, it would be transferred to the exchange merchants here and on the continent, who, connected with each other as they would soon become in that state of things, would affect the course of exchange at pleasure to answer their own purposes."

We shall see later on that the chief disadvantage of our exchange system ever since the return to specie payments has been the facility it affords to irresponsible financiers to withdraw the supports of home credit by sending gold abroad.

In 1811 Lord King, who had upheld the Bullion Committee's Report, caused a strong wave of indignation in the country by issuing a circular to his tenants reminding them that their contract was to pay a certain quantity of the legal coin of the country, and that, as the paper currency was considerably depreciated, he should in future require his rents to be paid in the legal coin of the realm, or by a sufficient amount of bank notes to purchase the necessary weight of standard gold. This led to a charge of incivism against him, and Earl Stanhope promptly introduced a bill into Parliament rendering it a misdemeanour to make any difference in payments between guineas and bank notes. The measure passed the House of Lords by a vote of 43 to 16, and the House of Commons by a vote of 95 to 20.

The drain of specie proceeded, and by August 1813 the paper price of bullion had risen to £5:10s. per oz. After Waterloo, however, the flow of gold was turned, the situation began to improve, and by 1816, the Bank directors were able to announce that they would redeem a certain quantity of their notes. The result was interesting as a demonstration of the principles which I have laid down in this book. Francis states in his *History of the Bank of England*, when treating of this period, that

whereas the financiers came in droves to take advantage of the return to cash payments by withdrawing gold for export abroad, the ordinary people, having acquired trust in the Bank of England, preferred its notes even to gold, thus proving that the demand for "honest dealing" on the part of the Bank was almost entirely from those who wished to take advantage of the high price of gold abroad to drain the Bank's reserves, regardless of the harm they might thereby inflict upon home commerce. On the other hand, the home trade merely needed a token which could be exchanged *for goods* at its face value; the nature of the token was immaterial.

The nation was then on the brink of a discovery which might have altered the whole subsequent industrial history of the world. The credit panics which wrought such havoc during the last century might have been largely avoided, and industrial prosperity and social equity might have been set up in place of trade stagnation and social misery. The Napoleonic wars had demonstrated the danger to national prosperity of a credit system which could be overthrown by the mere withdrawal of a quantity of gold. *Experience had demonstrated to producers that the reputation of the banker might form the basis of a sounder credit system than could a gold reserve.* So far had public opinion progressed that in 1811 Earl Stanhope moved a series of resolutions to abolish the gold basis of the Bank of England note. His proposals for the establishment of an invariable unit of value in place of the imperfect gold standard are most interesting, but can only be adequately discussed in a later chapter (see Chapter XIII). What concerns our present subject is that he wanted Parliament not to regulate the note issues of the Bank of England by the arbitrarily fluctuating quantity of gold in its vaults, but to receive a report from the Bank directors at the beginning of each session, and then to fix a maximum of

note issue for the coming session. Imperfect in many respects as this proposal was, it showed an insight into the theory of banking which fully justified a later declaration by Earl Stanhope to the House of Lords, to the effect that he had "given more time to this subject "[currency] than all the rest of the noble lords put "together" (April 28th, 1812). James Taylor, a banker of Bakewell, a prolific pamphleteer and energetic controversialist, had also pointed out in no uncertain terms[1] the disadvantages of the gold standard, and advocated a somewhat similar system to that of Earl Stanhope. But the nation which had shown itself so sagacious in practice was a babe in matters theoretical: the establishment of a more perfect banking system on theory alone was as yet beyond its powers. A fresh war scare might have compelled it to stumble in the right direction; but the fat days of peace returning, it sank back easily to the manners and customs of its fathers.

The cessation of the war enabled the impoverished continental nations to replace their depreciated currencies, and the high price offered for gold abroad induced speculators to withdraw gold from the Bank for exportation.[2] The result was a drain of gold in 1817, and again the nation was to feel the disadvantage which has burdened our banking system ever since the rise of continental commerce—the disadvantage of the use as a basis for home credit of the commodity which is required for the establishment of commerce abroad, and of inability to protect the gold basis of credit in times of strong foreign demand, as long as notes are redeemable at face value in gold on demand. The Bank in 1817 held to the views which had previously obtained the sanction of Parliament and, the need of credit for home commerce remaining the same, took no steps to

[1] *A View of the Money System of England, from the Conquest; with Proposals for establishing a Secure and Equable Credit Currency.* (1828.)

[2] See Andréadès, p. 238 of book previously quoted.

curtail its issues. England would soon have been drained of all her gold, had not an Act been passed in 1819 forbidding the Bank to make any payments in gold whatever.

As usual the crisis was followed by an enquiry, and, strangely enough, with the essential facts of the drain of gold abroad almost identical with those of 1797–1810, the witnesses examined were now almost unanimous in affirming depreciation of the notes, the Bank directors alone maintaining the contrary. The only explanation of this change of view is that the allayment of the fear of invasion reduced the force of those practical considerations which had been responsible for public opinion in 1811, and that theory alone was incapable of restraining Parliament from returning to the system sanctified by a century or more of custom. Peel had strenuously opposed the resumption of cash payments in 1811; he now as strenuously upheld it, candidly admitting that his opinion had since changed. He now maintained that the variation in the Bank note price of gold was no proof that the gold standard was variable: what had happened was that a substitute for gold had been introduced, and the price of gold had been considered in relation to that substitute. A very prevalent theory, he declared, was that—instead of regulating paper by the value of gold—gold should be regulated by the value of paper. This was nothing less than a fraud upon the public creditor. It was vain to think that foreign nations could be imposed upon by such a deception. We ought to follow the example of our wisest and most distinguished ancestors, and return to the ancient standard of the coins, etc., etc. The remarks here reported from Peel, uttered by him "with exclamation marks", described events in British finance which had actually occurred; but, so far from deserving exclamation marks, merited careful consideration. In Chapter XIII. I will demonstrate that the measure-

ment of the price fluctuations of gold by paper is perfectly sound theoretically. Experience had here proved its practicability, even unbacked by theory. But—the nation has always been very willing to follow the customs of its ancestors, and the Act of 1819 (for the return to cash payments by 1823) was duly passed.

Between 1819 and 1823 the Bank of England gradually withdrew notes from circulation, and substituted gold. There arose in England a demand for gold which was felt throughout the civilized world. Prices (according to Jevons) dropped 24 per cent. between 1819 and 1822. Yet England's prosperity was great, and she was able to stand the strain. Her stock of gold was then the largest in the world. Parliament had, however, thrown the Bank's gold store open to the world demand, and the nation was soon to reap the bitter fruits of this legislation.

It was at about this time that the South American States sprang into prominence, their struggles for independence having lately been crowned with success. There arose a great opportunity for our financiers to invest gold in the new States—the gold that was so much needed for industry at home—and the opportunity was seized eagerly. The Bank's reserves declined from £13,500,000 in January 1824 to £6,600,000 in April 1825. Up to the latter date the Bank had been steadily extending its issues in accordance with the demands of commerce; but it now took sudden fright and began to contract its issues. The result was widespread confusion in home commerce; but so strong was the foreign demand, that the drain of gold by financiers proceeded until, in December 1825, the reserves had fallen to £1,200,000. The Bank then took sterner measures, and severely curtailed its issues. The result was the failure of the London Bank, one of the leading banking firms, which bank dragged down with it sixty other financial companies. The general distress

was aggravated by the failure of thirty-six country banks. The low prices and compulsory sales caused by the money famine were at length effective in attracting gold to this country; but the prevailing distress at the time of the crisis may be gauged by Huskisson's statement in the House of Commons that during the greater part of December it was impossible to realize even the best securities, such as Government stock, shares of the Bank of England and those of the East India Company.

Economists have endeavoured to prove that the cause of the panic was wild speculation. "Over-speculation!" has been a most useful cry to enable economists to explain the export of gold abroad in the various crises of the past. It is a statement which is so easy to make and so difficult to refute definitely. Prosperity invariably brings with it a budding of enterprise. Industry becomes more active, employment increases, wages rise, profits increase, and prices rise. The consuming power of the general population increases. Naturally there ensues a growth of fresh industry to meet the demand for consumption. All fresh industry in its inception is necessarily speculative. The legal restriction of the exchange medium, however, and the encouragement given by our laws to the financier to withdraw the banks' gold, bring about a crisis in which a considerable quantity of the new enterprise is cut down. What more natural than that economists who have overlooked the part played by legislation in causing the crisis should endeavour to ascribe the whole difficulty to "unwise speculation". In the eyes of these economists the statement has never needed more proof than the fact that the new industry was actually "cut down by the first restriction of credit": the industry was unstable—hence it was rash speculation! Some excessive speculation there undoubtedly had been in 1825, both at home and abroad, and there is no doubt that even without the drain of gold, heavy liquidations

would have been necessary. But it is equally certain that the greater part of the gold sent abroad was exported in respect of legitimate foreign enterprise. The fury of the crisis began only when the Bank stopped credit issues to reliable houses.[1] The Bank could not be blamed. Rather does blame attach to the system which permitted financiers to export gold which was urgently required for the support of home credit—gold which the banks themselves would have liked to retain, but which, on account of State interference, they could retain only by simultaneously increasing the price of *credit* to those who had no need of gold whatever.

Consider the recent rubber boom in England. It undoubtedly caused a quantity of wild speculation. Subsequent events have shown how futile were many of the hopes entertained, and there have been heavy losses. Yet, owing to the fact that the speculation was chiefly confined to this country, the shares being merely driven up on the Stock Exchange, and that comparatively little capital was sent abroad, liquidation has proceeded without any dislocation of ordinary commerce. It has been asserted that crises in the past have been caused by the excessive rise in prices consequent upon extraordinary speculation. The banks, it is said, become suddenly afraid of their clients and withhold help; or the depositors are seized with sudden suspicion of their banks, and a run occurs. I do not doubt that these may be contributory causes to a crisis; but I affirm that so long as we permit the gold basis of our credit to be drained from our banks, either because high prices here, or a demand for gold for fresh enterprise abroad, render its export profitable, we can never deny with certainty that the main cause of a crisis is the primary restriction of credit by the banks, consequent upon the withdrawal of their gold. We have by legislative restriction rendered the banks powerless either to prevent

[1] Compare Mill, pp. 215-16 of the work previously quoted.

this withdrawal of gold, or make it good with paper. But we shall return to this subject later.

The usual enquiry followed the crisis. The extensive failure of country banks had drawn attention to their organization, and Lord Liverpool, the Prime Minister, strongly criticized the partnership restriction rule, declaring it to be responsible for the weakness of the country banks. His speech in the House of Lords on February 17th, 1826, contains the following significant passage:—

> "The present system is one of the fullest liberty as to what is rotten and bad, but one of the most complete restriction as to all that is good. By it a cobbler or cheesemonger, without any proof of his ability to meet them, may issue his notes, unrestricted by any check whatever; while, on the other hand, more than six persons, however respectable, are not permitted to become partners in a bank with whose notes the whole business of the country might be transacted. Altogether the whole system is so absurd, both in theory and practice, that it would not appear to deserve the slightest support if it was attentively considered even for a single moment."

Peel supported these views, and contrasted the monopoly which existed in England with the free Scottish system. He pointed out that in England a hundred banks had failed in 1793, 157 between 1810 and 1817, and 76 during the recent crisis; whilst in Scotland, on the contrary, there was only a single bank failure on record, and even in that case the creditors had ultimately been paid in full. But Peel joined with Huskisson in an attack upon the small notes. The £1 notes, he declared, not only served to encourage the formation of petty unstable banks, but tended to drive sovereigns out of the country. Here we perceive strange reasoning. The government had laid the Bank's gold store open to

the world, and accordingly the financiers abstracted gold for export abroad. Obviously the issue of £1 notes enabled the community to dispense with gold in its domestic exchange transactions, and thus permitted the export of the metal, but proscription of these notes would merely have brought on the crisis the sooner; it would not have prevented the export of the metal, since this export could be effected even more rapidly by conversion of large than of small notes.

The partnership restriction was abolished by the Act of 1826; but the reduction of the privilege of the Bank of England was, as usual, accompanied by a sop to that Bank, since the establishment of banks of issue within sixty-five miles of London was prohibited. London was the centre of English commerce, and to prevent the banks of issue from establishing branches there seriously hampered their operations. Indeed, in later years, in 1875, the National and Provincial Bank gave up a note issue worth a million sterling for the privilege of establishing a branch in London, so valuable did it consider this right. Thomas Attwood's *The Scotch Banker* (London, 1832) gives interesting information regarding the relations between the country banks and the Bank of England during this period. Finally, the possibility of effective competition between banks was largely annulled by the prohibition of the issue of all notes under £5 in value. Small notes had formerly been the chief aid to the establishment of a new bank. The evil effects of this legislative interference in preventing competition between banks have previously been demonstrated and need not be repeated here.

An attempt was made to bring Scotland into line with England by abolishing the Scottish small note. But Scotland had recognized the value of her small notes, and strong protest meetings were organized. Sir Walter Scott lent his pen to the protest in the famous

letters of Malachi Malagrowther, in which he satirically attacked the argument of the necessity for uniformity of system in the two countries. England had undoubtedly suffered from failures of unstable banks, and it was easy to demonstrate that the establishment of any small banks whatsoever would have been impossible but for the privilege of small note issue. Scotland equally possessed the privilege of small note issue; but the Scottish banks were renowned for their stability, and a Scottish £1 note was almost invariably preferred in Scotland to a sovereign. Scotland had suffered equally with England from export of her gold in times of strong foreign demand, but, in the absence of the right of issuing option-clause notes, the Scottish banks had habitually protected themselves by the simple method of sharply raising the discount rate, whereupon the resulting commercial distress quickly caused the gold to return. The popularity of the small note in Scotland easily outweighed any theories respecting the effect of such paper in driving out sovereigns. The union between the two countries was none too strong at the time, and it was found advisable to relinquish the attempt to abolish the Scottish small notes. By the Act of 1828, however, the circulation of Scottish notes in England was forbidden.

The period of semi-freedom in England was destined to be short-lived. The harvests of 1833–6 were remarkably abundant. The abolition of the partnership restriction enabled the establishment of a number of banks in the provinces; facilities for credit were increased, and a considerable reduction in the rate of interest was made. Finally, the success of the first railway lines encouraged the formation of numerous railway companies. The result was a great renewal of trade prosperity, and the usual blossoming of speculative enterprise. The situation differed from that of 1824 only in that money was being put into home instead

of foreign enterprise. Professor Leone Levi gives a list of companies formed in this period involving a total nominal capital of some 135 million pounds sterling. Here, immediately, appeared the evil results of the prohibition of small notes. The speculation had been great, but there is no record of any loss of commercial confidence. The enormous growth of industrial undertakings, however, caused a demand for credit and for medium of exchange to pay wages. Owing to the proscription of small notes a portion of this demand could be satisfied only by gold, and accordingly there arose a double drain of gold from the Bank of England into the country banks and thence into the channels of industry. Prosperity caused the usual rise of prices, and gold began simultaneously to be exported by financiers from our legally created "free" gold market in order to purchase cheap foreign goods to be "dumped" in the home market. At the beginning of 1836 the reserve of the Bank was over 8 millions. By the end of November it had declined to £3,640,000. The attempt to stop this outflow by raising the bank rate to 5 per cent. proved fruitless. To make matters worse, the United States suddenly determined to increase its holdings of gold. Anxiety was already coming over the speculators at the attitude of the Bank of England, and liquidation set in. A further drain of gold (to Ireland) decided the Bank to refuse flatly any re-discount of bills. The crisis then began in earnest. Lancashire was hardest hit. The Northern and Central Bank of Manchester was at length compelled to apply to the Bank of England for help. At first this was refused, but, in view of the great suffering which had already occurred, and the further disaster which would have been caused by the failure of the bank with its 39 branches in industrial districts, the Bank of England was forced to make advances of about a million. In January 1837 similar difficulties were experienced in London. The distress already occa-

sioned had, however, caused a sharp fall in the prices of goods in this country, and this circumstance, together with the high price of bullion, turned the flow of gold back to England. The bank was able to avoid a complete collapse of credit by advancing 6 millions.

The influx of gold continued throughout 1837. By March 1838 the reserve stood at £10,527,000. The crisis seemed to be over. In reality it was just beginning. The harvests, which had been excellent from 1833 to 1837, were very bad in 1838. Such scarcity had not been known since 1816; corn to the value of £10,000,000 had to be imported. The natural result was a great exportation of gold. A rise in the bank rate brought gold to this country, but aggravation of the situation was caused by a simultaneous demand for gold in America, France, and Belgium, where enterprise had also been outgrowing the legally confined limits of the credit system. In face of the revival of commerce after the famine, and the consequent increased demand for credit at home, the Bank of England did not raise its discount rate until its reserve had declined to £4,117,000. The rise of the bank rate to 5 per cent., however, did not prevent a further decline in the gold reserves; and at the end of two months (on July 16th, 1839) a sudden increase in the demand for gold in both America and Belgium brought the reserve down to £2,987,000.[1] As Dr. Andréadès declares, the Bank of England was then face to face with bankruptcy. At this time, if ever, the need for a liberal issue of small notes, and a premium upon gold, were clearly demonstrated. There was no loss of confidence in the banks at home; the need for unusually large purchases of food from abroad was past: the difficulty was due to the demand for gold from abroad. Yet legislation had laid the country's commerce at the mercy of the ex-

[1] Compare Mill, work previously quoted; chapter on "Regulation of Currency".

porter of bullion, and home commerce suffered martyrdom. The position was desperate: discount was of course almost entirely suspended, and the bank rate was raised to 6 per cent. Still the gold failed to return, industry abroad needing all the gold it could get. Bankruptcy might then have actually ensued had not Paris and Hamburg voluntarily come to the rescue with a loan of £2,900,000. The distress in England was frightful. Liquidation of the firms bankrupted in this crisis actually went on for four years, until 1843. During the crisis no less than sixty-three country banks had been compelled to suspend payment, the failure of each involving the ruin of much industry. The reserve was at its lowest in September 1839, when it stood at £2,406,000; but from this time the forced liquidation of stock and securities in England gradually attracted gold back, and bankruptcy of the Bank of England was avoided. But for many years British merchants and manufacturers counted in bitterness the cost of maintaining a free gold market.

After the crisis—the enquiry. For two years a Committee of the House of Commons sat to enquire into the state of the law with reference to banking. The rain of pamphlets was renewed with increased violence, each author proposing a different scheme to avoid financial crises.

Apart from the mass of more or less visionary schemes, two main lines of opposing thought gradually acquired popularity. These were the Banking Principle and the Currency Principle.

Briefly, the Banking Principle advocates, of whom the chief were Tooke, Fullarton (both theorist writers), and Wilson, editor of *The Economist*, affirmed that a bank's issues could not be declared excessive as long as its notes were convertible into gold at its counter; hence they opposed any legal limitation of the banks' note issues. Lord Overstone (formerly Samuel Jones

Loyd), the banker discoverer of the Currency Principle, and Colonel Torrens, his chief supporter, held that the main function of the Bank of England was not to supply medium of exchange to commerce, but to maintain the convertibility of the Bank of England note by altering the bank rate in sympathy with the influx and efflux of gold. The bank note was held to be peculiarly dangerous as an instrument for driving gold abroad (cheque circulation was at that period insignificant), and accordingly Lord Overstone proposed that the note issues of the Bank of England should be legally restricted to the amount of £14,000,000 in excess of the quantity of gold held in its reserve; furthermore, since it was necessary that country banks should fall into line, the note issue of each bank should be fixed at its average amount for a period preceding the passing of an Act to that effect, and regulations should be made for the gradual absorption of all note issues by the Bank of England.

To the student who would examine the arguments current at the time on these two Principles, I can recommend the impartial statement contained in Professor Andréadès' *History of the Bank of England*. I think it better to omit reference to these arguments except in so far as they bear upon the criticism which I shall now make on the controversy considered in the light of the principles laid down earlier in this work.

The central subject of discussion, as admitted by both parties, was the cause of drains of gold. Tooke declared the withdrawal of gold to be due to demand from abroad, or to legitimate import of foreign produce. Lord Overstone admitted these causes of gold drains but added a further statement, namely, that excessive note issues by the Bank of England and the country banks had been frequently responsible for a rise of prices here and a consequent withdrawal of gold,

either to countries where bullion was in greater demand, or in purchase of cheaper foreign goods. Tooke declared that a bank could keep a quantity of notes in circulation only proportionate to the demands of commerce. Any over-issue would immediately return to the bank for conversion into gold, and would thus compel the bank to reduce its issues. Both parties agreed that bankers must raise the discount rate when their gold reserves ran too low. Tooke insisted that the banks would do this voluntarily, and that the maintenance of a legally fixed proportion between gold and paper would act in restraint of trade by compelling banks to raise the discount rate when there was no real danger. Lord Overstone contended that the temptation to issue more credit in times of rising prices was too great to permit bankers to have regard to their gold store, hence a definite limit to note issues should be set up. The arguments of both sides on the "natural right" of either the individual or the State to issue paper money need not concern us here.

Later economists have generally decided that there was much truth on both sides of the controversy: Tooke was wrong when he declared that freedom of issue could not result in over-issue, and Lord Overstone was wrong in discriminating between the effects of bank notes and other forms of paper credit—to attain Overstone's end it would have been necessary to take all forms of paper credit under State control. For my part, although my sympathies are with Tooke in his protest against the legal limitation of issues, I must agree that he failed to meet Lord Overstone's point as to the danger of paper money "driving out" gold. Confusion appears to have arisen over the definition of the word "over-issue". For Tooke, "over-issue" meant "in excess of the legitimate demands of commerce"; whereas in Lord Overstone's reasoning, the term applied to any issue of paper which caused or enabled an undue efflux of gold from the

country. Now, whilst most modern economists are agreed that banks are rarely tempted to issue credit in excess of the needs of commerce, there is no doubt that Tooke was wrong if he meant that notes could not displace and drive out of the country an undue amount of gold, so long as they were convertible into gold on demand at the bank of issue. Both Tooke and Lord Overstone, however, were guilty of overlooking the fact that in most cases gold was "driven" abroad by note issue only because the State had proscribed the methods invented by bankers to protect their gold reserves. We now recognize that the essence of progress in the science of banking is the gradual supplanting of gold by paper, the metal being permitted to flow to whatever quarter it is attracted. We look back over the history of banking and perceive that governmental restrictions in every civilized nation have prevented the natural process of paper substitution and accordingly rendered gold more necessary to home exchange than would otherwise have been the case. There is no doubt, and this fact was overlooked by Tooke and the other advocates of the Banking Principle, that any period of prosperity in trade tends to cause a certain temporary rise of prices. Under the legal proscription of all notes save those redeemable in gold on demand, the commodity, gold, is not permitted to share in the general rise of prices, and being obtainable on demand at a fixed price by the conversion of notes, is withdrawn, frequently in undue quantities, and sent abroad in search of cheaper goods.

The restrictionists have always been fortunate in being able to appeal to that economic law, rendered famous by the name of Gresham, according to which "bad money invariably drives out good". It has usually been argued that whenever gold ("good money") flows abroad, it is because it has been supplanted by paper ("bad money"). There is no doubt of the general truth of Gresham's law: traders will generally endeavour to

effect exchanges with that medium which they least desire to retain, and will either hoard or export the more valuable medium. But Gresham's law might equally be defined as the process by which *cheap* money drives out *dear* money, and it then describes an exceedingly beneficial operation. The mistake of most economists who have appealed to Gresham's law when explaining a drain of gold is that the fact of the efflux of bullion is sufficient for them to characterize the supplanting medium as a "bad" one; whereas we perceive such drains to have usually been due to the introduction of a perfectly sound though *cheaper* medium, an excessive amount of bullion being drained from the country's banks only on account of the legal proscription of effective methods of protecting such bullion from the financiers. Mr. Charles A. Conant states:[1]—

> "The theory of statesmen and students of political economy had generally recognized up to this time (1844) only two causes of the export of gold—payments for merchandise and the pressure of a depreciated currency. The bullion brokers, without spending time over theories, had long since learned by observation that it became profitable to export gold when interest rates were higher abroad than at home. They fabricated bills of exchange, had them discounted by bankers, took the proceeds in gold and shipped the gold to the point where it would earn the highest interest. The bills fabricated for this purpose had the character of accommodation bills, in that they represented no merchandise transaction and were drawn for the single purpose of transferring money from the place where it was cheap to the place where it was dear, in order to earn the higher rate of interest."

This subject will be treated more fully later when we

[1] *History of Modern Banks of Issue*, 4th ed. (New York, G. P. Putnam's Sons, 1909), p. 129.

deal with the institution of the free gold market. Suffice it now to remark that the adherents of the Banking Principle failed to prove that it was excessive State interference which enabled the export of gold at times when it was needed at home. This failure brought about the triumph of the Currency Principle.

A few extracts from the tracts of Lord Overstone will demonstrate how completely the Currency Principle was dominated by the idea that gold is absolutely necessary to the exchange system. In his pamphlet *In Reply to J. Horsley Palmer, Esq.*, Lord Overstone says distinctly: "The one simple duty which the manager of the "currency has to perform is that of making the amount "of paper circulation vary precisely as the amount of the "circulation would have varied had it been metallic". Again, in his *Letter to J. B. Smith, Esq.*: "What is the "test of mismanagement of the circulation? I presume "the answer will not be disputed. Fluctuations of the "amount of paper issues not corresponding with those "of the bullion." Further on in the same pamphlet: "A "paper circulation is the substitution of paper with a "view to economy and convenience in the place of the "precious metals. The amount of it ought then to be "equal to what would have been the amount of a metallic "circulation, and of this the best measure is the influx "or efflux of bullion." Finally, in his address to the House of Lords, he described the reform scheme in all its nakedness: "Monetary distress tends to produce a "fall of prices; that fall of prices tends to encourage "exports and diminish imports, consequently it tends to "promote an influx of bullion." If we remember that the fall of prices in such cases is a despairing effort on the part of manufacturers to obtain money to meet their liabilities, further comment is needless.

Colonel Robert Torrens, the second chief promoter of the Act, says in his work, entitled *Peel's Act of 1844 Defended*:—

> "Money is employed as a measure of value, as a medium of exchange, and as a legal tender. Hence any object which is appropriated to these several uses comes under the denomination of money *and no object save those which have been so appropriated can be included under that denomination*" (italics mine).

Here we see the thought which lay at the bottom of the Act of Restriction. Its promoters could conceive of no money which was not at once a medium of exchange and a standard of value. In Chapter IV. I have shown this to be a primitive conception of money.

The attraction of Lord Overstone's arguments for his contemporaries, however, must be evident to those who have observed the ordinary effects of State enactments. The State prohibition upon the growth of stable banks had been imposed at a time when public opinion was swayed by the belief that permission to set up industry is a privilege to be begged from the monarch. In most primitive communities the protective spirit is strong. People look to the State to prohibit all dangerous enterprise, and regard with apprehension any proposals in the direction of freedom. The demand for free competition is only a later growth induced by a deeper study of political economy. It presupposes a public spirit strong enough to contemplate calmly the possibility of fraud, and to accept the risk for the sake of stimulating those less obtrusive but, to the industrial State, most important qualities of originality, independence, and initiative. The evil effects of the partnership restriction clause and the prohibition of option-clause notes were not generally apprehended in the early nineteenth century; the restrictions themselves had been almost forgotten, whilst the memory of the disastrous failures of banks was fresh in the public mind. What more natural than that the few politicians who interested themselves in the matter should turn eagerly to that

panacea of primitive politics—legal restriction of competition! We shall see later how different a spirit was engendered by a more liberal measure of freedom in Scotland.

An Act embodying Lord Overstone's proposals duly passed into Law in 1844 under the title of the "Bank Charter Act". Peel's opinions had meanwhile suffered another change. In 1826 he had advocated the removal of legal restrictions upon the free issue of notes. He had now become an enthusiastic supporter of Lord Overstone's views; indeed the 1844 Act is commonly called "Peel's Act".

Concerning the actual passing of the Act, Professor Leone Levi says:[1]—

> "It is to be regretted that, notwithstanding the immense importance of the measure, it failed at the time to excite any great interest. Few were ready to follow Sir Robert Peel in the difficult and intricate enquiries which he broached, or to discuss with him the basis of monetary science. Mr. Hawes made an ineffectual attempt to open up a discussion by moving an Amendment: 'That no sufficient evidence has 'been laid before the house to justify the proposed 'interference with the banks of issue in the manage-'ment of their circulation', but the amendment was lost by 30 votes to 185, and although the bankers made strong representations on the subject, the measure went through the House with the greatest ease, and the Bank Charter Act passed into law."

"Difficult and intricate enquiries"—yes, this has been a pretty general verdict. I have attached importance to the discussion surrounding the Act, but in reality the discussion never went outside the bankers and a few economic experts. The mass of the people used the banks without enquiring into the theory of banking,

[1] *History of British Commerce*, Part IV. p. 285.

looking upon monetary crises as a part of natural law; and this is largely the case to-day. I can only hope that the emphasis laid upon the importance of the relations between banking, commerce, and the social problem, in the earlier chapters of this book, may induce the reader to give the little attention necessary to enable him to master the subject.

One final point should be made here. By many economists it is asserted that the Bank Charter Act was passed to prevent the establishment of unstable banks. This is an error. The aim of the Act was to retain a certain quantity of gold in the country. Lord Overstone contended that no private banker whatsoever knew his own interests sufficiently well to restrict his issues when gold was flowing abroad, or at any rate that at such times the judgment of the wise was powerless to retain the gold which was being "driven abroad by the note issues of the rash". Up to 1844 banking was conceived of only as the profession of issuing notes, and, in the opinion of the promoters of the Bank Charter Act, this measure gave the State a sure control of the credit issues of the country. We shall see later that, happily for commerce, this anticipation was frustrated by the great development of entirely unsupervised cheque credit; but it is important to remember that the outcry against "petty shopkeeping banks" had been allayed by the 1826 Act which permitted traders to choose reliable banks.

Before proceeding to set forth the effects of the Bank Charter Act it may be well to devote some space to the description of events in the financial history of Scotland down to 1845.

CHAPTER VIII

A REVIEW OF SCOTTISH BANKING

SCOTLAND holds a unique place among the nations of the world as being the country where, for 150 years, banks enjoyed a measure of freedom. The Bank of Scotland was founded in 1695, with this fundamental difference from the Bank of England, that it was established, not to supply government with money, but the people with credit. This single circumstance altered the whole subsequent history of banking in that country. The Bank of England, in common with most other national banks, was established to meet the need of an impecunious government for funds, and the continued demands of the government upon it required compensatory privileges, which were accorded in the form of renewals of its original monopoly. The Bank of Scotland, on the other hand, was set up by the commercial classes to supply themselves with credit, and the Bank was looked upon as the servant of commerce, not as the tool of government. Hence, as soon as it appeared that monopoly of banking in the hands of one corporation was harmful to commercial interests, the monopoly of the Bank of Scotland was abolished. After a short period of monopoly (1695–1727), banks could be founded in Scotland wherever commerce established itself. They were at liberty to circulate whatever credit tokens the people would accept. Yet even Scotland could not escape the heavy hand of directive State interference, and the restrictions there are of especial interest to us as marking the direction of current ideas on banking prior to governmental interference.

I have previously pointed out that gold was rendered

necessary as an exchange medium on account of the people's distrust of each other, and their common distrust (which was well founded) of the reliability of governmental detection of commercial offenders. I remarked that popular desire for a greater volume of exchange medium than could be supplied by gold alone, coupled with the banker's desire for increased profit, combined happily to evolve the paper promise to pay gold to bearer on demand. Thus was the public partly weaned from its dependence upon the metal gold. It was, however, soon noticed by the directors of the Bank of Scotland that a great obstacle to the free working of the system was that too great a volume of notes was sometimes returned upon them simultaneously for redemption in gold. They could have redeemed the notes had they been able to extend payment over a longer period: it was the suddenness of the demand which overwhelmed them. They therefore introduced a note which was payable in gold to bearer, not on demand but at a certain period after demand, at the option of the banker, interest to be paid by the banker for the period during which payment was postponed. This was the option-clause note, referred to in the last chapter. The chief cause of its introduction was the short-sighted methods of competition on the part of a rival bank established in 1727, the Royal Bank of Scotland. In the endeavour to secure a monopoly of banking trade, the Royal Bank sought to ruin its rival by occasionally collecting a large quantity of Bank of Scotland notes, and suddenly presenting them for payment in gold. This method of competition was frequently used in later years by other banks. The banks thus suddenly pressed, resorted to many ingenious devices to gain time. On one occasion, being confronted with a bagful of notes for redemption, a certain bank fell to payment in sixpences, the cashier paying out very deliberately, examining every coin and every note carefully, and frequently stopping payment

to run out on some imaginary errand, to the great wrath of the emissary of the rival bank. Finally, however, the introduction of the option clause was found to be efficient protection against these sudden demands. The Royal Bank at first avowed a lofty contempt for these option-clause notes, and publicly advertised the fact that its notes were always redeemable in gold on demand. Yet, the Bank of Scotland option-clause notes circulated at par on account of people's confidence in the bank, and when, in 1761, a drain of gold to England set in, the directors of the Royal Bank were only too glad to avail themselves of the insertion of an option clause in their notes. The British Linen Company Bank, founded in 1746, adopted the same course a few months later, and its example was followed, although only after many years, by a host of small banks which began to spring up about this time. As I have previously related, the adoption of the option clause by the smaller banks sealed the fate of the system. The clause was certainly employed in some cases to bolster up an unstable bank, instead of merely to protect it against undue demands for gold, and there were frequent instances of notes circulating at a discount for months on account of diminution of public confidence in the bank of issue and inability to apply for immediate redemption of the paper in coin. Yet, I can only reiterate my opinion that the prohibition of these notes was one of the greatest disasters which ever befell British banking. There were other means available to the public than that of redemption of notes in gold on demand to check the reliability of banks, notably surveillance of issues and checking of accounts. These other means were actually being employed in the case of the more prominent banks. The option-clause note was capable of protecting the banking system against most of the evils which subsequently arose, and was a most important step in the evolution of a more perfect credit system.

At the present day we allow any individual to use cheques in his exchange transactions, and we throw the onus of ascertaining if he actually possess an account, or if the bank indicated on the cheque exist at all, upon the person who accepts the cheque. We recognize that if a depositor were compelled to have each of his cheques countersigned by the bank manager in order to guarantee the receiver against loss, the system would lose much of its usefulness. In other words, we suffer the risk of fraud upon unwise people because we find that normally alert people are able to use the cheque system without much danger to themselves. The eighteenth century government, however, thought it its duty to "protect the simple", even at the expense of the great majority of normal persons who were circulating the option-clause notes of the reliable banks in perfect confidence. The prohibition of the option clause in notes (in 1765) laid banks open to the danger of sudden demands for gold from any quarter of the globe, and we have seen how heavily people were made to pay for having shielded the fool from the results of his folly.

A few extracts from contemporary Scottish journals will show that public opinion, in Scotland at all events, was sometimes in favour of the option clause. We have seen that the clause was introduced in 1727 by the Bank of Scotland. William Graham says that the right the note bore on its face seems seldom to have been abused until about 1756. The British Linen Bank adopted the option clause in 1761, announcing that

> "the very great scarcity of silver, and the unwarrantable methods taken to carry it off, having induced the directors of the Royal Bank to issue notes with the like option clause contained in those of the Bank of Scotland and all the private banking companies, this measure of the banks has occasioned an unusual demand for specie for the company's notes, and

made it not only advisable but necessary to take the same precautions the banks and other companies have done."

This passage might be taken to contain an assertion on the part of the British Linen Bank that the issue of option-clause notes caused a lack of confidence in the banks; but that this was not the case is shown by the following extract from the *Edinburgh Courant* of February 1765:

"Notwithstanding this [option] clause, specie continuing to be scarce, and the security of the different persons undoubted, the notes continued to circulate with *the same facility as formerly*" (italics mine).

And the *Caledonian Mercury* on Whit-Sunday 1763 remarked that blame for the scarcity of specie had been laid upon the option clause, but that at present it was needed to limit the trade of sending specie to England; nine-tenths of the specie obtained from Scottish banks going there.

The *Scots Magazine* in the following year complained strongly of those persons who were making profit by withdrawing gold from Edinburgh banks and sending it to London. It concluded that

"the only remedy at present seems to be for banks to mark their notes to be paid in six months. They will circulate as well, if not better than before, and so these rascals will be baulked."

It is eminently desirable that further details of the issue and circulation of the option-clause notes should be obtained. Most of the facts above recorded are obtained from *A Century of Banking in Dundee*, by C. W. Boase (Edinburgh, 1867, R. Grant & Son), William Graham's work on *The One Pound Note*, previously cited, from Kerr's, and from Robert Somers' works

on Scottish banking. Most economists condemn the innovation on the orthodox "protective" grounds, and devote but little space to detailing the system. The one fact which is firmly established, however, is that option-clause notes were issued by the foremost banks in Scotland, and in these cases were freely circulated, at par. English economists have made much capital out of the fact recorded by Adam Smith that on a certain occasion the option-clause notes of a Dumfries bank were at a considerable discount in Carlisle as compared with English notes which were redeemable on demand. But if I have been able to make my meaning at all clear in this book, it will be recognized that the option clause was introduced only in order to stave off outside demands for gold. The ordinary customers of banks needed only exchange medium, not necsaresily gold, and they were quite content to accept the option-clause notes of a reliable bank. Those who desired to obtain gold for export, however, would undoubtedly differentiate between option-clause notes and those which were redeemable in gold on demand, and this would undoubtedly be twisted by English banks into an evidence of "depreciation" of Scottish paper, precisely as was the premium on gold during the period of the English Bank Restriction Act by those who were opposed to the Act.

A further restriction which obtained in Scotland was the prohibition of notes under £1 in value by the same Act (1765) which proscribed the option clause. The effects of the prohibition of small notes have already been described in connection with similar legislation in England, and need not be mentioned here.

With these exceptions, however, banking was left free in Scotland. Mark the result. The people, being to this extent free to accept or reject bank notes, favoured only banks of undoubted stability, and for many years after the establishment of the Bank of Scotland only

three banks were able to circulate notes at all. It has been affirmed by modern economists that the ordinary people of to-day are too ignorant to be able to use a system of free banking. Let us remember that in 1700 Scotland was one of the most backward countries in western Europe. Outside the few towns, the people lived under the primitive clan system, with continual strife and general insecurity of property. In his recently reprinted work on *The One Pound Note*, Graham states that in 1699 the different parts of Scotland were separated from each other by tracts of uninhabited waste, across which it was dangerous to travel, because of robbers and the inclemency of the seasons. Roads were present merely as tracks worn deeply into the soil by centuries of traffic. Along these tracks strings of packhorses crept twice or thrice a year, forming the only means of conveyance open to the public. It was among such a primitive people that the delicate machinery of banking was established; yet the comparative absence of coercion on either side of the operation enable the necessary growth of mutual confidence. It is noteworthy that whereas in England, owing to repeated failures of unstable banks, there was a continually lurking distrust of bank notes, in Scotland the local private bank notes came to be preferred to Bank of England notes and even to gold, for the simple reason that gold was scarce and ordinary people were unable to detect counterfeits. The local banker, however, kept a sharp watch for forgeries of his notes, and, as Professor Shields Nicholson remarks, actual forgeries were far rarer than counterfeit sovereigns.

Graham states,[1] that in the Scottish fishing towns, strangers having local bank notes could purchase herrings at 1s. to 5s. per barrel cheaper than those having gold.

In the hundred years previous to 1845, when at every

[1] p. 131 of work previously quoted.

crisis the miserable English banks failed by scores, very few of the Scottish banks stopped payment, and most of those which did stop redeemed their notes subsequently in full and again commenced business.

All writers on Scottish banking, even opponents of its introduction into England, agree in praising its effects on the prosperity of the country. Within 150 years, under the double influence of her banking and educational systems, Scotland sprang from her barbarous state to the position of being the most prosperous country in Europe. Adam Smith, quoting from a report, states that the trade of Glasgow doubled within fifteen years of the establishment of banking there. *The Wealth of Nations* contains many eulogistic references to the part played by the Scottish banking system in developing the resources of the country. We may readily perceive how greatly that country must gain whose *capable* men, no matter what their station, are provided with cheap capital. Bankers perform the function of public conservators of the commercial virtues by demonstrating and advancing the pecuniary value of a good moral character. Gilbart shrewdly remarks that "there is many "a man who would be deterred from dishonesty by the "frown of a banker, though he might care but little for "the admonition of a bishop." The Scottish bankers knew the life-history and character of all members of the local families, and made but few mistakes in allotting credit. When the son of the local tradesman was to be set up in business, he obtained credit from the local bank. Young farmers obtained credit to purchase land; they obtained more credit in the spring when purchasing seeds and tools; and again in autumn when heavy wages had to be paid; they redeemed the credit when their crops had been sold. Young men who came from other districts could obtain credit by inducing two guarantors to recommend them to the bankers. Scottish farmers came to be renowned for their skill and thrift;

Scottish merchants went all over the world; and there was scarcely a man of position and wealth in Scotland who did not owe his success to the advances made to him by a banker at some period of his career.

The Scottish banks were enabled to make these "dead" loans by reason of the long period of circulation enjoyed by their credit token—the bank note. The notes returned by the public were usually returned only in payment of debt due to the bank, scarcely ever for redemption in gold. Indeed the shopkeepers helped their local bank by circulating its notes as long as possible. Competition induced the bankers to go to much greater trouble to meet the wishes of their clients than was the case in England. In the records of the Coutts family[1] we find:—

> "Although John Coutts and Co. (established about 1730) was the earliest private banking house in Scotland, many other private firms doing banking business soon arose in Edinburgh. [Here follows a list of nineteen Edinburgh banking firms. The writer proceeds:] Lord Provostships, baronetcies, and seats in Parliament were showered upon our early Edinburgh bankers, who were generally not only men of wealth, landed property, and influence, but also of great public spirit, and usually of large private charity."

From the *Circular to Bankers* of October 11th, 1833, it appears that in London on that date there was not more than one bank to every 30,000 people. In Edinburgh, in the same year, there was a bank for every 9000 people; and within three miles from the centre of Edinburgh, that is to say, at Leith, there were other banks carrying on extensive business. Whence it appears that commerce thrived where conditions were sufficiently peaceful, and the comparative absence of legal restric-

[1] *Coutts & Co., Bankers*, Ralph Richardson, F.R.S.E. (London, Elliot Stock, 1900), p. 53.

tion caused no lack of competition among stable bankers. The Scottish banker welcomed the smallest deposit of cash, and paid interest on the smallest sums—daily interest—according to the amount left with him.

Political economists have marvelled at the great deposits in the Scottish banks and at the manner in which the wealth of the country was thus economized and utilized. The explanation of these circumstances lies in the payment of interest to depositors by the Scottish banks, the system of daily interest calculation inducing the deposit of the smallest sums for even the shortest period. The banker was enabled to give interest since he paid notes instead of gold to any depositor who might call, and was thus able to operate with a smaller reserve of gold than would otherwise have been necessary; in other words he was able to issue a larger volume of credit on a given gold basis than can the modern banker. The system of "cash credit" was also advantageous to the borrower, because, whilst a certain sum was placed at his disposal, interest was charged only on that portion of the loan which he was actually using; there was thus incentive for him to make prompt repayments. During the enquiry of 1826 it was stated that two-thirds of the business of Scottish banks consisted of cash credit operations. Competition among bankers was responsible for their endeavours to adapt themselves in this manner to their clients' requirements. Branches of the large banks were established wherever there was the least opportunity for trade. At the Scottish fairs the bankers went so far as to set up booths in the market-place where clients could settle their transactions on the spot without the transfer of any cash whatever.

Scotland had yet, however, to feel the results of restrictive banking legislation. The hundred years from the Stuart rising in 1745 to the financial crisis of 1846 might be called the dark days of banking. Scotland, equally with England, sustained runs on her banks in

the various political crises of the period, although the runs were less severe than in England on account of the greater confidence of their customers enjoyed by the Scottish banks. Yet, when the abnormally timid people came for redemption of their notes, and when the hunger for gold from the wretched English system tempted financiers to convert Scottish notes into gold for export, the Scottish bankers had ample time to regret the legal prohibition of the option clause in their notes. Scotland, equally with England, experienced the industrial revolution, and the Scottish banker was continually torn between the tempting offers of those who begged for credit to enable them to set up the new machines, and his fear of an unforeseen drain of gold from his defenceless reserves. The majority of the petty shop-keeping English bankers had little reputation to lose, and consequently, small scruple in their loans; when the times of gold scarcity came they were content to stop payment and go into bankruptcy. The Scottish banker, however, with a larger circulation of notes, knew that his reputation was worth more to him than much interest to be gained on individual loans. The result was that he was always more cautious in his issues,[1] and, at the sign of approaching stringency, compelled the return of quantities of his loans, no matter what the cost to his clients. The "brutality of the Scottish banker" became proverbial in English banking circles.[2] Hence the stability of Scottish banks was preserved at the cost of their clients, and it is not surprising to find that glut of labour products, and scarcity of factories where machinery might employ the labour which it had displaced, were almost as serious a blot on the Scottish industrial system as on the English. The

[1] See W. Graham (book previously quoted) for a report of the manner in which the Scottish banks were compelled to limit their issues, even well into the nineteenth century, on account of the general insecurity of the times and the danger of drains of gold.

[2] See Thomas Attwood, *The Scotch Banker*, previously cited.

Scottish banker attained his aim however: his reputation for caution obtained for him an almost implicit confidence on the part of his customers. In 1797, for instance, when Pitt legally absolved the Bank of England from the necessity of redeeming its notes in gold, the Scottish people voluntarily undertook, for patriotic and economic reasons, to make no demand for gold upon their banks, and actually maintained this suspension of demand for cash payments for twenty years. Of course the wave of patriotism evoked by Napoleon's attack was chiefly responsible for this arrangement between banks and their customers, and similar arrangements were arrived at between English bankers and their customers; but the lack of confidence in English banks rendered demands for gold far more frequent in England than in Scotland.

A most useful check upon the operations of Scottish bankers has been the system of frequent exchange of notes between the various banks. This is a sharp check upon over-issue; since individual banks are thus exposed to expert criticism. The public has usually been able to rely upon any bank whose notes are freely accepted in the Edinburgh Clearing House.

I have previously recounted the attempt of the British government in 1826 to bring Scotland into line with England by the abolition of the Scottish £1 note, and the energetic opposition of the Scottish people to the proposed legislation. On further consideration, the government decided that no legislation was necessary for Scotland other than to prohibit the issue and negotiation of Scottish notes in England. This was done by the Act of 1828. On the decision being made known the Scottish bankers at once proceeded to confine their issues within the limits of Scotland, and accordingly notified their local correspondents of the necessity of closing all accounts south of the Border within a few weeks. Now the stability and reputation of Scottish

banks had given their notes a considerable vogue in the northern English counties: during the enquiry of 1826 it was said that seven-eighths of the rents of English estates on the Scottish border were paid in Scottish £1 notes. It is not therefore surprising that a petition was addressed to the Lords of the Treasury for the continued circulation of Scottish notes in England, signed by the "principal gentry, land occupiers, merchants, "manufacturers, and tradesmen of Cumberland, North- "umberland and Westmoreland", supported by the two members of Parliament for the district, Sir Philip Musgrave and Sir James Graham of Netherby. The memorial is interesting as demonstrating that where people had the opportunity to experience in practice the different results of Scottish and English banking legislation, they arrived at decisions to which apparently no quantity of theoretical pamphlets could bring the rest of the English people. The memorial proceeds:[1]—

> "An Act of Parliament limited the number of partners in our English banks to six at the utmost, while the absence of any such limits in Scotland gave a degree of strength to the issuers of notes, and of confidence to the receivers of them, which several banks established in our counties have not been able to command. The natural consequence has been that Scotch notes have formed the greater part of our circulating medium, a circumstance in which we have reason to rejoice, since, in the course of the last 50 years, with the solitary exception of the Falkirk bank, we have never sustained the slightest loss from one acceptance of Scotch paper; while, in the same period, the failures of banks in the north of England have been unfortunately numerous, and have occasioned the most ruinous losses to many who were little able to sustain them."

[1] W. Graham, work previously quoted.

Considering the difference of degree in State interference with banking in England as compared with Scotland, we may judge how much reliance may be placed upon orthodox banking theories when we read the statement of so eminent an authority upon matters financial as Professor Bonamy Price to the effect that:[1]—

> "In England private banks had proved themselves to be bad and unsafe issuers of public currency. The Act of 1844 wisely and justly substituted for them issues controlled by the State. In Scotland the private issues have displayed on trial unchallengeable quality; few persons, not doctrinaires, would dream of suppressing them in favour of Government notes, except under some call of necessity."

It is surprising that it should still be necessary to-day to demonstrate with argument the fact that, given freedom, the majority of people will deal only with reliable and cautious bankers. It is open to any trader to-day to supply shoddy goods; but we do not find the majority of normal folk possessed of an incurable preference for such goods, although poverty frequently compels them to demand cheaper goods, and this cheapness can often be supplied only by the use of less costly adulterants. In the present imperfect state of social sympathy, the knowledge that fraud is possible is the great incentive to watchfulness on the part of purchasers, and the knowledge that his customers are free to go elsewhere the great inducement to the trader to earn and cherish a reputation for honest dealing. Had the government but devoted a tithe of the time and money spent on prohibition to dissemination of information regarding the best test of a banker's soundness,[2] or even (and I state it

[1] *Currency and Banking* (London, 1876, King & Co.), p. 48.

[2] The action of the London General Omnibus Company in placarding London with warnings of the dangers of swift street traffic, and with sugges-

deliberately) had the government simply left people alone and permitted them to gain experience of banking in their own manner, confining its attention to the perfection of the administration of justice, we might have been spared the greater part of the misery which our industrial system has entailed.

The Scottish banking system was suppressed in 1845 because it transpired that at times when gold was being drained both from Scottish and English banks the Scottish bankers had not restricted their note issue, but had withdrawn gold from the Bank of England to support their credit system. The defenders of Scottish banking methods imitated the unfortunate example of their English co-doctrinaires in omitting to protest that it was precisely State interference with freedom of banking which, by prohibiting the option-clause note, enabled unforeseen drains of gold; hence the opposition offered to the 1845 Act was ineffectual. In England the restrictionists could point to the instability of the country banks as an additional reason for their suppression; but no such accusation could be levelled against the Scottish banks. Strong protest was indeed raised against the Act by the Scottish people, but our ministers had gained in political wisdom since the attempt to suppress the small notes. In 1845 they won the consent of the Scottish bankers by the grant of a similar monopoly to that extended to English banks of issue, namely, that no fresh bank of issue should be permitted to be established. The passage of the Act in Scotland was then almost as easy as it had been in England.

The importance of note issue in promoting the establishment of new banks may be judged by the fact that, according to Sir John R. Paget in the *Encyclopædia Britannica* (Eleventh Edition) article on banking, no

tions as to the best method of crossing busy thoroughfares and alighting from omnibuses, affords an example of what might be done with regard to banks.

important bank has been established in Scotland since 1845.

We should remember that, even in 1845, Scotland was oppressed with bad land laws; a cumbrous protective system obtained; justice was exceedingly insecure; that the people were still learning the principles of banking by the primitive method of trying all possible systems; that the banks frequently attempted to ruin each other by a sudden presentation of notes, a practice which mature reflection has caused to be relinquished; and that with every one of the crises and the demand for gold thereby set up by the restricted English system, the Scottish banks were obliged to protect their gold store by a ruthless calling in of loans, levelling at one blow scores of competing employers. If, besides these disadvantages, we bear in mind that even in 1845 the ideal of the cheap and automatic conversion of future profit into present purchasing power was far off realization, we may gain some idea of the benefit which might result from the establishment of a rational banking system in such a community as our own at the present day.

So late as 1875, after the Scottish banks of issue had established branches in London, English deposit bankers protested vigorously against the unfairness of the competition from the "privileged" Scottish banks, even when the privilege of the latter consisted only of such limited small note issue in Scotland as was permitted them by the Act of 1845 (the law of 1826 prohibited the issue and negotiation of Scottish notes in England by the Scottish banks). The protest of the English banks was justified, however, if we remember firstly, that even under the primitive system which existed in Scotland in 1845, when the substitution of gold by paper was yet in its infancy, the profits from note circulation amounted to one-third of the total profits of the bank, and secondly, that no English pro-

vincial bank of issue was permitted by the 1844 Act to open a branch in or within sixty-five miles of London without surrendering the whole of its issue. Moreover, as we have seen elsewhere, the privilege of small note issue is a potent factor in enabling a new branch of a bank to be founded. People will accept a single small note of a new bank where they will not trust it with their savings. The note can be passed on in a few days; the deposit of savings necessitates extensive trust. Hence we see that the power of £1 note issue gave the Scottish banks certain material advantages over their English competitors, and doubtless enabled them to transact ordinary business at a cheaper rate than the latter. Palgrave states[1] that the history of banking in Ireland pursued very closely the same process of development as in England. Note circulation preceded and fed deposits. The credit which the banks obtained by the ready acceptance of their notes, brought customers to their counters, and thus the existing system, fortunate in excellent managers, was built up gradually and surely. The tables of deposits in Irish banks exhibit a progress unequalled, so far as he knows, in any country during a like period.

So strong a hold has the small note taken upon the Scottish people, that even to-day, when every note in excess of a certain fixed amount has by legal enactment to be backed by an equivalent sum of gold held at the bank of issue, the people still prefer notes to gold; and the Scottish banks are obliged to make periodical demands for gold upon the Bank of England in order to enable them to issue the notes required for certain quarterly payments. The withdrawal of this gold invariably hardens the London money market and restricts commerce. But the law is inexorable. The gold is solemnly conveyed to Scotland and deposited in the vaults of the issuing banks. The cases in which it arrives

[1] *Notes on Banking* (London, 1873).

are never even opened. The notes are issued and, after a certain time, return to the banks, when they are retired and the gold just as solemnly sent back to England. This procedure only needs to be exposed to discussion by commercial men, for its childishness to be revealed. It may emphatically be stated that the Scottish banks are less likely to abuse freedom of note issue than is the Bank of England, since they possess a tradition and experience of note issue which the Bank of England has never known; yet we submit the Scottish banks to this expense, and our own commerce to this restriction, because no economist has yet come forward to expose the system in sufficiently scathing terms.

The history of Scotland conclusively answers the question as to whether a freer system of banking is practicable. In subsequent chapters we will consider what measure of freedom is advisable.

Various countries have been pointed to as offering examples of the unwisdom of freedom of banking, notably Switzerland and the United States of America. Upon examination, however, it will invariably be found either that the so-called "free" system was seriously hampered by governmental restrictions, or that freedom was abolished at the first catastrophe, without permitting the people to profit by experience. The banking history of America is especially instructive. The early colonists were speedily embarrassed by the lack of gold exchange medium, and numerous experiments in paper money were attempted. An energetic enterprising nation like the American would naturally make more mistakes than a nation of older tradition, and we find that in those American States wherein the banking system was not ruined by exorbitant demands upon it by impecunious legislatures, it fell victim to the protective spirit. At the first crisis due to unwise speculation on the part of banks, governmental restriction was usually imposed. For the detailed history of banking in

foreign countries the student is referred to that excellent work *A History of Banking in All Nations* (by several writers, 4 vols., New York, 1896), upon which, together with the reviews of various national banks issued by the United States Monetary Commission (Washington, 1910), the above contention is mainly based.

CHAPTER IX

THE ACT OF 1844 AND ITS EFFECTS

THE point of the 1844 Act which chiefly concerns us is that it prohibited all extension of the note issues of the country banks, limiting them to their respective annual averages previous to 1844, the establishment of further banks of issue being absolutely prohibited. The Bank of England itself was compelled to limit its uncovered note issue to £14,000,000, no excess of notes over this amount to be issued unless balanced by a corresponding decrease of country issues or an increase in the amount of gold held in the reserve. Furthermore, various rules were set up which provided for the gradual extinction of the note issues of country banks, the chief of which rules were that any bank of issue wishing to establish a branch in London must forfeit its right of issue throughout its branches, and that a bank of issue could (with but a few exceptions) only amalgamate with another bank, or increase the number of its partners, by giving up its right of issue. Lastly, the Bank of England thought it its duty to assist the process of elimination of banks of issue by refusing them all discounts and accommodation. If we now bear in mind that the prominent feature of all commerce since 1844 has been the crushing out of small firms by large joint-stock companies, chiefly due (as will be demonstrated later) to legal restrictions on the development of credit, the reason for the gradual disappearance of banks of issue is evident. The London banks of issue had previously discontinued note issue owing to unfair competition from the Bank of England, which Bank, deriving a considerable revenue from the sum paid it for managing the public debt, could transact

its note issuing business at lower charges than an ordinary bank.[1] The object of the promoters of the 1844 Act was to secure the convertibility of the Bank of England note by giving the Bank of England a secure hand over the paper issues of the country. In respect of the note issue at least, they have so far succeeded that at the present day it forms a most insignificant portion of the total credit token circulation of the country. The 1845 Scottish Act placed no restrictions on amalgamations of banks. The result has been that whereas the ten large banks in Scotland still possessed the power of note issue in 1906, nearly all the provincial banks in England had by then lost the right of issue.[2] During the month ended October 12th, 1844, there was issued in England by[2]—

207 Private banks	.	£4,674,162 in notes
72 Joint-stock banks	.	£3,331,516 „ „

By May 1907 these figures were reduced to—

12 Private banks	.	£122,536 in notes
17 Joint-stock banks	.	£437,693 „ „

The two main results of the 1844 Act have been (1) to tie down the credit system of the country more closely to its gold basis, since, in the more domestic exchange, the only effective substitutes for gold—the circulating promises to pay gold to bearer—have been prohibited; (2) to render the entire superstructure of credit more unstable, since the Bank of England has been prohibited from circulating any notes save those redeemable in gold on demand, and the frequent export of gold encouraged by this institution of a "free" gold market must usually be balanced by the destruction of a portion

[1] See *The Scotch Banker*, Thomas Attwood (London, 1832), p. 117.

[2] Figures from Sir John R. Paget's article on banking in the *Encyclopædia Britannica* (Eleventh Ed.).

of the credit based thereon. Palgrave states in the course of his *Notes on Banking*:—

> "I well remember that about that period (1844) I was staying with those friends with whom I was afterwards associated in business, and I well remember one of them (the late Mr. John Brightwell) who was most competent to give an opinion, saying to me that he considered the result of these alterations (the 1844 Act) would, as their influence extended more and more, tend more and more to increase and augment the numbers of changes in the Bank Rate of discount, his words, as well as I can remember them, were, 'Watch it and you will see'. I think the results bear out the anticipations of his long tried sagacity."

Palgrave's friend was not mistaken. The result of the Bank Charter Act has been to render the credit system of this country unnecessarily dependent upon the fluctuations of the home and foreign demand for gold. From this one circumstance grave consequences arise.

Sir Robert Giffen has likened our credit system to the long arm of a lever. The least touch upon the cash basis will suffice to displace a heavy weight of credit at the opposite end. The simile is very apt. The tendency of the development of exchange expedients has for centuries lain in the direction of the enlargement of the superstructure of paper credit upon its gold basis. The greater the volume of credit the more precarious became its position upon its narrow and legally-weakened basis.

The quantity of gold in Great Britain to-day [1] is usually estimated at about £113,000,000, of which £30,000,000 is the ordinary amount of the Bank of England reserve. It must not, however, be assumed that thirty millions sterling is the available gold reserve of the Bank. At least 17 millions of this amount is held in

[1] Written in 1913.

the Issue Department of the Bank, and can be withdrawn only when a corresponding quantity of notes is withdrawn from circulation. This is the famous "automatic "check upon over-issue of notes" provided by the 1844 Act. Hence, the actual amount of gold which is available as a support to the existing superstructure of credit is from 13 to 15 millions sterling. On the stability of these 15 millions of gold depends the safety of the vast superstructure of paper credit which is the motor power of our commerce. A portion of these 15 millions is owed to the various banks. One-half, roughly, of the remaining 80 millions circulates in the pockets of the members of the community; the other half is held in small quantities as till-money by the various banks. Some seven or eight years ago Mr. Tritton, president of the Institute of Bankers, estimated the daily turnover of commercial transactions in London alone as varying between 30 and 130 millions. These are large figures, but the average of the London clearings alone is 30 millions a day, and the business done outside the Clearing-house by the banks, brokers, and the Bank of England may certainly be taken as averaging 30 millions more. It is calculated that 98 per cent. of the daily exchange transactions of the country are carried out on paper.

Lord Avebury likened the credit system to an inverted cone resting upon an apex of gold. We may, with Mr. F. W. Bain, extend the simile and call the cone a whipping-top, the point alone on which it spins being of gold, the overhanging body consisting of paper credit. While spinning, the top is maintained in unstable equilibrium, but a slight change at the point will check it and cause the top to wobble. Confidence between the banks and their customers is the whipping which keeps the top spinning. Unexpected reduction of gold reserves is the check at the point which endangers the stability of the top. But the early bankers

had recognized the danger. The evolution of the small note to protect the gold against home demands, and of the option-clause note as a protection against foreign demands, represented the efforts of bankers to steady the gold basis in order that the credit superstructure might be rendered adequate to the needs of commerce. The 1844 Act represented the culmination of the State's clumsy efforts to remedy the evil which had been set up by its own vicious interference with the natural evolution of credit.

As might be expected, the Act did not prevent crises; indeed, as we shall see, it increased their frequency. This, however, did not disconcert its promoters. Their one aim was to provide a means for retaining gold in the country. They noticed that notes were capable of displacing gold—hence the issue of notes must be checked.

It might be supposed that the Act, absolutely limiting as it did the means of increasing the volume of bank notes, would have completely crippled the exchange system. By a dangerous device, however, the bankers have partly evaded the Act. Side by side with the issue of bank notes had grown up the cheque system. In reality the cheque bears no similarity to the bank note. It is merely an order from a person who has wealth deposited with a bank, authorizing the banker to pay a certain amount to another person; and we have seen that its introduction dates from more primitive times than the bank note. When the bankers were prohibited from advancing credit in notes they fell back upon the plan of permitting the applicant for an advance to draw cheques upon them, trusting to the chance that the daily amount of cheques drawn upon them would be balanced by approximately equal payments into the bank. In this way only has the vast extension of commerce during the last century been rendered possible.

It has been asserted by modern apologists for the Bank Charter Act that the cheque system obviates the

need for bank notes. There is only a limited amount of truth in this statement. It is true that when a person has a banking account it is easier for him to write a cheque for the exact amount of a bill which he has to meet, than to send notes and postage stamps. There is, however, a fundamental difference between the cheque and the note—a difference which reduces the value of the former as a credit token when compared with the latter. A bank note circulates from hand to hand among people who may be entirely ignorant of each other's honesty; it circulates because it bears the banker's generally recognized guarantee of payment. A cheque, on the contrary, carries no assurance of payment: we accept cheques only from those persons of whose integrity we are certain.

In this erroneous view respecting the sufficiency of a cheque circulation we see the ordinary result of State interference, as demonstrated in so many instances by Spencer. The point which I desire to emphasize, in opposition to most of the economists who have written upon this subject, is that the enormous development of cheque circulation to-day as compared with the volume of notes is largely a result of governmental prohibition of the latter instrument. In previous chapters I have remarked that the cheque is actually a more primitive credit instrument than the note, for the reason that it demands less organized mutual confidence. The cheque is virtually a private credit instrument, in that it is usually merely an arrangement between two persons: the payer, and one payee. The cheque rarely circulates beyond the actual payee because his reputation is not so widely known as that of the banker whose profession it largely is to spread a knowledge of his own integrity. A banker does not engage in production: his business is to safeguard and publish his reputation in order that his credit may be relied upon by the community. The cheque was used by goldsmiths and their customers from very early

days merely as a means of transferring gold from one person to another. The payee accepts the cheque because he knows the payer and has confidence in his signature. On the other hand, the note could come into use only when there arose organized confidence between a large circle of producers and the banker. The note became of use to commerce only when it was circulated through many hands without its redemption in gold being demanded. The less frequently that gold was demanded in exchange transactions, the more automatically the banker was able to transfer goods from those persons who had produced for exchange to those who were capable of using the same wealth productively. So much more important was the note circulation of a banker than his cheque transactions, that by the beginning of the eighteenth century, in practically every civilized country, banking was held to consist chiefly of the function of issuing notes. Any legislation in regard to banking was aimed at the regulation of note issues only, and history shows that the circulation of notes grew steadily until the State proscription of the instrument. Yet, in every community the tendency to approve of that which has been decided upon by majority vote, and the profit which results from such acquiescence, are so great that in these latter days, when the controversy which attended the passing of the Bank Charter Act has receded into the dim past, we find the mass of economists prepared to state that what the government has done is wise. The cheque has superseded the note? Good! the note has lost its usefulness; the cheque is inherently superior as a credit instrument!

The usefulness of the cheque cannot be denied; but the cheque is inferior to the note in one important quality. Since the great majority of cheques are returned upon the bank by the actual payee, effecting only one payment, they can be met by the banker only if he have sufficient wealthy customers who are continually paying

money into the bank. On the other hand, the note, especially the small note, circulates for extended periods in payment of wages and in performance of small domestic transactions without its redemption in gold being demanded. Hence we may say that the note is essentially the credit instrument for long-date loans and the promotion of fresh production, while the cheque is a convenient instrument for the liquidation of debts between holders of banking accounts. When fresh industry is being promoted, it means that the community must provide the promoter with capital during the space of nine, twelve, or more months until he is able to obtain his expected return. In any community of high productive power, considerable quantities of goods are continually being produced in excess of the present needs of the producers. The essential function of a banker's note circulation is that it enables this wealth to be lent for extended periods to those who are capable of using it in fresh production, at the same time enabling the lenders thereof to purchase immediately the goods they require for present consumption. The stress of supporting industry which must in the nature of things consist, for a period at least, of unproductive consumption, is thus spread over the whole community, and is noticed but very little by the individual producers of that community. If now the banker, being prevented from issuing notes or *circulating* tokens, attempts to establish any quantity of fresh industry upon his cheque credit alone, his credit instruments will be returned upon him immediately as usual, and since the returns of his customers will not be obtained before many months, he will be obliged to drain his gold store in meeting these cheques, and, in a very short time, will be prevented from making any further issues whatever, although the production of general commodities in the community at large is proceeding apace, and the demand for credit increasing rather than diminishing. The

restriction of credit in such cases proceeds from no diminution of confidence between the bank and its customers, and there is no lack of capital wherewith to support the fresh production; the restriction is due simply to the fact that we are not a gold-producing country, that gold cannot be produced abroad in sufficient quantities to effect the exchange of the ever-increasing mass of commodities, and that the banks have been prevented from issuing such substitutes for gold as the community is perfectly ready to accept and use in exchange. If the quantity of fresh industry established at any one period be too great, prices will of course tend to rise until the commodities resulting from that industry are placed upon the market. This danger, and the safeguards necessary to prevent it, will be examined later; but it is obvious that the danger of excessive consumption of goods in the establishment of fresh industry is sufficiently remote in our present state, when glut of goods in the hands of producers, and involuntary idleness on the part of capable producers are such patent evils.

The distinction drawn above between the functions of a note and a cheque is a broad generalization. Let us proceed to examine the matter in closer detail. We have seen that the cheque is useless as an exchange medium among the majority of ordinary people because it carries with it no guarantee of payment. Hence the mass of domestic purchases must, in the absence of an adequate supply of notes, be transacted on a coin basis. The demand for gold is thus greatly increased by the proscription of small notes. Mr. F. Straker, Fellow of, and Lecturer to the Institute of Bankers, states:[1]—

> "At the end of each week bankers lose a large amount of cash, which is drawn for wage-paying purposes, and it is not for several days that this cash

[1] *The Money Market* (London, Methuen, 1904), p. 88.

gradually dribbles back through tradesmen paying in the money they have received from the wage earners. A similar depletion of cash takes place at the end of each month for the payment of salaries. Again, about the middle of each month, suburban and provincial banks have their balances depleted owing to retail customers paying the monthly accounts of their wholesale houses (this latter demand is not for cash, but is satisfied from the Bank of England balances, which, however, has of course the same ultimate effect as if actual cash were drawn). At the end of each quarter there is also a disturbance of balances for rents then falling due; and finally, in the summer and autumn months much actual cash is temporarily taken from the banks for harvest and holiday requirements. Thus the banks lose a portion of their cash or bank balance on certain days and at certain seasons of the year. These are all *known demands*, and the banker is prepared accordingly."

We have already seen that the quantity of gold circulating as change in the community is greater than the entire amount of the Bank of England's gold reserves. If the whole of the productive ability in our midst were being utilized to its utmost extent, and were receiving a better reward for its efforts, the quantity of small change needed would be increased many-fold. Furthermore, the banker is obliged continually to stock a greater amount of gold to meet occasional demands than would be necessary if an elastic note system existed. The ordinary manufacturer's payments to-day are of two sorts: (1) payments for raw material, for which a cheque suffices, (2) payments for wages, which must at present be largely made in gold.[1] There are many industries in which the amount paid in wages is considerably greater

[1] The present issue of Treasury notes, being limited in volume, does not materially affect this statement.—H. M., 1916.

than that expended upon raw material. If wages could be paid in small notes, the paper might circulate for extended periods in the neighbourhood of the bank without being returned for redemption in coin. Every such note which circulated would enable the banker to economize the use of gold, to increase and cheapen his issues, and thus facilitate commerce. Furthermore, and more important, the poorest classes of the people would thus be brought into relations with the bank and would be impelled to keep a watch over their bankers. In proportion as confidence increased between the community and its banks, the ordinary daily demands for gold upon the latter would diminish. It would be to the interest of the banker to invent such methods of proving his stability as would induce ordinary people to refrain from returning his notes for redemption in gold. It would also be to the interest of the employer to induce his workpeople to refrain from demanding redemption of notes at the bank, since the diminution of such calls would enable the banker to grant more extensive and cheaper accommodation. The local tradesmen, who would usually also be debtors of the bank, would have an interest in stimulating confidence in its issues by freely accepting and circulating its notes. Hence the interests of the whole community would work together towards the substitution of cheap and elastic paper credit for dear and inelastic gold medium.

The governments of every civilized nation, however, have copied England, and have set severe restrictions on the quantity of notes which may be issued. Any considerable increase of prosperity in a country demands an increase both of credit and of wages. We have seen that the prohibition of notes compels bankers to hold more gold to meet the ordinary daily demands of their customers than would otherwise be necessary. Obviously, when they increase their credit issues, the prohibition of notes compels them to add proportionately more gold

to their reserves. Hence the universal proscription of increase of note issue aggravates the demand for gold all the world over, and exposes the reserves of any one bank to the universal demand for wages and banking reserves. At the first sign of increased prosperity at home the position of the banks is attacked both from above and below. They are required to expand the volume of their paper credit, and at the same time to yield gold from their reserves for payment of wages. An appearance of prosperity sufficient to make an appreciable difference to industrial conditions to-day tends to drain gold from the banks into the channels of exchange.

Sir Robert Giffen writes:[1]—

> "It is easy to see how material an annual supply of gold from the mines may become in connection with the rate of discount. One year with another, other things being equal, the population of gold-using countries increases in numbers, and commodities are multiplied in even greater proportion. Given the same range of prices and the same rate of wages as before, and a continuance of the same general conditions of business, this means that one year with another a banker's deposits and liabilities will increase, or rather the aggregate deposits and liabilities of a given banking system will increase, and consequently a larger and larger reserve will be required. If no such reserve is forthcoming, then equilibrium can only be restored by a decline in nominal values, which must be brought about, if necessary, by a raising of the rate of discount. For similar reasons a steady increase in numbers and wealth, other things being equal, implies a larger and larger requirement for cash and small change. If no such cash is forthcoming, then it is quite impossible for the increased and richer population to effect their transactions. To

[1] *Essays in Finance*, Second Series (London, Geo. Bell & Sons, 1890), p. 52.

effect them they must trench on the bank reserves, necessitating the same rise of discount rate and fall of nominal values which would in any case become inevitable from the decline in the proportion of the banking reserves to liabilities. The two effects are produced *pari passu* and thus contribute in turn to the same result. To maintain equilibrium in the complex system, therefore, a steady addition to the stock of cash is required. There is nothing that is more essential."

He elsewhere suggests that an issue of small notes might be advisable; but does not press the proposal. To-day, under the legal proscription of note issue, prosperity tends to drain the gold from the banks for payment of wages. In the United States where the West is more exclusively productive and the East financial, this tendency is clearly noticeable. In the case of England such a drain of gold compels the banks to attack the gold reserves of the Bank of England, which they accomplish by discounting securities at the Bank and demanding payment in notes which they subsequently exchange for gold.

In such times there is, moreover, a further drain on the gold reserves of the Bank of England. It is a fact which can be verified from history, that an extended period of trade prosperity invariably causes at least a temporary increase of prices. Adam Smith demonstrates the fact in Book I. chapter xi. of *The Wealth of Nations*; Tooke continues the demonstration in the *History of Prices*; Mill supports it in Book III. chapter xii. of the *Political Economy*; Giffen corroborates it in the *Essays in Finance* (Second Series); and Gilbart long ago pointed out in his work *A Practical Treatise on Banking* (London, 1865), vol. ii. p. 81 *et seq.*, that whilst a low discount rate, by affording cheaper money to commerce, tends to promote industry, it also tends to raise prices.

Whether the prosperity result from cheaper money or not, however, the result is the same. Men are tempted by trade activity to extend their operations; credits are extended, either by means of bank advances, or book credits between individuals; the first result is an injection of purchasing power into the market; and prices tend to rise. High prices are not in themselves an evil, since higher prices increase trade activity, and increased trade activity usually causes an increase of wages, the increase of wages ensuing the more automatically as the demand for labour becomes keener. I will discuss later the probability that a rise of prices from the present low level is a necessary part of the cure of the present social evil. Under a rational credit system, real wages, or consuming power, must eventually rise to such a degree as amply to counterbalance the preliminary rise of prices. To-day, however, we have not only limited the note issue—we have further forbidden the Bank to circulate any notes save those redeemable in gold on demand. Hence we have legally proscribed the natural defences of our banks' gold stores, and financiers take advantage of high prices here to import cheaper goods from abroad and pay for them with the gold which is so sorely needed at home.

The process of the export of gold in such cases deserves detailed examination. The elevation of gold in most civilized countries into the virtual position of sole legal tender has enormously increased the demand for it as a basis of credit. In all countries there are latent industrial projects, only waiting for credit (and therefore for gold) to bring them to realization. There exists, consequently, a general and continuous hunger for gold —a hunger which is far keener than that for any other commodity. Hence, whenever the discount rate or price of money here falls low enough, sooner or later general prices rise; but the price of gold remains fixed by law, and our financiers withdraw gold from the Bank of

England for investment abroad, while the foreigner simultaneously exports cheap goods to us, taking in exchange our gold to that country wherein gold is dearest. According to Goschen a difference in the discount rate between England and France exceeding 2 per cent. is sufficient to cause an export of gold. The fact that gold can be obtained cheaply here at such a time tends to discourage other exports from this country, and hastens the process of stagnation in home industry. Moreover, the restriction of commodity exports turns the trade balance yet more decidedly against us and precipitates the outflow of gold. The rising prosperity would therefore be checked by these circumstances, even in the absence of other hindrances. But the legal strangling of prosperity is made doubly sure. The Bank of England's gold reserves are attacked both by the home demand for wages and credit, and by the foreign demand for cheap gold and for payment of "dumped" goods. The Bank notices that its gold store is running low as compared with its outstanding advances and, being legally exposed to the danger of additional foreign demands for gold, raises the bank rate, that is, increases the charge for discounts in order to discourage further applications for notes and gold, and also to attract gold from abroad—this precisely at a time when the credit system of the country is already strained and the hunger for money is great. Banks all over the country are compelled to advance their own rates to that fixed by the Bank of England in order to avoid a disproportionate increase in their credit advances as compared with their gold reserves. If the market rate does not follow the Bank of England rate with sufficient alacrity, the Bank goes down into the money market and itself borrows funds or sells securities until a monetary stringency is created severe enough to force the market rate up to the required point. This rise in the bank rate means that the cost of every exchange of commodities is increased by

2 or 4 per cent. (it has sometimes meant an increase of 6 or 8 per cent.). When we remember that transactions to the value of thousands of pounds are performed daily for the sake of a 2, nay, less than 1 per cent. profit, the consternation set up by such an increase in the bank rate may be imagined, since it affects all discount of bills as well as credit advances.

In his address to the Liverpool Bankers' Institute in December 1907, Sir Edward Holden, the well-known manager of the London City and Midland Bank, repeating the statement of every writer on banking or finance, said:—

> "The base of credit consists of gold, and it is the ratio of the base to the total credits which restricts bankers from increasing unduly their loans. If business increases unduly, and if bankers continue to increase their loans, of course concurrently increasing their credits, and not being able to increase the gold base, then evidently they are getting into danger, and the only judicious course which they can pursue is to curtail their loans, curtailing an undue increase of business, which will curtail the credits, and thus re-establish the ratio."

The doom of industrial prosperity is here distinctly pronounced. We have prevented the banker from issuing such paper substitutes as would protect him from demands for gold, thus *legally exposing* him to the danger of depletion of his gold reserves by both home and foreign demand whenever trade prosperity increases—and we then calmly declare that any growth of industry which will endanger his gold reserves is an undue growth *because it threatens his reserves*! In other words, we deliberately and quite unnecessarily limit industry by making it depend on the available quantity of gold in the country instead of on the demands and needs of our people.

Macleod details the relations between the producer and his banker. He states:[1]—

> "Almost all men in commerce are under Obligations: that is, they accept Bills of Exchange which must be paid at the fixed time, under penalty of commercial ruin. To meet Obligations due by them, they have property of two sorts—Debts or Obligations due to them; and secondly Commodities. To meet their own Obligations, they must sell one or other of these kinds of property. They must either sell their Debts to their banker, or they must sell their Commodities in the market. While Credit is good—that is, while bankers buy Debts freely—they can retain their Commodities and watch their opportunity of selling at a favourable moment. As their own Obligation falls due, they sell to their bankers some of the Debts due to them. Thus if Credit was always good, they might go on for ever, without the necessity of ever having a single piece of money paid into their account, or having any money at all beyond what is necessary for their daily petty transactions. But if Credit receives a check, and the banker refuses to buy their Debts, they must still meet their own Obligations under penalty of ruin. They are consequently obliged to throw their Commodities on the market, and sell them at all hazards: the supply of them becomes excessive and inevitably depresses the price."

The strain is especially felt by those merchants who happen to have large liabilities falling due at the time of the stringency. The financier who, in taking advantage of the legal exposure of the banks' gold stores, has been the proximate cause of the trouble, retires with his gains as soon as the discount rate is raised. Men of

[1] *Elements of Banking*, p. 129.

business, however, must carry on their regular trade; if it cannot be carried on without borrowing at high rates of interest, high rates of interest must be paid. They must consider themselves lucky if they are able to obtain discounts at any price, for the tighter the credit market, the more the banker must restrict his advances. If the stringency persist, discounts are refused; but the merchant's obligations continue to mature and, stringency or no stringency, must be met on pain of bankruptcy. The merchant thereupon turns to other methods. Money must be obtained, so goods are thrown upon the market at low prices, unfortunately at a time when the purchasing powers of the community are also restricted. Buyers hold back in the hope of a still further reduction in prices. The progress of stagnation is thus doubly swift, and, one after another, factories slow down.

In most cases the fall of prices thus occasioned, together with the high bank rate, is sufficient to attract gold to this country, and industry, with its optimism well checked, proceeds in miserable stagnation as before. Occasionally, however, it happens that one or two large houses, which cannot afford the necessary sacrifices to meet their liabilities, are made bankrupt. The financial experts now begin to talk gravely of "rash speculation". The suspicion arises in the community that the banks have been fostering unwise speculation, and there is then imminent danger of a run by depositors upon the banks to obtain their gold. This is the time of danger for the banks. Timid persons begin to withdraw their deposits. The banks, to save themselves, must refuse advances to commerce, and if the strain continues, must even call for the return of loans. Should the banks have great liabilities they may be compelled to refuse advances even to firms of undoubted integrity. The news of such a refusal spreads rapidly through the commercial world and increases

popular suspicion of the stability of the banks; the danger of a run is thereby increased. Should the run actually occur it means a complete break-up of the credit system of the country. In reality the operations of the banks may have been perfectly sound, and they need only time in order to realize their assets. But the depositors cannot wait: each one hopes by early application to save at least his own gold from the ruin; even those depositors who have no suspicions of the bank are compelled to join in the rush for gold, owing to their fear that the demands of the more timid depositors may ruin the banks. Factories are stopped, and workers thrown out of employment. In 1857, with a bank rate of 10 per cent., out of 236 factories and workshops in Manchester, only 54 were working full time with a full complement of hands; 23 were stopped altogether. Security and bills that were previously accepted by bankers as a basis for advances are, at a time of credit stringency, rejected, and manufacturers are bankrupted on every hand. Moreover, it is the smaller firms which fall first—precisely those which were growing into competition with the wealthy combines.

The reason for the suddenness of the ruin which accompanies such crises is thus made apparent. The mercantile classes must pay, it may be, a double price in order to get their bills discounted (those who are fortunate enough to get them discounted at all) and also, in consequence of the depressed state of the market, they lose 15, 20, or even more per cent. on sales of goods. Moreover, the firms who suffer are not necessarily those which have sinned in wild speculation, but those that merely happen to have large liabilities due at the time of the stringency. This form of "natural selection" is, from the point of view of social good, absolutely immoral. The evil would be more tolerable if it affected all classes of the community equally; its especial vice lies in the fact that it benefits a minority

at the expense of the majority, and thus strengthens the hold of the monopolists, financial and industrial, on the rest of the population. Those financiers and wealthy firms which are able to survive the crisis gain a rich haul.

When the crisis is over, the bank rate is again reduced, but the industry of the country lies inert. We marvel that at such times trade should be slack while the national gold reserve is abundant and credit cheap —we have yet to learn how much easier it is to break industry down than to set it up.[1] Gradually the capital from the ruined firms goes to swell the remaining ones, thus reducing the number of competing employers. The evil effect is threefold, since, in addition, the workers from the bankrupted factories must offer themselves to the remaining employers, thereby further increasing competition among labourers and reducing wages; and the reduced purchasing power tends further to produce glut and stagnation in the surviving industry. Slowly, it may be after five years, industry again becomes normal. Commercial reputations are gradually built up again, and bankers are again able to be a little more liberal with credit advances. Cheap credit is the great source of prosperity; commercial enterprise everywhere takes advantage of the proffered aid; activity in any one trade tends to promote similar conditions in other trades; the ripple of activity spreads, and again the Nemesis of credit stringency approaches.

History shows that crises similar in effect to that sketched above have occurred with fatal regularity almost every ten years since 1844. I do not assert that every one of them was caused solely by an increase of prosperity in this country: details of the various crises are related fairly dispassionately by Professor Andréadès

[1] Goschen's two famous essays: "Seven per cent." and "Two per cent.", printed in his *Essays and Addresses on Economic Questions* (London, Arnold, 1905), should be read in this connection.

in the work previously cited. The peculiar stupidity (if I may use the word—it strangely fits the case) of our system is, however, that the bank rate must be raised and our whole exchange system hindered, whenever, for any reason whatever, the gold store of the Bank of England runs low in comparison with its credit issues. Palgrave lays his finger on the fundamental contradiction of our present system when he remarks:[1]—

> "A purely provincial and home demand for gold operates on the Bank reserve in exactly a similar way as a demand for export (of gold) induced by the state of the foreign exchanges. But it was to bring the note circulation into accordance with the demand indicated by the state of the foreign exchanges that the Act of 1844 was framed. The state of the foreign exchanges has, however, less influence on the provincial demand for an increased circulating medium, than the state of the weather throughout the year. The influence of the weather on the harvest has a decided effect on the provincial note circulation, while the state of the foreign exchanges is absolutely unknown."

Previous to 1844, as Mr. Hawes pointed out in his speech in the House of Commons on June 13th, 1844, if the banks judged that the drain of gold would be temporary, scarcity of exchange medium was met by increased note issues from the country banks, and the internal trade of this country proceeded, within certain limits, as usual. The Bank Charter Act was, however, paternally designed precisely to prevent this substitution of paper for gold, and the system of a fluctuating bank rate operated by the Bank of England was set up. But the gold store of the Bank may run low for many diverse reasons. The modern banker is not only exposed to the danger of calls for gold from his immediate

[1] p. 59 of work previously quoted.

neighbourhood, but he labours under the continual danger of totally unforeseen demands for gold from abroad. Let failure of harvests here necessitate increased purchase from abroad; let a sudden period of prosperity occur in any foreign country (the general prohibition of circulating paper substitutes for gold in foreign countries causes prosperity abroad to be attended by the same increased demand for gold as has previously been demonstrated in the case of our own banks); let Egypt have a rich cotton crop; let the United States muddle its banking system; let Germany threaten to make war and thus set up fear in its people's hearts that their gold deposits may be in danger; let Argentina plan extensive railways, or Turkey demand a large loan; on all such occasions there arises a sudden demand for gold on the various banks of the world which causes every nation to raise its bank rate in the endeavour to protect its gold store.

Sir Edward Holden is again perfectly frank on this point. In the address previously mentioned, he states:—

> "It may happen that the trade of one country grows by leaps and bounds, the loans and credits, of course, following, while the trade of other countries remains normal. What then takes place? The gold base of the former becomes too small, and it is necessary to enlarge it. *How is the increase effected?*" [italics Sir Edward's]. "It is effected by the representative bank of the more prosperous country attacking the gold bases of other countries, and the instrument by which the attack is made is the rate of discount. By this means gold will be attracted from the bases of other countries, and unless those bases are too great for the adequate protection of the credits, the representative banks of those countries will meet the attack by also putting up their rates. But it may happen that the trade of every country has in-

creased by leaps and bounds, and that all loans and credits have also increased. Then the fight begins by each country putting up its rate, first, to prevent its base being diminished, and, secondly, to increase it if possible. Hence we have the English rate at 7 per cent., the German rate at 7½ per cent., the Austrian rate at 6 per cent., the Dutch rate at 5 per cent., the Belgian rate at 6 per cent., the French rate at 4 per cent., the Italian rate at 5½ per cent., the Russian rate at 7½ per cent., but as the United States have no central bank there is no official rate for that country."

The 1907 gold stringency in the United States affords a striking instance of the working of this system of mutual hindrance. There are sinister rumours that the stringency was caused by a ring of Wall Street financiers who withdrew their gold from the banks. Let us note that, however the United States may have sinned, the demand for gold set up in New York caused every nation to raise its bank rate more or less sharply. If the ruin to industry, and misery to workers, were great in America, conditions were scarcely less grave among the trading classes of Europe who were perfectly innocent of a share in causing the disaster.

The object of this rise in the bank rate is to make money dearer and thus to turn the foreign demand into a desire to supply gold. The trouble is that money is thereby made dearer for the home manufacturer and trader, as well as for the financier and the foreigner. We actually make money dearer for home commerce in order to afford inducement to the financier to return the gold which he had previously obtained so cheaply. If it were not that the man of millions can usually find more lucrative employment for his capital, he could make a comfortable income by depositing his gold in the Bank of England, withdrawing it occasionally when

the money market were likely to become tight, and purchasing securities at the low price caused by the consequent high bank rate. Normal times returning, he would sell out at the higher price. It is estimated by one authority that a rise of one per cent. in our bank rate costs the producing classes of this country at least £50,000 per week in increased discounts, other authorities estimating the loss at £200,000 per week. The 100 millions or more of the daily commerce of this country must thus be taxed because 4 or 5 millions of bullion have travelled abroad, the departure of the bullion being in most cases directly caused by State interference with our banks. We sacrifice the majority of home traders to the minority of bullion speculators by the laws which prevent home commerce from protecting itself against the financier's demand for gold. We have expressly forbidden the banks to issue option-clause notes to protect themselves against the financier's demand; and we have also prohibited them from issuing notes redeemable on demand to replace the gold which legislation has unfairly enabled the financier to abstract. We permit home commerce to be mulcted in enormous sums in order to assure stability to banks which we have legally exposed to danger.

Here we lay the finger on the fundamental cause of the disease in our social system. We here perceive that ignorant legislative interference with freedom of contract has compelled the community to sacrifice the interests of the majority of its members in order to retain a small quantity of a scarce metal within its confines.

A further serious evil is, moreover, that owing to the continual danger of drains of gold and consequent high bank rates, our bankers are continually compelled, *even in normal times*, to confine advances to holders of security *which is saleable in times of gold scarcity and high bank rate*. With every diminution of their gold reserves the bankers are compelled to increase the standard of

intrinsic worth of the security upon which they make their advances, and even, if the drain proceed, to recall a portion of their loans, which act compels enforced sales on the part of borrowers in order to obtain the necessary funds. Hence, with every successive rise of the bank rate, progressively widened circles of manufacturers and merchants are deprived of the means which they had counted upon for meeting their liabilities. Accordingly a mass of stock and securities is thrown on the market at low prices in the endeavour to obtain money, and the less valuable species of security become progressively unsaleable. In the *Bankers' Magazine* (December 1896) it is recorded that on August 19th, 1896, the bank rate stood at 2 per cent. By September 10th in the same year an export of 5 millions sterling had caused the rate to be increased to 2½ per cent. A further loss of 1 million of gold brought the rate to 3 per cent. on September 24th; and by October 22nd the rate stood at 4 per cent. The total amount of gold exported during the ten weeks ended October 27th was only 11 millions sterling, but the result was a fall in the price of 325 representative securities amounting to £115,509,000. The bankers had been apprehensive of a still greater rise in the bank rate, and had accordingly restricted their loans, that is, they had demanded progressively more valuable security as a basis for loans, and the rejected securities consequently experienced a serious fall in price, to the dismay of all who had built their hopes upon them. In the final resort, as we have seen in the case of the 1825 crisis, it may happen that even the most valuable "gilt-edged" security becomes quite unsaleable. Accordingly the banker, who, in times of financial peace, desires to prepare for the frequent times of stringency, confines his loans to holders of gilt-edged security, such as stocks, shares, and, to a lesser extent, mortgages, etc. The banker aims at making the greater portion of his

advances either at short terms, or on security that is easily convertible into gold even in times of credit stringency. That this is no exaggeration on my part may be ascertained from any modern text-book on banking practice. It will invariably be found that the banker is especially warned against making more than the smallest proportion of his long-date loans on other than gilt-edged security; and in practice it will usually be found impossible to obtain a long-date loan of any magnitude from a bank except on gilt-edged security.

In the course of his remarks to the United States Monetary Commission, whose proceedings were published in 1910, Sir Felix Schuster, the prominent banker, stated:—

> "We certainly discriminate against securities, and reject them if they are not to our liking. *We do not look so much perhaps to the intrinsic value of the security as to the negotiability of it*" (italics mine).

Sir Edward Holden says:[1]—

> "Every banker must make up his mind by what amount his credits are liable to be diminished, both in ordinary and in extraordinary times, and when he has thus made up his mind, he ought to keep that amount of available resources in gold, *or in a means of obtaining gold*" (italics mine).

State interference operates in several distinct ways to expose the banker to the danger of a depletion of his reserves, and thus increases many-fold the frequency of the "extraordinary times" referred to by Sir Edward Holden. Legislation at home compels industry to attack the banker's gold reserves for wages, constrains the banker to obtain more gold than would otherwise be necessary to support increased loans, and also exposes him to a demand for gold from abroad in

[1] Address previously quoted.

exchange for cheaper "dumped" goods, whenever industrial prosperity in this country increases beyond a certain point; furthermore, legislation abroad similarly increases the frequency of the foreign demand for gold, to which demand we have legally exposed our home banks by our proscription of option-clause notes. The banking legislation of civilized nations has thus compelled commerce to wage a deadly struggle to obtain gold, and industry consequently suffers in curtailment of credits. This universal restriction has debarred the bankers throughout the civilized world from introducing substitutes for gold in the channels of exchange, and has thus prevented them from building up industry on a basis of mutual trust which might be extended with the ever-growing needs of commerce. Industry is compelled to mark time while the bankers of the world are legally set to struggle with each other to capture gold reserves. Hence the anxiety with which commerce watches the movements of the smallest quantity of bullion, whilst the banker, in Sir Edward Holden's words, "makes up his mind by what amount his "credits are liable to be diminished, *both in ordinary "and in extraordinary times*," and prudently restricts his advances in order to safeguard himself against the legally-increased danger of depletion of his gold reserves. Let him who doubts the anxiety of the commercial class respecting movements of bullion visit the Stock Exchange on a day when a change in the bank rate is expected, and he will not convict me of exaggeration.

Here then we see the modern counterpart of the evil which was exhibited at the period of the industrial revolution. The ordinary manufacturer to-day, with his security of stock, plant, and the certainty afforded by his good name that he will repay a loan within a stated period, is compelled either to apply to a moneylender and pay exorbitant interest when he desires to extend

his operations, or he must convert his business into a joint-stock company and thenceforward pay away his profits to a host of more or less idle directors and shareholders. Let me not be misunderstood. When I speak of "more or less idle directors and shareholders", I do not wish to imply that the labour of these people is overpaid under present conditions. On the contrary; under our present restricted system the loaners of gold are more necessary than many inventors and scientists, and the legally-aggravated danger of drains of gold, with the accompanying danger of increased frequency of industrial bankruptcy, render the investment of wealth no easy task to-day. But the State has exaggerated the importance of gold by prohibiting industry from using substitutes in exchange. The willingness of gold owners to permit their legally-monopolized commodity to be used to further commerce is comparatively cheaply purchased to-day. If they were to use their already powerful political influence to secure a further restriction of banking facilities, as for instance in the measure recently proposed to "protect" the community from Charing Cross Bank failures by compelling all banks to deposit a large sum with the State to safeguard depositors, banking would be rendered a yet more costly operation; we should be forced to pay a still higher price for loans, and still be glad to get them.

When I affirm that State interference with banking has aggravated the difficulty of obtaining loans, I refer of course to loans for extended periods. A merchant who requires money on a commercial bill merely three months before payment is due, can usually obtain it if he be a person of sufficient standing, and if there be no sign of approaching credit stringency; but when the ordinary manufacturer wishes to extend his factory, or introduce fresh machinery, he needs a loan for a year or eighteen months, and it would be quite useless under our present system for him to apply to a banker

when every experience and tradition of the latter warn him against such "dead" loans. The same applies to loans to agriculture. An examination of the accounts of the Birkbeck Bank some years ago showed that only 5 per cent. of its advances were against ordinary industrial security, or business reputation unbacked by gilt-edged security.

Mark now the vicious circle. The employer who, by reason of special ability, is just beginning to compete effectively with the Trust, cannot obtain credit advances (which advances are readily secured by the Trust and the speculator) because his security is unsaleable. *But his security of plant and stock is unsaleable precisely because those who would ordinarily purchase are legally prevented by banking restrictions from monetizing similar forms of security.* It is an exact replica of the case of A and B which was set forth in Chapter IV.

In *Lombard Street* Bagehot provides the now classic example of the bounty to production afforded by access to cheap credit. He says (p. 8):—

> "If a merchant have £50,000 all his own—to gain 10 per cent. on it he must make £5000 a year, and must charge for his goods accordingly; but if another has only £10,000 and borrows £40,000 by discounts (no extreme instance in our modern trade), he has the same capital of £50,000 to use, and can sell much cheaper. If the rate at which he borrows be 5 per cent., he will have to pay £2,000 a year; and if, like the old trader, he makes £5,000 a year, he will still after paying his interest, obtain £3,000 a year, or 30 per cent. on his own £10,000. As most merchants are content with much less than 30 per cent., he will be able, if he wishes, to forego some of that profit, lower the price of the commodity, and drive the old-fashioned trader—the man who trades on his own capital—out of the market. In modern English busi-

> ness, owing to the certainty of obtaining loans on discount of bills or otherwise at a moderate rate of interest, there is a steady bounty on trading with borrowed capital, and a constant discouragement to confine yourself solely or mainly to your own capital."

In the foregoing extract, Bagehot refers, of course, to short-date loans when he speaks of the certainty of obtaining loans on discount of bills, and he himself has been most prominent in drawing attention to the restriction of even the short-date loans in times of gold stringency. But if, in the above extract, we replace the "old-fashioned trader" by his modern counterpart, the small trader—the man who, from necessity rather than choice, trades on his own capital—we will appreciate the enormous handicap upon the small trader's endeavours to hold his own in competition with the man who is in possession of gilt-edged security.

The evil which afflicts the working class is a precisely similar one. The man whose sole wealth is ability and willingness to labour, cannot partake of the wealth which has been produced and which frequently deteriorates for want of a purchaser, because those manufacturers who are able and willing to utilize his labour profitably are prevented by law from obtaining the loan which would enable them to purchase in the glutted commodity market, set up factories, and transfer consuming power to the worker, although the banker may be perfectly convinced of their ability to return such a loan within a given period. The legally-increased danger of export of his gold abroad compels the banker to confine his loans to those who possess security which is saleable in times of high bank rate, i.e., gilt-edged security.

Let not the reader who notices in the financial column of his daily paper the statement that "money was plentiful and cheap yesterday" imagine that this indicates

that all demands for credit were satisfied on the day in question. "Cheap money", in the language of the "City Editor", means only that the demand for discount on short-term commercial bills and for loans on gilt-edged security is diminished in comparison with the supply. The mass of productive ability possessing only the less valuable forms of security remains excluded from the benefits of credit to-day, whether money be dear or cheap, and will continue to be so excluded as long as the present legal aggravation of the danger of drains of the banks' gold reserves is maintained. Mr. Kitson says truly: "Money is not cheap to the man who cannot "get it, even if the rate be but 1 per cent." I advance this wholesale legal exclusion of security from the benefits of credit as the fundamental cause of industrial monopoly to-day.

The Bank Charter Act destroys public confidence at times of credit strain by compelling banks to restrict credit, not because they have lost confidence in their customers, but because their gold reserves have been legally and unnecessarily exposed to depletion. This legislation must be abolished before economists can justify their present assertions that "financial crises will, "under any circumstances, recur as frequently as here-"tofore until human nature be perfect."

Examination of the works of practically every orthodox writer on the subject of financial crises reveals the fact that there is general omission to remark the effect of unwarranted State interference with banking in causing these convulsions. Hence there remains for these writers only the explanation of "wild speculation" to account for the trouble; and this factor is developed and exaggerated out of all proportion to its real importance in the question. Prof. Sidgwick shows a little advance upon orthodox opinion in this respect when he states:[1]—

[1] *Political Economy*, p. 258.

> "The banks have no interest in producing the mistaken beliefs that tend to inflate prices. No doubt they profit by them directly through the greater demand for their commodity; but the danger of the collapse when the mistake is discovered decidedly outweighs this gain."

Prof. Sidgwick here certainly exonerates theoretically the banks from a share in producing financial crises: but he still fails to trace the real cause of crises, in that, by omitting reference to unwise State interference with banking, he throws the whole blame upon the commercial classes. Modern manufacturers, for the most part, however, have attained their positions after many years of hard experience of markets; it is inconceivable that they should mistake the public demand and purchasing power as often and as simultaneously as these economists would have us believe. We have seen South Sea Bubbles—we have seen rubber booms—but these were the work of unprofessional investors; the average mill owner, or iron manufacturer, does not lay down new plant upon such slight evidences of public demand for his product. In sober confidence I advance the statement that the withdrawal of gold in times of prosperity and high prices, or in times of strong foreign demand, is a far more frequent cause of financial crises than excessive speculation on the part of manufacturers and merchants. At any rate, I desire to demonstrate that State interference with banking is now solely responsible for a considerable number of commercial crises, and is undoubtedly a contributory cause to the crises which are attendant upon excessive speculation. This interference is entirely unwarranted, and must be removed before we can estimate the exact part played by excessive speculation in causing financial crises.

Great Britain, moreover, suffers peculiarly to-day from the effect of demands for gold from abroad, owing

to her maintenance of the prohibition of option-clause notes in the establishment of that institution which has been so much praised by our financiers—the free gold market. Under this system the Bank of England is compelled to exchange for gold upon demand as many of its notes as are presented for payment at its counter, no matter how low its store of gold. But England is the only civilized country in the world which permits the supports of its home exchange system to be thus withdrawn. It is true that the civilized nations have copied England's example in restricting note issue; but every foreign nation has recognized the importance of stability in its home exchange, and has placed hindrances in the way of those who would withdraw gold from its banks. In France, the Banque de France reserves the right to pay its notes in silver when the demand upon it for gold becomes too severe, and has therefore retained silver as a legal tender. A similar system obtains in the countries of the Latin Union, and formerly in the United States of America; but the currency system of the latter country has now been modified (see p. 182). Germany maintains the equally strong deterrent—one which is more in harmony with her military régime—described by Mr. F. H. Jackson, one of our prominent bankers, as "the Imperial displeasure", and consisting of semi-official pressure upon any commercial firm or bank which attempts to withdraw an excessive amount of gold for purposes of export.

The result of our free gold market is that England has come to be regarded as the gold storehouse for the world. The financiers in the various capitals of the world, knowing how useful is a gold store in times of prosperous trade at home, take care in normal times to hold a stock of bills payable in London. A demand for gold in any country in the world is instantly followed by a purchase of bills on London in the various capitals of the world by the financiers of the country in ques-

tion. The bills are collected, discounted in the London banks, and payment in notes demanded; these notes are carried to the Bank of England for conversion into gold, which conversion is readily accorded by our laws. The banks replenish their store of Bank of England notes by taking securities to the Bank of England, and the drain of gold thus proceeds until the Bank, fearing that its gold store may run too low, raises the price of its loans upon securities until the price of gold becomes too high for export of the metal to be profitable. Since notes can be obtained only from the Bank of England, and the Bank holds the gold reserves of all the banks of this country, a rise in the bank rate is the signal that the country's superstructure of credit is in danger, and all ordinary banks are consequently compelled to discourage further applications for credit, even for purposes of home exchange, by increasing the price for loans proportionately. This means that every merchant and manufacturer in this country must be penalized in order that a few people (the business is in the hands of about six great London financiers) may profit by the export of legally cheapened gold to a foreign country and by the subsequent return of the metal.

According to the 1908 Report of the Banking Committee of the Association of Chambers of Commerce, to our free gold market must be attributed the fact that the average annual number of changes in our bank rate is at least eight times as great as that of, for instance, France, where the free gold market is abolished and where the government maintains an ample store of gold to cover all contingencies. The greater part of this Report is devoted to the consideration of means for mitigating the evils of the free gold market. It is the commercial world which is hit hardest by fluctuations in the bank rate, and it is encouraging to find that merchants and manufacturers are at length becoming aware of the real source of their discomfort. In his work

La Banque de France et l'Escompte (Appendix E), M. Paul Loubet records that during the period 1875–1900 the English bank rate was altered 167 times, whilst only 84 changes are recorded in Germany and 25 in France. The average duration of the same rate he records as 365 days for the Bank of France, 108 days for the Bank of Germany, and 54 days for the Bank of England. Professor Andréadès, who is a notable exception to the majority of financial experts in that he shows some appreciation of the disadvantages which England suffers from her free gold market, says:[1]—

> "What is more serious is that the fluctuations in the English bank rate are not only very frequent, but are also very great. The Bank of England is the only bank at which the range of fluctuation during the same year has on three occasions amounted to 5½, 6 and 6½ per cent. Nowhere else, except on one occasion in Germany, have the fluctuations during a single year reached 4 and 5 per cent., as a rule they have not been more than 1 or 2 per cent."

I have previously stated that the lowest estimate of the loss to the producing classes of this country from a rise of 1 per cent. in the bank rate is £50,000 per week: the loss is sometimes estimated at £200,000 per week. If we further consider the difficulty of carrying on commerce when merchants can never be sure of obtaining the means of meeting their liabilities, the disadvantages of the free gold market will be manifest. How euphemistic then appears the designation of this system as a "free" gold market! It is *free* only to the foreign financier. To our home exchange system, at the present stage of social morality at all events, gold is as the plane to the carpenter—an absolute necessity. Should we call the carpenter free, were he obliged to

[1] p. 315 of work previously quoted.

yield up the means of obtaining his livelihood at a certain fixed price whenever it should be demanded of him?

Our financiers are wont to defend the free gold market with the statement that it renders London "the financial centre of the world". This somewhat impressive phrase is echoed by economists, and seems in their opinion to need no further explanation. In recent years, however, I have frequently endeavoured through the medium of the press to induce the bankers and financial experts to define the phrase more closely. So far my letters and articles have failed to elicit a reply that convinces me of the error of my criticism of the "free" gold market. I am perfectly willing to concede that the frequent movements of bullion give rise to extra discounts, and accordingly, profits, to the banks through whose agency they are caused. I admit further that the knowledge that bills on London are infallibly convertible into gold, causes foreign financiers to give better terms to our import houses. But I see no other advantage, and I cannot admit that these benefits are sufficient to counterbalance the great harm wrought upon our home production in restriction of credit by the constantly fluctuating gold reserves of our banks. The bankers and financiers who benefit by the free gold market, however, are precisely those whose opinions are given the most weight in the councils of the nation on this subject; and it is not surprising to find that during the official enquiry into the banking system held in Germany in 1908, there was a considerable body of opinion in favour of throwing open the German gold market to compete with London. At least one member of the Commission, however, Count von Kanitz, protested strongly against the proposal to abolish the defences of the home credit system, and advocated the building of a "wall of silver to protect the country's gold store" after the manner of France. It is high time that the

commercial classes here became thoroughly alive to their interests in this direction.

Professor Andréadès states:[1]—

> "In England the trade in gold is absolutely free; perhaps it is this which makes London the financial capital of the world, but in return, it leaves only one means of resisting a demand for gold, that is an increase in the value of the capital lent, or in other words, a rise in the rate of discount. England thus subjects herself to fluctuations in the discount rates, but she does it only because she finds that the advantages of possessing a free market for gold fully counterbalance the disadvantages, and at any rate she acts with her eyes open."

It is because I doubt if the commercial class of England has really considered the disadvantages of the free gold market with open eyes that I have brought the question within the scope of this book.[2]

Indeed, it behoves the commercial classes of the world to bestir themselves, for signs are not wanting that the financiers of other nations are awakening to the value of a "free" gold market. The chief advantage proposed by the recent measure for the reform of American banking[3] is the virtual establishment of a

[1] p. 317 of work previously quoted.

[2] *Note to Second Edition.*—It is encouraging to find that the real problem is being more clearly seen to-day. Messrs. Keynes, Hawtrey, and McKenna are constantly drawing attention to the fact that it is impossible to keep the home and the foreign exchange rate stable at the same time. We can keep the foreign rate stable only at the expense of the home rate, namely, by raising or lowering the home rate to attract or discourage foreign investors and traders. Now, whilst we have some control over our home banking policy, we have none whatever over the policy of foreign countries, and it is evidently unwise to expose our home system to the hazards of foreign currency experiments. It is of course unfortunate that fluctuations of the foreign exchanges hamper our foreign trade; but our home trade is at least twice as great as our foreign trade. Many of our industries, moreover, produce both for home and export trade, and what they gain by the stabilization of foreign prices, they lose on the restriction of their home market.

[3] Written in 1913. This measure has since become law.—H. M.

free gold market in that country. In the United States to-day the French plan of optional redemption of notes in silver obtains, and the financiers accordingly find it difficult to export gold in sufficiently large quantities to be profitable in times of foreign demand. In so far as the new plan offers opportunity of increased note issue, and the mitigation of the effects of the bad law which at present compels American National banks to keep a 25 per cent. "lawful money" reserve, the scheme is good. But to effect these reforms it is clear that merely a reduction of present legislative interference with private banking is required—not the imposition of fresh laws. The restrictionist sweetens his pill by pointing out to American banks that they cannot at present deal in commercial bills to the extent that they would like, because they cannot be sure of obtaining funds when they need them, and he offers this centralized reserve as a remedy for this state of affairs. But the experience of such a centralized reserve in Great Britain is that it enables financiers to render the banks' supply of gold even more uncertain than would be the case if each bank held its own reserve. It is urged that the present American system of permitting each bank to keep its own gold reserve, or keep its reserve in certain scattered "reserve cities" and fix its own discount rate, enables individual banks to make wild issues and thus to embarrass other banks; whereas the managers of the centralized gold reserve will fix the bank rate for the whole country as is the case in Great Britain. This is paternalism pure and simple. It is to the interest of every bank to avoid wild issues. When each bank maintains its own reserve, crisis only occurs *when* banks issue to excess; and, while financial crisis certainly affects all banks, yet the greatest sufferers are the offending banks, and the latter are weeded out by a process of natural selection. Under a single centralized gold reserve system, on the contrary, crisis may be

set up without any excessive issue on the part of ordinary banks at all, simply by the action of financiers in withdrawing gold for export, and the individual banks, be they never so virtuous, are powerless to prevent the drain.

American restrictionists follow the example of the promoters of the English 1844 Act, and point to the various American financial crises as evidence for the necessity of some form of centralized control of banking. An examination of the various financial crises in the United States, however, shows that when not due to the issue of State paper to provide sinews of war, these crises were chiefly caused by the drain of gold from the banks, either into the channels of home exchange for wages in times of trade activity, or abroad in times of unusually strong foreign demand. As we have seen in the case of our own crises, it is always possible to argue that such drains of gold are due to previous excessive issue on the part of the home banks; but so long as the legal proscription of all increase of note issue prevents the banks from supplying with paper the increased need of commerce for wage-paying medium in times of prosperity, and so long as the lack or legal prohibition of efficient protection for the banks' gold exists, the charge of excessive issue of credit can never be proved against the banks, since, under such circumstances, even a legitimate growth of industry causes drain of gold and financial panic.

The American people is being beguiled by these "reformers" with the same phrases as are used to maintain our own "free" gold market. "A share in the world's discounts" is offered to American bankers in the inner States who want nothing so much as to be permitted to develop the resources of their own immediate neighbourhood. "Competition with London's free gold market" is dangled before the eyes of American patriots. Those English merchants who understand

the full significance to British commerce of London's free gold market, will be only too willing to share the blessings thereof with the United States. I repeat that the new scheme is, in the main, one which will benefit a minority, the great American financiers, and not American commerce.

It should be noted that the Banque de France has been legally permitted to extend the volume of its permanent note issues on several occasions since its foundation. To this circumstance and to the abolition of the French free gold market, must be attributed the fact that monopolization of industry in few hands has not proceeded to the same extent in France as in other countries. In a future chapter the advantages derived from abolition of the free gold market in France will be detailed. Yet the prohibition of free increase of note issue in all other countries causes the general hunger for gold to be great, and any increase of prices in France consequent upon a period of less restricted credit and trade prosperity is followed immediately by a demand by its financiers upon the Banque for gold for purposes of export in exchange for cheaper foreign goods. The Banque is able to prevent a serious drain by exercising its right of payment in silver; but the tendency of gold to flow abroad is invariably met by a curtailment of issues at home. Indeed, France has in recent years expressly withdrawn a quantity of small notes from circulation with the avowed object of causing more gold to circulate in the country—so deeply has the gold superstition penetrated present political economy. Development of prosperity is thus kept back in France to the average European level, in spite of the country's steady increase (so far as the central bank is concerned, at any rate) in the volume of its note issue. The restriction of commerce at such times is, of course, gravely supported by French economists with the old fallacious principle that scarcity of gold and high prices invariably

indicate excessive speculation at home. M. Gide, whose work *Principes d'économie politique* is the classic of modern French political economy, states on p. 313 of the 1911 edition of that work (Recueil Sirey, Paris):[1]—

> "Il y a en effet des signes certains, familiers à l'économiste et au financier, qui permettent de reconnaître le danger (de l'émission de la monnaie de papier en quantité supérieure aux besoins), même à distance, et qui donnent des indications plus sûres que celles que le plomb de sonde ou les amers peuvent donner au pilote: (1) Le premier, c'est la *prime de l'or*. Du jour où le papier-monnaie a été émis en quantité exagérée relativement aux besoins, il commence à se déprécier suivant la loi constante de valeurs, et le premier effet de cette dépréciation, le premier signe qui la révèle, alors qu'elle n'apparaît point encore aux yeux du public, c'est que la monnaie métallique fait prime. La monnaie métallique n'est point englobée, en effet, dans cette dépréciation commençante de l'instrument monétaire: pourquoi le serait-elle, puisque l'or et l'argent ont conservé partout leur ancienne valeur? Les banquiers et les changeurs commencent à la rechercher pour l'envoyer à l'étranger sous forme de lingots et ils paient une petite prime pour se la procurer. Voici alors pour les financiers le moment d'ouvrir l'œil!"

[1] "There are in fact certain infallible signs, familiar to the economist and "the finance expert, which enable the detection of the danger (of the issue of "paper money in excess of the need), even at a distance, and which provide a "more certain indication than the sounding-lead or landmarks can afford the "pilot: (1) The first is the *premium on gold*. From the day when paper money "has been issued in excess of need, it begins to depreciate in accordance with "the unaltering law of value; and the first effect of this depreciation, the first "sign by which it is revealed, even when it is not apparent to the eyes of the "public, is that metallic money is at a premium. Metallic money is not in-"cluded in this gradual depreciation of the monetary instrument: why should "it be, since gold and silver have retained everywhere their old value? Bankers "and changers begin to collect gold and send it abroad in the form of bullion, "and they pay a small premium to obtain it. Now is the time when finance "experts must keep their eyes open!"

Further on he states (p. 315):[1]—

> "Sitôt donc qu'un gouvernement constate les signes précurseurs, à savoir la prime de l'or ou la hausse du change, son premier devoir est de s'interdire absolument toute émission nouvelle du papier-monnaie: il a atteint en effet la limite à laquelle il faut s'arrêter. S'il a eu le malheur de la franchir et s'il voit se manifester les conséquences plus redoubtables de la hausse et du dédoublement des prix qui lui crient: casse-cou! il doit faire machine en arrière et détruire tout le papier-monnaie au fur et à mesure qu'il rentre dans ses caisses, jusqu'à ce qu'il l'ait ramené à de justes proportions."

Here, it will be seen, the Currency Principle is adhered to as rigidly as any disciple of Lord Overstone could desire. Any efflux of gold must be met by a destruction of home credit. It is to be hoped that, before long, economists will recognise the truth and the implications of the principle enunciated by Dr. Pierson, the eminent Dutch economist, when he states:[2]—

> "When therefore a bank commences to issue, or, within the limits of prudence increases its issue of uncovered notes (i.e. notes unbacked by an equivalent quantity of gold held in the issuing bank's reserves), and when exports of bullion take place in consequence, these exports must not be deplored. It is the business of a *bank* to drive away gold and silver; this is the

[1] "As soon as government establishes the heralding symptoms, namely, "premium on gold, or a rise in the foreign exchanges, its first duty is to "prohibit absolutely all further issue of paper money: the point has in fact "been reached where a halt must be made. If this point has unfortunately "been exceeded, and if more formidable consequences of the rise in exchange "and of prices are manifested and evoke piteous appeals: let the consequences "be what they may—the government must reverse engines and destroy the "paper money as fast as it is returned until it has been reduced to its proper "proportions."

[2] *Principles of Economics*, English translation (London, Macmillan, 1902), p. 553.

> very purpose for which it is established. Economy in the use of bullion implies that a certain quantity of specie has become redundant. To wish for such economy and yet insist that exports of bullion should be prevented is absurd. There is no economy so long as there are no exports."

In this passage, of course, Dr. Pierson supposes the bank of issue to be set up when there is no demand for increased credit; accordingly the gold may be freely permitted to flow abroad to countries which are not sufficiently advanced to dispense with specie. The one objection which is advanced by most orthodox economists against Dr. Pierson's theory as above set forth is that unless firm control be maintained by the State upon the note issues of its banks, gold will be "driven" abroad at times when it is urgently needed at home. The proper person to decide if gold is needed to support credit at home is, however, the banker; and I have sufficiently demonstrated that the State proscription of the issue of option-clause notes has hitherto prevented the banker from exercising his judgment in this direction.

The system of increasing the bank rate when gold flows abroad would almost seem to have been specially designed to favour the financial class—the gold owners—at the expense of the rest of the community, by preventing all efforts to cheapen gold. It may be that the modern bankers support this system because they earnestly believe it to be a necessary foundation of prosperity; but I would warn the person who sets out to propagate banking reform that he must not expect to obtain enthusiastic support from bankers. The banker reaps his profit on gold whether the bank rate be high or low, since those who would exchange goods are obliged to apply to him. In fact, in his evidence before the Committee of the House of Commons in 1858, Mr.

Neave, Governor of the Bank of England at that date, stated frankly:—

> "The Bank of England profits rise and fall with the rate of interest. These are greatest when the distress of the mercantile classes is greatest."

This is equally true of the ordinary banks. That wise old Quaker, Hudson Gurney (1775–1864), the banker descendant of a line of bankers (the Norfolk Gurneys), remarks:[1]—

> "My view is that in all changes, excepting that of utter subversion or civil war, some class is silently waxing on the wane of others, and that the banker holds the bag to those who have something to put in it, and that for his trouble in some way or other, he will be paid, and cannot well be done without."

France has recognized this fact and has decreed that all profits accruing to the Banque when the bank rate rises over 7 per cent. shall flow into the reserve—not into the profits. Our English bankers, however, in their comparatively secure monopoly, retain the whole harvest reaped from the community's industry by a high bank rate. Therefore, although the removal of governmental restrictions on note issue must provide a great increase of business to present bankers, yet, the banks will be then exposed to greater competition, since, as has previously been shown, a bank of issue requires less gold than a bank of deposit, and is thus easier to establish. In most men there is an inherent desire to avoid competition from others, and we must not be surprised to find opposition to our proposals from bankers, even if such opposition be founded merely on a perfectly unconscious dislike of competition. In

[1] W. H. Bidwell, *Annals of an East Anglian Bank* (Norwich, A. H. Goose, 1900), p. 185.

that excellent work *Lombard Street*, Walter Bagehot states:[1]—

"The real introductory function which deposit banks at first perform is much more popular, and it is only when they can perform this more popular kind of business that deposit banking ever spreads quickly or extensively. This function is the supply of the paper circulation to the country, and it will be observed that I am not about to overstep my limits and discuss this as a question of currency. In what form the best paper currency can be supplied to a country is a question of economical theory with which I do not meddle here. I am only narrating unquestionable history, not dealing with an argument where every step is disputed. And part of this certain history is that the best way to diffuse banking in a community is to allow the banker to issue bank notes of small amount that can supersede the metal currency. This amounts to a subsidy to each banker to enable him to keep open a bank till depositors choose to come to it. The country where deposit banking is most diffused is Scotland, and there the original profits were entirely derived from the note circulation. The note issue is now a most trifling part of the liabilities of the Scotch banks,[2] but it was once their mainstay and source of profit. . . . The Bank of Dundee, now amalgamated with the Royal Bank of Scotland, was founded in 1763, and had become before its amalgamation, a bank of considerable deposits. But for twenty-five years from its foundation it had no deposits at all. It subsisted mostly on its note issue, and a little on its remittance business. Only in 1792,

[1] p. 83. (It is noteworthy that so prominent a writer upon Money as Professor Stanley Jevons states in the introduction to *Money and the Mechanism of Exchange* that his work is merely to be considered as an introduction to "the admirable essay of Mr. Bagehot on *Lombard Street*".)

[2] Owing chiefly to the limitation of note issue by the Act of 1845. (See Chapter VIII.)—H. M.

after nearly thirty years, it began to gain deposits, but from that time they augmented very rapidly. The banking history of England has been the same, though we have no country bank accounts in detail which go back very far. But probably up to 1830 in England, or thereabouts, the main profit of banks was derived from the circulation, and for many years after that the deposits were treated as very minor matters, and the whole question of so-called banking discussion turned on questions of circulation.... The reason why the use of bank paper commonly precedes the habit of making deposits in banks is very plain. It is a far easier habit to establish. In the issue of notes the banker, the person to be most benefited, can do something. He can pay away his own 'promises' in loans, in wages, or in payment of debts. But in the getting of deposits he is passive. His issues depend on himself; his deposits on the favour of others. And to the public the change is far easier too. To collect a great mass of deposits with the same banker, a great number of persons must agree to do something. But to establish a note circulation, a large number of persons need only *do nothing*. They receive the banker's notes in the common course of their business, and they have only *not* to take those notes to the banker for payment. If the public refrain from taking trouble, a paper circulation is immediately in existence. A paper circulation is begun by the banker, and requires no effort on the part of the public; on the contrary, it needs an effort on the part of the public to be rid of notes once issued; but deposit banking cannot be begun by the banker, and requires a spontaneous effort in the community. And therefore paper issue is the natural prelude to deposit banking."

I think Bagehot under-estimates the trouble of the public in ascertaining the genuineness of a new issue of

notes; but the passage is a fair illustration of the manner in which competition in banking is stimulated by liberty of note issue. In these days when the complaint against amalgamation of banks is constantly being heard, the part played by legislation in preventing competition among banks should not be overlooked. As I have stated elsewhere, competition in banking is desirable on account of the possibility thereby afforded of a reduction in the rate of interest. There are few banks to-day which declare less than 10 per cent. dividend: in many cases it ranges from 15 to 20 per cent. Furthermore, a loan which is rejected by one banker because he judges the risk too great, might be accepted by another banker who has a greater knowledge of the branch of industry concerned. Competition between banks must evolve the banker of soundest judgment and lowest charges for advances.

It is interesting to note how often one hears to-day the objection that banks should not increase their risks since they may thus further jeopardize the savings of their depositors. The reply is that if the State had not interfered with the development of banking, our banks would now be mainly trading on their own capital increased by a note issue.

We may now sum up the case against our present credit system thus: (1) it automatically throttles prosperity; (2) it operates as a continual handicap to the manufacturer in favour of the wealthy combine; (3) by periodical financial crises, and legally encouraged export of the gold basis abroad, it crushes out the mass of smaller firms which were growing into competition with present employers of labour; (4) it prevents competition among bankers. Labour suffers on all four counts in unemployment, low wages, and obstruction of the avenue of entry to the employer class. To put the matter otherwise, the fundamental evil of our exchange system has been in the past, and still is, that the volume of

goods requiring exchange continually expands faster than the means of effecting the exchange. This book is but an endeavour to show that present industrial evils are chiefly manifestations of this deep-lying disease.

More than sixty years before the appearance of Adam Smith's *Wealth of Nations*, i.e. in 1710, Bishop Berkeley could ask in his celebrated *Querist*:—

"Whether the four elements and man's labour therein be not the true source of wealth?"

"Whether money be not only so far useful as it stirreth to industry, enabling men to mutually participate in each other's industry and the fruits of each other's labour?"

"Whether any other means equally conducing to excite the industry of mankind may not be equally as useful as money?"

"Whether the real aim and end of men be not power, and whether he who could have everything else at his will or wish would value money?"

"Whether the public aim in every well-governed State be not that each member, according to his just pretensions and industry, should have power?"

"Whether, other things being given, as climate, soil, etc., the wealth be not proportioned to industry, and this to the circulation of credit, be the credit circulated by what tokens or marks soever?"

"Whether money is to be considered as having an intrinsic value, or as being a commodity, a standard, a measure, or a pledge, as is variously suggested by writers?"

"Whether the true idea of money, as such, be not altogether that of a ticket or counter?"

"Whether the terms, crown,—livre—pounds sterling, etc., are not to be considered as exponents or denominations? And whether gold, silver, and paper,

are not tickets or counters for reckoning, recording, or transferring such denominations?"

"Whether, the denominations being retained, although the bullion were gone, things might not nevertheless be rated, bought and sold—industry promoted, and a circulation of commerce maintained?"

Yet, on such unfruitful ground have Berkeley's words been sown, that there is to-day scarcely one economist, among those commonly accepted as teachers, who would not misapply these words of Leroy-Beaulieu in the *Économiste Français* in 1907:—

"Capital limits industry—development of industry is limited by the available supplies of capital and, more generally, by the sum total of annual savings."

The principle itself is sound, as has been sufficiently demonstrated by John Stuart Mill in his *Political Economy*. In practice, however, these professors use the doctrine as a comforter to soothe the irritation of the producing classes when unemployment brings misery into the homes of able and willing workers, or when industry has been ruined by a rise of the bank rate consequent upon an export of *gold* abroad. "Industry is limited by Capital—Capital is the result of saving" declare the professors, and the unfortunate employee is assured that political economy demonstrates that prosperity and increased employment can only appear when he shall decide to save more out of his already scanty earnings. So prevalent had this doctrine become that it needed a whole volume by Mr. J. M. Robertson, M.P., on *The Fallacy of Saving*, to show that the evil was rather under-consumption, and that a further restriction of consumption on the part of the masses would intensify rather than remedy the evil.

Industry is indeed limited by capital; but we have

produced wealth in plenty, and there is yet unemployment. The real evil is that we have set legislative restriction upon the means of consuming wealth productively. Fresh production is useless unless it be accompanied by such a development of credit as enables the automatic capitalization of the wealth thus produced. A man's capital is his power to purchase with the aim of production. Our legislative interference with bankers compels them to confine the capitalization of wealth to those who either can produce a profit within two or three months, or who possess gilt-edged securities; the remaining wealth of the community in security and productive ability, which, were freedom granted to the banker to protect his gold store against unforeseen depletion, could easily be capitalized, stagnates and blocks the channels of exchange. Industry is indeed limited by the sum total of annual saving; but we have legally prevented the capitalization of the savings of all but a small minority of the community—hence it may with truth be said that our laws actually discourage saving. Industry is indeed limited by the *available* supplies of capital; but our laws severely limit the *available* supplies of capital, and consequently limit the development of industry.

There is perhaps no economist whose opinions on matters of currency and banking enjoy greater weight to-day than John Stuart Mill. His pronouncements upon the nature of capital, and the limits of credit are cited everywhere as representing the last word on those subjects. Yet, and I state this deliberately after a considerable study of his works, I find Mill to be a dangerous writer from whom to quote, and I have been pleased to find in recent years that this opinion receives support from no less keen a reasoner than Mr. J. M. Robertson in *The Fallacy of Saving*. Mill's polemical and constructive work was spread over a good number of years, and he seems to have omitted to bring certain isolated por-

tions into harmony with one another. I find statements in his *Political Economy* which are almost directly contradictory. I will quote his criticism of John Gray's work on *Money* to justify my accusation. I quote from p. 81 of vol. ii. of the 1852 edition of his *Political Economy*:—

"One of the most transparent of the fallacies by which the principle of the convertibility of paper money has been assailed, is that which pervades a recent work by Mr. John Gray (*Lectures on the Nature and Use of Money*), the author of the most ingenious and least exceptionable plan of an inconvertible currency which I have happened to meet with. This writer has seized several of the leading doctrines of political economy with no ordinary grasp, and among others, the important one, that commodities are the real market for commodities, and that Production is essentially the cause and measure of Demand. But this proposition, true in a state of barter, he affirms to be false under a monetary system regulated by the precious metals, because if the aggregate of goods is increased faster than the aggregate of money, prices must fall, and all producers must be losers; now neither gold nor silver, nor any other valuable thing, 'can by any possibility be increased *ad libitum*, as fast 'as all other valuable things put together': a limit, therefore, is arbitrarily set to the amount of production which can take place without loss to the producers: and on this foundation Mr. Gray accuses the existing system of rendering the production of this country less by at least one hundred million pounds annually, than it would be under a currency which admitted of expansion in exact proportion to the increase of commodities.

"But in the first place, what hinders gold, or any other commodity whatever, from being 'increased as

'fast as all other valuable things put together'? If the produce of the world, in all commodities taken together, should come to be doubled, what is to prevent the annual produce of gold from being doubled likewise? for that is all that would be necessary, and not (as might be inferred from Mr. Gray's language) that it should be doubled as many times over as there are other valuable things to compare it with. Unless it can be proved that the production of bullion cannot be increased by the application of increased labour and capital, it is evident that the stimulus of an increased value of the commodity will have the same effect in extending the mining operations, as it is admitted to have in all other branches of production.

"But, secondly, even if the currency could not be increased at all, and if every addition to the aggregate produce of the country must necessarily be accompanied by a proportional diminution of general prices; it is incomprehensible how any person who has attended to the subject can fail to see that a fall of price, thus produced, is no loss to the producers: they receive less money; but the small amount goes exactly as far, in all expenditure, whether productive or personal, as the larger quantity did before. The only difference would be in the increased burthen of fixed money payments; and of that (coming, as it would, very gradually) a very small portion would fall upon the productive classes, who have rarely any debts of old standing, and who would suffer almost solely in the increased onerousness of their contribution to the taxes which pay the interest of the National Debt."

Mill here would appear to contradict every writer on the subject of currency. Even the promoters of the 1844 Act never went to the extent of denying that the Bank's contraction of the exchange medium upon an increase

of trade enterprise caused harm to commerce: they simply declared that the harm caused was unavoidable if the greater evil of total depletion of the banks' gold stores was to be avoided. The only assumption on which Mill's contention would find some measure of justification would be that the measure of value and the exchange medium are entirely independent of each other; that the metal which constitutes the measure of value may become rarer without thereby contracting the means of exchanging commodities. But this is most decidedly not the case to-day or there would be little need for agitation for banking reform. Moreover, Mill has himself in the same work recorded the evils of the indiscriminating guillotine action of the 1844 Act in the following words:[1]—

"This function of banks in filling up the gap made in mercantile credit by the consequences of undue speculation and its revulsion, is so entirely indispensable, that if the Act of 1844 continues unrepealed, there can be no difficulty in foreseeing that its provisions must be suspended as they were in 1847, in every period of great commercial difficulty, as soon as the crisis has really and completely set in. Were this all, there would be no absolute inconsistency in maintaining the restriction as a means of preventing a crisis, and relaxing it for the purpose of relieving one. But there is another objection, of a still more radical and comprehensive character, to the new system.

"Professing, in theory, to require that a paper currency shall vary in its amount in exact conformity to the variations of a metallic currency, it provides, in fact, that in every case of an efflux of gold, a corresponding diminution shall take place in the quantity of bank notes; in other words, that every exportation

[1] *Political Economy*, vol. ii. p. 214.

of the precious metals shall be virtually drawn from the circulation; it being assumed that this would be the case if the currency were wholly metallic. This theory, and these practical arrangements, are adapted to the case in which the drain of gold originates in a rise of prices produced by an undue expansion of currency or credit; but they are adapted to no case beside."

He goes on to point out that in several of the late crises in which the bank rate had been sharply raised there had been little or no excessive speculation, but merely an increase of purchase abroad, or of industry at home. He proceeds:[1]—

"There was nothing in these circumstances which could require either a fall of general prices or a contraction of credit. An unusual demand for credit existed at the time, in consequence of the pressure of railway calls, and this necessitated a rise in the rate of interest. If the bullion in the Bank of England was sufficient to bear the drain without exhaustion, *where was the necessity for adding to the distress and difficulty of the time, by requiring all who wanted gold for exportation, either to draw it from the deposits, that is, to subtract it from the already insufficient loanable capital of the country, or to become themselves competitors for a portion of that inadequate fund, thus still further raising the rate of interest?* [2] The only necessity was created by the Act of 1844, which would not suffer the Bank to meet this extra demand for credit by lending its notes, not even the notes returned to it in exchange for gold. The crisis of 1847 was of that sort which the provisions of the Act had not the smallest tendency to avert; and when the crisis came, the mercantile difficulties were probably doubled by its existence."

[1] *Political Economy*, vol. ii. p. 223.
[2] (Italics mine.)—H. M.

Mill makes no attempt here, it will be noticed, to advance the argument which he has used against Gray in reply to a similar contention on the part of the latter—he does not now suggest that specie from the mines may be substituted for the gold and notes which have been withdrawn from circulation. It will scarcely be believed that the theorist who penned the previously cited reply to Gray is the author of the above passage. Moreover, he writes elsewhere [1] that if the demand for loanable capital is greater than the supply, interest will rise. Hence, even if we suppose Gray to have done that which in effect he did not, namely, use his illustration with the presumption that the increase in production of commodities would be abnormally slow, how can Mill assert that, if in such circumstances there were no addition to the currency, there would be no loss to producers? The introduction of a profitable invention into a market in which the supply of currency and credit is only just sufficient to maintain the existing industry will be precisely similar in evil effect to the export of capital described by Mill in connection with the crisis of 1847 (quoted above). When the new invention is introduced there will be a movement of capital in its direction, and, in the absence of means of increasing the volume of credit medium in the country, this medium must be withdrawn from other industry, producing bankruptcy, and eventually financial crisis, in precisely the same manner as though gold had been exported from the country.

It is even possible to drive Mill out of his last ditch. For, even supposing the increase of production to be extremely gradual—so gradual that the slow increase in the demand for credit and exchange medium gives men time to open fresh gold mines; yet Gray's contention that the compulsory use of gold in exchange "sets a limit to the amount of production which can take place

[1] *Political Economy*, vol. ii., p. 190.

"without loss to the producers" still holds good to a great extent, since goods will be dear in proportion to the amount of labour which is diverted from the production of ordinary commodities to that of gold; that is, the cost of production of goods will be increased by the cost of obtaining the gold, involving a loss to every producer in the community—a loss which will become greater as the metal becomes gradually more difficult to obtain. It must not be thought that I am unduly exaggerating a mere slip on Mill's part. His error has been echoed in later times by no less an economist than Professor Bonamy Price, who states:[1]—

> "A diminution of gold in England, it has been argued, makes coin dear, and causes a local fall of general prices. An over-abundant circulation, it has been held, generates the opposite result, and consequently the amount of the circulation in England is carefully recorded every week. I regard this as a very decided error, and this circulation theory built upon it as an entire mistake. It forgets that the metal of coin, gold, is very portable, easily removable from one country to another. Long before the coin was so scarce as to act upon prices, the inconvenience felt would have fetched supplies from abroad very speedily with the modern means of locomotion. The slightest difference in the purchasing powers of gold in two neighbouring lands would swiftly lead to equalization by importation."

If this statement were true, it would scarcely be necessary for the Bank of England to raise the discount rate to 7 and 8 per cent., as has so often been necessary in modern times, in order to cause gold to flow to this country. The one prominent and damning fact of our present credit system is that existing industry must be sacrificed by an increase in the bank rate in proportion

[1] *Currency and Banking* (London, King & Co., 1876), p. 28.

to the home and foreign demand for bullion whenever prosperity increases either at home or abroad. Hence the social importance of demonstrating the fallacy of any assertion which attempts to minimize unduly the evil of the legally created need of commerce for gold to-day.

It must not be concluded, however, that I wish to depreciate the value of Mill's contribution to political economy in other directions. I am merely a little sore at the frequency with which he is quoted to prove the fallacy of the doctrines of banking reformers. If I have been instrumental in inducing the reader to adopt a little more critical attitude in respect of Mill's pronouncements than he has done hitherto, I shall be satisfied.

Insistence has been laid by me upon the effect of State restrictions in compelling the banker to hold a larger quantity of gold, in exposing him to the danger of the loss of that gold and in consequently compelling him to confine his advances to holders of gilt-edged securities. It must not be supposed, however, that I ascribe this action of the bankers solely to the above described State interference. The fear of war is also still partly responsible in these days, although in a much smaller degree, I believe, for the quantity of gold which must be held in a country's banks. It will be remembered that the recent war scare between France and Germany over the Morocco question was first evidenced by a run of Berlin depositors to withdraw their gold from the banks. There is not the least doubt, as Mr. Norman Angell so ably demonstrates in *The Great Illusion*, that the fear of this dislocation of commerce is gradually becoming the most powerful deterrent from war. There is many a perfervid militarist who remains unmoved by the weeping of the widows and orphans caused by his lust for territorial expansion, but who is induced to pause and consider a little when he learns that a modern European war means extensive dislocation of commerce.

The realization of the burden of armaments imposed upon the nations, even during the long years of peace, by the continued threats of the bellicose, is already causing "The Flag" to be a little less ostentatiously displayed. Mr. Angell may be recommended to bring home to these aggressively disposed individuals the further point that their inflammatory utterances are a directly contributory cause of the circumstance that their bankers are compelled, even in times of peace, to refuse *them* advances to extend their commercial operations: this process is continually in operation, whether the actual war fever have spread to the rest of the community or not.

If, however, we examine the actual cause of this war fever a little more closely, we observe it to be frequently related to the persistent congestion of home markets which is so prominent an evil in every progressive country to-day. "Trade follows the Flag" is the war-cry which leads many a modern militarist to identify his primitive aggressive qualities with the industrial spirit. It is undeniable that the "Over-production" which is such a constant feature of modern industrialism tends to make the nations look jealously at colonial markets and to quarrel about "concessions" in some little strip of a barbarous land. In Chapter III. it has been demonstrated that an increased consumption of goods will create an ample market within the frontiers of civilization to employ as many machines as can be kept running. Hence we may reasonably hope that progress in this direction will tend to diminish the frequency of war talk, and we shall see, moreover, that note issue will be a decidedly progressive step towards the creation of home markets.[1]

I have judged it unnecessary for the presentation of my case to criticize the 1844 Act further, although this might be done. I have refrained from detailing the harm-

[1] These pages were written before August 1914.—H. M.

ful effects of this legislation in the various crises which have convulsed industry since 1844; the reader is referred for these details to Professor Andréadès' work. In the chapters which now follow, the examination of the problem of exchange is brought up to date.

CHAPTER X

THE INTERNATIONAL ADOPTION OF A GOLD CURRENCY

TOWARDS the end of last century British manufacturers began to feel severely the results of foreign competition. Foreign firms were able to export to us, and undersell our manufacturers in their own markets in this country. The matter seemed the more inexplicable since England's stores of mineral wealth were unexhausted, she stood foremost in mechanical science and industrial co-operation, and had command of the markets of the world. Politicians and economists were unable to assign a reason for the sudden blossoming of foreign industry. Even so comparatively poor and undeveloped a country as Germany then was, harassed our manufacturers exceedingly. A certain party of politicians proposed tariff reform as a remedy. The fact that wages were low abroad might have seemed to explain foreign prosperity; but prices of food were also low there, and the foreign workman was able to live on much lower wages than the Englishman. Major Phipson pointed out the reason in his voluminous work *The Redemption of Labour*, but his style seems to have discouraged most readers. Moreover, Major Phipson vitiates his case by basing it upon an erroneous view of paper currency. In his opinion, a banker who issues £2 in cheque credit when he possesses only £1 in gold, commits a fraud upon the community and tends to inflate prices harmfully. To this inflation Major Phipson ascribes the power of foreign nations to export to us cheaply. There is no ground, however, for this assertion. The reader who has followed me so far will have no difficulty in seeing that not only is no harmful inflation necessarily caused by the issue of paper

substitutes for gold, but disaster must inevitably have overtaken commerce but for this action on the part of the banks. Nevertheless, Major Phipson has provided telling tabular statements, and in the following pages of this chapter I quote partly from *Britain's Destiny*, a very readable outline (by Mr. Mark B. F. Major) of Major Phipson's book.

Previous to 1872 Great Britain alone had used an exclusively gold monetary unit. Other nations for the most part had silver or mixed currencies, and, as gold was therefore little in demand abroad, those who sent produce to this country took manufactured goods in exchange. All this was changed when in 1872 Germany adopted a gold currency, her example being gradually followed by most other civilized nations, in spite of the warning of many of the delegates to the previous international congress of bankers at Brussels. If we refer to the tables of exports from Great Britain, it can be seen that in ten years (1860–70) British exports showed an increase of 47 per cent.; but in the subsequent twenty-five years they increased by no more than 19 per cent. If we now compare these figures with those of the other countries which, since 1870, have adopted for their monetary unit the same metal as is employed by Great Britain, an extraordinary contrast is observable. During the ten years (1860–70), the rate of increase in the exports from all these countries was 38 per cent.; but their rate of increase for the subsequent twenty-five years was 116 per cent. This great difference is not to be explained by the mere circumstance of the growth of continental industry.

Great Britain was the richest and almost the only manufacturing nation in Europe previous to 1870. Instead of being permitted to build up her commerce upon a basis of mutual trust and paper tokens, however, she had been compelled in the manner described in the previous chapters to acquire an immense store of gold.

Continental nations, especially Germany, were mainly engaged in agriculture and, there being little demand in those countries for wage-labour, wages there were low. Their food prices, however, reckoned in gold, were also low, and, even if manufactured comforts were somewhat high-priced, the German peasant was fairly prosperous. After the conclusion of the war with France, however, Germany set herself to develop her industry, her example being gradually followed by the other continental nations. Germany soon found coal at home, and, taking advantage of and improving the latest inventions of British industry, her manufacturing activity increased by leaps and bounds. Now, previous to Germany's adoption of our monetary unit there had been a steady interchange of foodstuffs and manufactures between her and this country. Any excess of export from Germany to us would, after a certain point, have been made up by an increased import into Germany (or some other silver-owning country) of our manufactures, since we possessed little of Germany's money, silver, and she, in common with most other countries, had only a restricted market in the various gold-using industries for our gold. After 1872, however, the sudden blossoming of German industry required a development of credit in Germany, and the new system caused this to assume the form of a demand for gold. Wages and food prices were low in Germany, and production was accordingly cheap. The one commodity we now possessed which Germany really urgently required was gold. The laws of England put no limit to the quantity of gold which might be abstracted from our stores, and our banks were legally prohibited from adopting any measures to prevent the withdrawal of the metal. This was the opportunity for foreign countries. For years they could manufacture and export to British markets at a profit, securing payment in our one cheap commodity, gold. Gradually gold was drained from the free gold market in Great Britain,

and much misery was caused here. Sir Robert Giffen, referring to Great Britain, states:[1]—

> "For ten years, from 1873, inclusive, there was at least one month in every year in which the average [discount] rate in this country amounted to or exceeded $4\frac{1}{2}$ to 5 per cent."

Elsewhere he declares that there was stringency in our money market every year between 1871 and 1885 owing to demand for gold from abroad. Further on:[2]—

> "There has been no marked increase in the rate of wages since 1873, and there are now (1885) in all directions reports of strikes and low wages; rents are undoubtedly falling; the Income Tax assessments have increased more languidly since 1875 than they had for many years before; the returns of property liable to legacy and succession duty . . . would also appear of late years to have been stationary or declining."

The drain of gold has only of recent years become less noticeable, as food prices and wages abroad begin to equal our own, and the world's credit system slowly and painfully expands to meet the extra strain. In 1872 London was the heart of the economic system of the world. Gold and silver had flowed thither to be sent out again in the shape of loans to distant colonies which were in process of development. But these loans had to be repaid, and since the adoption of a gold currency by other European nations increased the worth of gold, prices of goods reckoned in gold gradually fell, that is, gold daily commanded a larger and larger amount of commodities; the produce of the debtors failed to realize the necessary sum and they became bankrupt. This was

[1] *Essays in Finance*, Second Series (London, Geo. Bell & Sons, 1890), p. 25.
[2] *Ibid.* p. 28.

the period when great fortunes were made by the gold-owning classes here, while the manufacturing and industrial portions of the community were on the verge of bankruptcy.

Sir Robert Giffen describes the gold famine:[1]—

"In 1861–70 the annual gold coinage in the United Kingdom was about 5 millions sterling; the amount in 1871 was nearly 10 millions; in 1872 just over 15 millions. The average of the period 1874–83 was 1½ millions sterling only, while in 1881–2 there was no coinage at all."

In reading these statements by Sir Robert Giffen it must be remembered that although the drain of gold and consequent industrial misery in this period caused a considerable increase in the number of those persons who advocated the inclusion of silver as a legal tender, Giffen was a consistent opponent of bi-metallism, and hence would scarcely be likely to exaggerate the evil. Certain economists were inclined to ascribe the whole of the fall of prices during this period to improved methods of production; but Giffen is emphatic in imputing the major part of the fall to scarcity of gold. There had previously occurred periods of greater industrial development (e.g. 1846–56) which had been accompanied by no such decided fall in prices, but rather by a slight rise, and a rise in wages. Speaking at Glasgow in November 1873, just after the change of her standard by Germany, Mr. Disraeli said:—

"I attribute the monetary disturbance which has occurred, and is now to a certain extent acting very injuriously upon trade, I attribute it to the great changes which the Governments of Europe are making in reference to their standard of value. Our gold

[1] *Essays in Finance*, Second Series (London, Geo. Bell & Sons, 1890), p. 25.

standard is not the cause of our commercial prosperity, but the consequence of that prosperity. It is quite evident that we must prepare ourselves for great convulsions in the money market, not occasioned by speculation or any of the old causes which have been alleged, but by a new cause with which we are not sufficiently acquainted."

Six years later, in March 1879, when, as Mr. Moreton Frewen writes, "The monetary morbus had become evident", Mr. Disraeli, since become Lord Beaconsfield, said:—

"All this time the produce of the gold mines in Australia and California has been regularly diminishing, and the consequence is that, while these great alterations on the continent in favour of a gold currency have been made, notwithstanding that increase of the population which alone requires a considerable increase of the currency to carry on its transactions, the amount of the currency itself is yearly diminishing, until a state of affairs has been brought about by gold production exactly the reverse of that which it produced at first. Gold is every day appreciating in value, and as it appreciates, the lower become prices. It is not impossible that, as affairs develop, the country may require that some formal investigation should be made of the causes which are affecting the value of the precious metals—and the effect which the change in the value of the precious metals has upon the industries of the country, and upon the continual fall of prices."

Up to 1876 England had been a large importer of gold bullion; but in 1877 the balance turned, and during the next ten years her export of gold exceeded her imports by £2,259,000. Of course the payment of the Franco-German war indemnity was partly responsible for the

drain of gold at the beginning of this period; but the economists who ascribe the whole difficulties of these years to the payment of this indemnity, overlook the great strain placed upon the world's gold supply by the action of continental Powers in adopting a gold-based currency. Up to 1876 the United States were exporters of gold. In 1875 $53,000,000 worth was exported. In 1877 export practically ceased. In 1878 they began importing. This was the period of the resumption of specie payments and consequent increased demand for gold in U.S.A. In his address to the Bankers' Institute in April 1883, Goschen stated that during the ten years 1873–83 there was absorbed in gold by Germany 84 million pounds sterling, by Italy 16 millions, and by U.S.A. 100 millions, whereas the total production of gold during that period was only 100 millions, or about half the amount required by those three countries alone; the balance was of course drawn from the previously existing gold supply in other countries, partly from England. The suffering in England was then severe. By 1886 (the time when socialistic doctrines began to take root in England) prices had fallen about 40 per cent. below the level of 1873, and England sought relief by calling in her loans, hoping thus to obtain exchange medium. The result was to crush the debtor nations. The first country to suffer was Australia. Between 1873 and 1888 wool fell from 36 cents a pound to 16 cents. In Melbourne in 1892 the distress was frightful. The turn of Argentina followed. In the United States conditions were equally bad; America relied on the sale of farm produce to meet its debts; in 1873 wheat brought $1.85 per bushel in London; by 1889 it had fallen to $1.03. Violent labour troubles occurred in America in 1877. England, however, continued to call in her loans; America was compelled to continue the export of bullion to this country, and in 1893 the great financial panic began in the United States.

It is necessary only to look at the position of debtor nations to understand the straits in which they are placed by an increased strain on the metal that forms their currency. India can only with difficulty meet her interest liabilities. In Russia prices have been forced so low that the peasant is left with the narrowest margin of profit on which to live. Food may be plentiful and cheap but the people too poor to buy. The peasant has to contribute two bushels of wheat in taxes (calculated in money of course) where formerly he gave one; the crop is therefore forced on the market to fetch what price it can. In England, as the drain of gold went on, the owner of productive property was often driven to the wall, for, though the price at which he could sell his commodity declined, wages were maintained by the trade unions; and, though workmen might be starving through irregularity of employment, the pay roll remained the same. The mines of the Midlands seem to have been showing a loss at times when the men left the pits on strike, and the best cotton mills of Lancashire did not average more than one per cent. of profit applicable to dividends for several years.

There is thus shown to be reason in the contention of Protectionists that there has occurred an unfair "dumping" of foreign goods upon our shores; and although the gold supply has since been somewhat more evenly distributed among the industrial nations, we have seen that our free gold market still exposes us to imports of cheap foreign goods in times of prosperity and high prices here. I do not advocate Protection, but it is conceivable that if, during the period above-mentioned, England had adopted a protective tariff as a reply to foreign adoption of her monetary unit, the import of cheap foreign goods and simultaneous withdrawal of gold would have been largely prevented. The Free Trader's contention that "goods pay for goods", and that a reduction of imports must cause a reduction of

commodity exports, is shown to be incorrect in face of the fact that under the gold standard whenever our prices tend to rise or foreign prices to fall sufficiently, the resulting consignment of "dumped" foreign goods is paid for in gold.

CHAPTER XI

AN EXAMINATION OF PRESENT SYMPTOMS

Our industrial system exhibits to-day various signs of ill-health. An examination of the symptoms may assist us to diagnose the disease.

The deep evil of our system is manifested in an inability to sell, even on the part of those who have correctly anticipated a demand in the community. This inability to sell produces unemployment. So great is the evil that there are not wanting those who declare that a catastrophic destruction of wealth is beneficial since it provides employment. Let us consider this for a moment. The apparent evil is unemployment. In Chapter III. this has been traced to the deeper cause of lack of demand for labour among employers. An increased demand among employers for labour, resulting in higher wages and cheaper commodities, would remedy the evil. Enquiring now into the cause of the lack of demand for labour among employers, we find that one of the most fundamental reasons is the inability on the part of manufacturers to sell the goods already produced. The evil does not lie with production. Invention has evolved wonderful machinery. Men are skilled. The goods produced are those which men desire for consumption. Yet employers and manufacturers are unable to sell their goods, and are periodically compelled to suspend production in order to permit demand to catch up with supply of commodities. The cry of the manufacturers is not "Give us improved machinery!" but "Give us markets!" Our system is vastly overcharged with middlemen, commercial travellers, and advertising agents—all evidences of a feverish search for buyers.

What is the explanation? The phenomenon becomes more comprehensible when we perceive that the demand for goods is not an effective one, i.e. not expressed in purchasing power. Now, in Chapter IV., I have shown that wherever society is compelled to use a dear credit medium, a certain amount of commercial ability (unvoiced demand for goods) must remain unmonetized. I have shown that we have actually been prohibited from using efficient substitutes for gold, that credit has in consequence been rendered dearer, and that the monetization of a great mass of otherwise eligible security has thus been prevented. Hence widespread restriction of purchasing power. The remedy does not lie in the unproductive destruction of wealth, but in its consumption as capital. Here then we discover the cause of the prevalent difficulty in finding purchasers for goods. John Gray, in his book *Lectures on the Nature and Uses of Money*, of which Mill's criticism was noticed in a preceding chapter, has summed up the position admirably by the remark that an adequate credit system would convert the present inability to sell into a difficulty to purchase. This is not an exaggeration: our desires are always in advance of our capacity to supply them, and, since the function of credit is to bring into commerce the present worth of a *future* profit, the gradual perfection of the credit system must remove the strain from sellers and place it upon buyers. In other words: at present the difficulty is for labour to obtain credit or purchasing power; under a more perfect banking system it will be difficult for purchasing power to find labour. Mr. J. Chamberlain's ideal of two employers searching for one employee will be realized; and under such conditions labour must be paid as high a reward as the returns from industry can afford. This is as it should be. Excessive competition among labourers becomes competition for bread; whereas any extreme of competition among employers can at most be merely

competition for more wealth among those who already possess the means of livelihood, and can be suspended at will.

The fact is generally recognized that demand is the cause of production, for no one produces except to supply an existing or prospective demand. In his *Elements of Political Economy* James Mill proves, however, by elaborate length of argument, that production is equally the cause of demand. I condense his argument:—

> "Two things are necessary to constitute a demand, (1) a wish for the commodity, (2) an equivalent to give for it. . . . A man's demand is therefore exactly equal to the amount of what he has produced for exchange."

It is obvious that if this were as true in practice as it is in theory, there could be no glut of saleable commodities in the hands of producers who wished to sell, and no simultaneous involuntary idleness on the part of those who possessed willing ability to labour, together with a desire to consume the commodities which now deteriorate in the hands of producers. It is, however, evident that, under present conditions, production continually outstrips the effective monetary demand. Orthodox economists have termed the phenomenon "over-production", and have thereby incurred the scorn of the socialist school which sees that there exists continually a "natural" demand, although not a monetary one, for the "over-produced" goods; the demand emanating from (1) able men who would work if only they could find employment, and (2) the mass of workers, who are producing considerably more goods than their wages enable them to repurchase. To the Socialist we now point out that a sufficient injection of credit would assist manufacturers to monetize the powers of the former class, thus gradually tending to increase the wages and

(by reduced prices of commodities also) the consuming power of the latter.

A tower of strength to socialism, and to its practical experiments as shown in modern liberalism, is Mr. J. A. Hobson. Where others have based their socialism upon emotional appeal, Mr. Hobson has set dispassionately to work to locate the hitch in the mechanism of exchange. The modern opponent of socialism is inevitably confronted by Mr. Hobson, and I, who contend that socialism is based upon an erroneous conception of the social problem, propose therefore to criticize Mr. Hobson's views. It will be convenient to examine the brief *résumé* of his opinions set forth by Mr. Hobson in the September 26th, 1908, issue of the *New Age*, under the heading: "The Meaning of Unemployment". He writes:—

> "Now trade depression means in the first instance the existence in many or most important industries of large quantities of capital unemployed or underemployed. . . . What is wanting to make the factors of production produce? The first answer is that employers and *entrepreneurs* believe they cannot sell the goods this capital and labour would make at a profitable price if they ordered them to be made. . . . If we regard the industrial system as a continual stream of processes engaged in working up raw material into useful forms and putting them into places where they will be bought by consumers and consumed, or by producers in order to assist further production, the actual congestion and its attendant unemployment seem evidently due to a refusal to withdraw goods at the end of the series as fast as they can be passed down the productive stream. But this merely states the problem in new terms; it does not solve it. If the *entrepreneurs* insisted on putting to productive uses the unemployed capital and labour,

the goods it would produce would belong to somebody who presumably would want to consume them, or to exchange them for other goods he did want to consume, or to save and apply them to further purposes of production. Every addition to supply creates a corresponding addition to demand; this doctrine all economists accept. How then can it be true that capital and labour must stand idle because the goods they make cannot be sold, so as either to be consumed or to be applied to increase the fabric of industry? The only apparent answer to this question is that, though 'somebody' could buy whatever can be produced by the 'unemployed', that 'somebody' would not buy it, because he wants neither to consume it nor to 'save' it and apply it and the fresh capital to assist production.

"This connection seems at first sight incredible, but, does it not follow unerringly from the analysis of facts? If everything that can be produced must continuously be bought, either for consumption or for saving, i.e. as increased plant, raw material, etc., it is clear that there could be no unemployment other than what is occasioned by the normal requirements of the changing arts of industry and the minor accidents of season, etc. If, therefore, such unemployment exists, it can only be because some of the power to demand created with every increase of supply will not be exercised either in demanding (buying) consumables, or new pieces of capital, i.e. the 'income' will neither be 'spent' nor 'saved'.

"There is only one hypothesis which explains the possibility of such a refusal to apply the power of demand. It is the existence in the industrial community of a chronic tendency to try to save and apply in increased capital a larger proportion of the general income than in the actual conditions of the industrial arts is economically required to supply

commodities at the current or prospective rate of consumption."

Mr. Hobson proceeds to trace this tendency to the great inequality of fortunes existing in the community, contending that it is not so necessary for the rich to spend the whole of their incomes as for the poor. He continues:—

"If this hypothesis be true, it has the advantage of furnishing a sound economic basis to the policy of public expenditure upon unemployed relief which otherwise is lacking. For it removes by rating or taxation certain portions of income which, if not so taken, would neither be spent in demanding commodities, nor be invested in productive employment, and applies them directly to employ 'out of works' ".

Mr. Hobson adds that if his hypothesis be rejected the policy of taking money from taxpayers simply causes a fresh lot of unemployment by reducing the quantity of capital which would otherwise be loaned to productive enterprise.

"But," he proceeds, "though an economic justification is thus found for public provision of unemployed relief, it is evident that such a policy is only a palliative, not an organic remedy, for an industrial disease due to chronic causes. Organic remedies can only be found in an absorption of 'surplus' or unearned income, either by diverting it from rents, excessive profits, etc., into wages, or by taking and spending it as public revenue."

Mr. Hobson offers no scheme for diverting this unearned income into wages; hence there remains in his opinion only the scheme of taxing it away from its owners, that is, the "organic" remedy is merely the

extension of the palliative. In my discussions with Socialists, this phrase of Mr. Hobson's, affirming

> "the existence in the industrial community of a chronic tendency to try to save and apply in increased capital a larger proportion of the general income than in the actual conditions of the industrial arts is economically required to supply commodities at the current or prospective rate of consumption",

has again and again been brought up against me. Let us examine it in the light of its context.

I have nothing but praise for Mr. Hobson's diagnosis of the existing evil. His presentation of the Mill theory respecting the theoretical relationship between production and demand is simple and lucid. As a general principle it may without doubt be affirmed that no man produces except to supply some want of the community, and except he himself desire to consume. Hence production should be the cause of demand. The problem that confronts every economist who dares to interrogate the Sphinx of modern industrialism is "Why does not production to-day cause demand?" The earlier economists frankly replied that more commodities were being produced than could possibly be consumed—"Over-production!" Much propaganda on the part of Socialists has compelled the recognition of the opposite theory of under-consumption on the part of the majority of the community. In his phrase: "the existence in the industrial community", etc., above quoted, Mr. Hobson returns to the theory of over-production; but he is careful to qualify it by stating that more capital is applied to industry *than the current or prospective rate of consumption requires*. By this qualification, however, Mr. Hobson actually begs the question. He simply states that goods cannot be consumed because—more are produced than can currently be consumed! Therefore,

says modern Fabianism with conviction, since there is no other method of diverting these goods into the channels of consumption, we must tax them away.

Let us, however, recognize that this "explanation" of Mr. Hobson's is no explanation of "Over-production" at all, and examine the problem afresh. We have previously noticed the necessity for the uninterrupted conversion of potential into actual purchasing power in the industrial system. Wealth must be transformed as automatically as possible after production into purchasing power. By this means alone is it possible to avoid glut of goods and unemployment. Now, taking the ordinary economist's definition of capital as "Wealth destined to be consumed in the production of fresh wealth", we find that the fundamental evil is not the attempt to apply to production more capital than is economically required; but the fact that bankers have been prevented from distributing the wealth already produced among those who would most economically use it in the production of fresh wealth. Hence "over-production" and unemployment. Manufacturers who have produced wealth exhibit no desire to retain it; on the contrary, they are usually prepared to sell on credit at comparatively long dates, at considerable risk to themselves, if only somebody will take their goods off their hands. The central evil is that most of the potential consumers have been prevented from monetizing their power to demand, except by yielding up the greater part of their profits to a moneylender. The manufacturer cannot *give* his goods away; he waits for the professional banker to indicate by means of his tokens of purchasing power those who are economically deserving, i.e. those who either have produced or who are capable of producing wealth.

The evil is exaggerated by the circumstance that, under the present system, the purchasing power required for fresh production is largely subtracted from

the circulating exchange medium of the community, instead of being created afresh with every increase of production. Any considerable and decided extension of production, as for instance that which results from the introduction of a useful invention, automatically withdraws a certain portion of the previously existing "power to demand" and prevents the exchange of goods that have already been produced. This is an important point, and one that deserves closer examination. Let us suppose an individual A to have produced £10 worth of goods. He wishes to purchase, and, upon the security of his goods, obtains £10 worth of exchange medium from a banker. Now, unless he use the whole of this exchange medium in purchasing goods—unless he put the whole of it into circulation—some part of his own product must remain unsold. "Exactly so", interjects Mr. Hobson, "let us therefore tax him and buy his goods from him." But it is inconceivable that A should hoard his exchange medium: hoarding is rarely practised in Western civilization. We shall see that the evil rather is that legal restrictions upon professional lenders of capital direct too great a stream of demand upon A's medium of exchange and thus cause his commodities to be unsaleable. Let us suppose that B wishes to undertake production and, instead of applying to the banker for fresh purchasing power, borrows £5 worth of A's exchange medium. By the time B has created his anticipated wealth there will be £15 worth of goods circulating, for which there will exist only £10 worth of effective monetary demand. This is the real reason why goods remain unsold. The proportion of commodities which remains unsold from this cause is the measure of the perfection of exchange expedients in the community. Under primitive conditions, scarcity of exchange medium and risk of destruction of credit by social unrest compel producers to pay highly for the exchange medium, that is, producers obtain a proportionately

smaller quantity of purchasing power in respect of a given product, and prices are unduly low. If the productive powers of the community increase faster than the credit system permits, prices are not only unduly low, but a quantity of goods remains unsold. The equalization of the productive powers of the community and its consumption of commodities depends upon the flexibility of its banking system.

The case of A and B above mentioned is the more interesting since it contradicts the assumption of certain economists that the community's exchange of commodities can be equally efficiently transacted by a relatively much smaller quantity of exchange medium on account of the circulating power of the medium. For instance, on p. 7 of the *Political Economy* (vol. i.) Mill gives his support to the doctrine which, more than any other, has been responsible for loose thinking on currency questions, by stating that exchange is not hindered by restriction of a community's supply of money. He writes:—

> "Further consideration showed that the uses of money are in no respect promoted by increasing the quantity which exists and circulates in a country; the services which it performs being as well rendered by a small as by a large aggregate amount. Two million quarters of corn will not feed so many persons as four millions; but two millions of pounds sterling will carry on as much traffic, will buy and sell as many commodities as four millions, though at lower nominal prices."

This doctrine is true only within certain limits—it must not be carried too far. Mill, however, makes no attempt in the context of the passage above cited to qualify his statement, and the passage is often quoted as it stands, against those who endeavour to point out the evil of a restricted exchange medium. It is true that, *if the needs*

of a country for exchange medium are already fully supplied, the existing quantity of its exchange medium will transact its commerce as efficiently as twice the amount; but the error of the unqualified statement that the quantity of a country's exchange medium has no effect upon the facility of the transaction of its commerce may be incontrovertibly exposed in the following manner. Let us suppose that A, B, and C have each produced £1 worth of goods, and that the banker issue £1 worth of exchange medium to A only, trusting to the circulating power of the medium to effect the transfer of the goods produced by all three. Now, in a few chance cases it may happen that A requires B's goods, B requires C's, and C finally A's; but it is only in a case of this type that the exchange of goods will proceed smoothly; and even here C must wait until the exchange medium reaches him before he can purchase of A, although, having himself produced saleable commodities required by another who has also produced, he is presumably fully entitled to purchase immediately. It may frequently happen, however, that C requires A's goods, but that neither C nor B have produced goods desired by A, who alone possesses exchange medium. The latter accordingly purchases elsewhere or retains the exchange medium until he has found other producers with desirable objects of purchase; meanwhile A, B, and C's goods remain unsold and deteriorate. Orthodox economists will here record over-production, although it is quite possible that B may desire C's goods, and C have equally developed a desire for B's goods, B requiring in this latter case only a credit issue to enable him alike to purchase of C and sell his own goods (it is here supposed, of course, that barter is out of the question). Even if both B and C were provided with £1 worth of exchange medium each, on the security of their product, no question of redundant currency could arise, since a total of £2 worth of exchange medium would have to be

returned to the banker in respect of B and C within a certain stated period.

This latter case is also noteworthy as providing an instance of the *necessity* of credit in any advanced system of division of labour. Credit is merely an extension of mutual trust. If the banker provide credit on the security of goods produced, he relies on the borrower's guarantee that the goods are really saleable, and it is to the interest of the borrower not to deceive his banker. When the banker is assured of the integrity of his client he may equally provide him with purchasing power on the latter's guarantee to produce saleable goods within a certain period. Hence it is desirable and perfectly safe to avoid the risk of insufficiency of exchange medium. Professor Bonamy Price's treatment of the Quantity Theory is more accurate than Mill's. He states:[1]—

> "A nation is not the poorer for having little gold, nor the richer for having much, *if only it have enough*. The precious metals flow to countries of low civilization, of political insecurity, where the law is weak and justice uncertain; also to nations using large banking reserves. . . . whilst they find scant resting-place in lands of high commercial development, where property is safe, credit secure, the recovery of debts easy and to be relied upon, and where the owners of goods are willing to part with them for cheques and bills, and similar processes of deferred payment" (italics mine).

It is of course evident that every fresh invention must tend to turn the stream of capital to itself and away from the machinery it displaces. But the deciding factor in altering the course of the stream of capital should be co-operation between the manufacturer and the banker —not indiscriminating coercion on the part of the State. Legal restrictions upon the creation and loaning of

[1] *Currency and Banking* (London, 1876, H. S. King & Co.), p. 24.

capital to-day compel the banker to withdraw purchasing power from quarters in which purchase is still desired, simply because the capital is more urgently desired elsewhere, and the State has prevented him from creating a fresh supply. The reduction in the demand for credit should come from the manufacturer when he perceives his profits dwindling—and from no other cause. The present system literally compels the destruction of existing industry whenever a sufficiently large quantity of fresh industry is created, although the latter may be actually inferior to that which it destroys. The normal and harmless method of transfer of capital from unprofitable industry is lucidly described by Bagehot thus:[1]—

> "The bill-brokers and bankers' bill cases as a rule are full of the bills drawn in the most profitable trades, and *caeteris paribus* and in comparison empty of those drawn in the less profitable. If the iron trade ceases to be as profitable as usual, less iron is sold; the fewer the sales the fewer the bills; and in consequence the number of iron bills in Lombard Street is diminished. On the other hand, if in consequence of a bad harvest the corn trade becomes on a sudden profitable, immediately 'corn bills' are created in great numbers, and, if good, are discounted in Lombard Street. Thus English capital runs as surely and instantly where it is most wanted, and where there is most to be made of it, as water runs to find its level."

Bagehot is right: capital always runs to the place where it is most wanted. The trouble is that when the "want" increases beyond a certain point, in spite of the fact that it may emanate from a perfectly legitimate growth of industry, legal restrictions prevent the means of transfer from increasing proportionately, and capital runs only to places where the demand is abnormally

[1] p. 13 of work previously quoted.

keen, that is, where men are prepared to sacrifice gilt-edged security to obtain it. Since only a small proportion of manufacturers can afford at a given time to lay out any portion of its capital in comparatively unproductive gilt-edged security, in times of strong demand for discounts capital runs only to this small proportion; not (let me repeat it) because of any dearth of capital, or of any diminution of mutual trust or confidence that men will meet their engagements, but simply because the State has seen fit to restrict the issue of the means of transfer of capital to the amount which many generations ago it considered sufficient for the needs of the community for all time.

The cause of the lack of buying power in the community to-day is not only the legal exclusion of a vast mass of eligible security and the absence of suitable banks, but that, even when obtaining due monetization of their goods, producers pay to the financial class excessive interest on the medium of exchange. For every £100 worth of exchange medium received from the financiers, producers must obtain from somewhere and return to their creditors £105 (when interest is at 5 per cent.), and a still greater sum when the capital is obtained from financier shareholders. Therefore, in circumstances like our own, where the exchange medium is limited in volume, and high interest is paid in dividends to shareholders, the tendency will be for the exchange medium to be accumulated gradually in the hands of the financial class. Mr. Hugo Bilgram states:[1]—

> "The amount of exchange medium thus withdrawn from its purchasing function and used to accumulate fresh interest for the financial class, accounts for the stagnation of business and the accumulation of all kinds of products in the hands of the producers."

[1] *Involuntary Idleness* (Lippincott, Philadelphia, 1889), Introduction.

Demand will never equal supply until all goods produced are readily monetizable into almost equivalent purchasing power, allowing merely a margin for the banker's labour and possible depreciation. This can be accomplished by cheapening the credit medium. The most rational method of attaining this end is to permit the banks to substitute the gold credit token by the paper promise to pay. Further, the circulating power of this latter instrument will render automatic the creation of supply by demand, since it will facilitate monetization of productive ability by the banker.

The disease in our industrial system manifests itself in other symptoms. I have remarked in an earlier chapter that our judicial system is gradually perfecting its methods of preventing the satisfaction of demand except by the performance of equivalent service. Yet there exists a considerable class in our midst of which we feel, more or less vaguely, that it is not performing due labour for the reward it receives. I refer to the class which lives on share dividends. Of most ordinary industry it may be said that the individual must give up the product of his labour in order to receive reward, or, in cases of hire, the object hired is gradually worn out: if the individual desire further reward, he must labour afresh. Yet in dividend receivers we find those whose commodity, gold, is never consumed, but yields reward unceasingly with unduly little further labour. The explanation lies in our faulty credit system. The vast majority of the members of society live by exchange. We have rendered gold more necessary to the process of exchange than it need be. Gold is the one commodity that controls *all* exchange, and—we have prohibited the only effective substitute for it, namely, the bank note. Therefore, in justice, we must pay gold owners what they ask for the use of their commodity.

It is at once strange and pathetic to notice how reformers have hovered around this evil without being

able to strike at its cause. Society has been likened to a great waggon drawn by the workers. From time to time a worker throws off his harness, jumps into the waggon, and is thereafter drawn without further exertion on his part. The labour of the rest of the workers is thenceforward increased, since not only are their numbers lessened, but the weight to be drawn is greater. Later reformers have resolved the metaphor somewhat, and we have the modern Socialist who affirms that the certificate of entry into the waggon is the possession of machinery; he therefore proposes to prevent entry into the waggon by prohibiting individual ownership of machinery. But the protest arises from the Anti-Socialist party that, while certain possessors of machinery are perhaps reaping exorbitant profit, yet, as a class, they are performing useful organizing labour, and no scheme has yet been proposed by which, with human qualities in their present stage of development, ability may be so automatically attracted to this branch of industry, and be so thoroughly tested, as by free competition and private retention of profits. It has been left to modern economic science to go one step further and declare that (if we omit reference to the land question) it is the possession of gold which enables entry into the waggon of idleness. It is virtually by possession of gold alone that ability is to-day enabled to undertake production. Of almost all other commodities it may be said that, if the demand for them increase, and their price rise by reason of insufficient supply, we turn to some substitute. Gold is the one commodity for which we have prohibited effective substitutes. On all industrial activity this vampire preys with full legal sanction. I have said that a broad survey of the industrial problem reveals a lack of effective demand for goods. Land questions apart, this is to be ascribed to the second circumstance that labour is obliged to yield up a great portion of its product to the non-producing

gold-owning class, and is therefore never able by the sale of the rest to repurchase as much as it might. Orthodox economists have defended the gold owners in their levy of interest on the grounds that they perform useful service in supplying capital to labour. Agreed! We merely point out (1) that this service is being purchased ten, and frequently twenty, times as dearly as it might be; (2) that our whole industry suffers by its exchange system being legally bound more closely than is necessary to gold, a commodity at once monopolizable and arbitrarily fluctuating in available quantity.

There is yet another symptom of the underlying disease of credit restriction. Let us suppose the capable worker to obtain possession of machinery. By due attention to business and a careful outlook upon the needs of the market he obtains increasing reward. There comes the time when, in order to extend operations, he has need of more capital than is provided by the average returns of his business in its present form. Here then is an opportunity for a loan. Since his returns from the additional capital will be obtained only after a lapse of a considerable period, such an advance falls into the category of "long-date" loans. Now, although we have in the banker a professional judge of commercial integrity and ability, we have legally exposed him to the frequent and unforeseen danger of the withdrawal of his gold, and have thus precluded him from making long-date loans. The employer is therefore obliged to apply to the unprofessional outside public—the holders of gold—and turn his business into a joint-stock company. This is attended by several distinct disadvantages:—

(I) The original employer it is who has brought his business to its present state of perfection, and who may conceivably be trusted to know best how it should henceforth be conducted. Yet he is compelled to receive,

and submit his opinions to, a board of directors (who again must study the wishes of the ignorant shareholders), the board having power to alter the whole character of the business. There can be no doubt that the business would be more economically and progressively conducted if the original employer were provided with the additional capital by a banker, and the management of the business left in his own hands. If the employer value the advice of other men, let him employ them as managers, or otherwise purchase their advice; but let him not give them the right of veto over his actions.

(II) The banker, as a professional judge of commercial worth, would be more likely to encourage true ability than does at present the untrained public. We do well to secure to ability its reward. Yet we see to-day that the specious, self-advertising swindler, with his seductive prospectus, frequently secures advances from the public, to the exclusion of his competitor who may be a more capable producer. This is distinctly bad from a social point of view.

(III) The frequent occurrence of such fraudulent company-promotion is proved by the fact of our having instituted the law of Limited Liability (a further example of one act of interference necessitating another). It is contrary to all ideas of commercial justice that debts should be incurred for which the debtor party is not responsible. In the early days of the growth of joint-stock companies, however, the public became fearful at the many failures which occurred among such companies at times of financial crisis, and evinced reluctance in lending its gold. Hence was passed the law which renders the individual shareholders of a company liable to that portion of the company's debts only which is covered by the amount of their respective holdings of shares. This is a premium upon reckless trading, a hindrance to the growth of mutual trust

in commerce, and implies disregard of the law that morality results from the exposure of the individual to the full consequences of his actions. It is noteworthy that Sir R. H. Inglis Palgrave is of opinion[1] that the stability of Scottish banking has been largely promoted by the fact that the entire private fortune of every partner is answerable for the debt of the bank. The limited liability company is a peculiarly immaterial, irresponsible organism, containing no solid person who is responsible for debts incurred. Every single commodity which is exchanged to-day is rendered dearer by the extra amount which must be charged by producers to cover the losses from bankruptcy of these irresponsible bodies.

The question of limited liability companies is an interesting one. I have been surprised at the apathy with which the commercial world accepts such a law, and can only suppose that the comparative ignorance of the principles of credit which prevails even among the mercantile classes is responsible for this attitude. Extension of industry was a pressing necessity, and such extension was not thought possible without an application to the unprofessional public for gold. The gold-owners were thus able to dictate their own terms. Professor Irving Fisher attempts to defend the Bankruptcy Laws in respect of limited liability companies on the grounds that they represent the recognition of the principle that a creditor of a concern is a risk taker. This is an exaggeration of the liberty doctrine. Political economy justifies the exposure of an individual to risk only when the gain from such a course outweighs the danger. On Professor Fisher's reasoning we might argue that a man who steals my watch in the street should not be compelled to make reparation because in promenading the streets with a watch in my pocket I am a risk taker. The justification for the Bankruptcy Laws

[1] Work previously quoted.

is not that the creditor is "naturally" a risk taker—he *is* a risk taker, but we have artificially compelled him to undertake excessive risk. The reason for the existence of Bankruptcy Laws is that under an industrial system like our own wherein it is said that 95 per cent. of existing firms have at some time or other been on the verge of bankruptcy, it is possible to induce the unprofessional loaners of gold to capitalize industry only by protecting them from ruin in the event of the failure of the concern which they have financed. It has, however, been sufficiently insisted upon throughout this book that our banking laws at once prevent the greater part of industry from being financed by a professional lender, the banker, and expose all industry to a greatly increased risk of bankruptcy whenever prosperity increases in any country of the world.

(IV) A banker would advance credit at a fixed rate of interest, reduced to its lowest point under competition from other bankers, and all profits from industry above this charge would accrue to the employer. The company shareholders, however, advance their gold only on condition of sharing proportionately in all increased profit from the business. The dividends paid to them form an ever-increasing drain upon industry, and the stimulus of personal profit to the original employer is diminished. It is not of course contended that the establishment of rational banking will completely abolish the private lending of capital. There will always remain a fringe of investments that are too uncertain for the banker to risk his reputation in their capitalization; these undertakings will be financed by money-lenders or shareholders at a rate proportionate to the risk involved. Our present laws, however, throw a large class of investments into this latter category which, under a less restricted banking system, could be, with safety, financed at a low rate by the banker.

A further evil of our industrial system is the fre-

quency of bankruptcy proceedings, and the leniency of the law with regard to bankrupts. There is no doubt that it has been generally observed that, for some reason at present unknown to the orthodox economist, the smaller manufacturer has considerable difficulty in meeting his liabilities under our present system, and the law therefore inclines to look indulgently upon his failure to meet his engagements. The result of this leniency is, however, that in every trade there are crowds of rogues who gradually work their way to fortune by buying extensively on credit as a preliminary to a declaration of bankruptcy. They remove a goodly part of their stock, or arrange for its sale to a friend from whom it can be afterwards repurchased, and proceed to file their petition. They liquidate their debts at a rate of a fraction in the pound, and immediately afterwards set up in business again in a far more prosperous way than before on the proceeds of this fraud upon their unfortunate creditors. Under better social conditions, when the smaller manufacturer is able freely to obtain the credit he needs, and the establishment of industry is easier, the judicial system will ensure that bankrupts pay their debts in full before commencing trade afresh. The more fundamental evil in such cases is of course that such unreliable persons are able to purchase on credit at all. This brings us to a further symptom of disease in our exchange system.

"Terms 30 days" and "Terms 3 months" have become inseparably connected with modern commercial transactions. These expressions indicate that the banker has been prevented from fulfilling the function of local valuer of security, and that individuals must therefore run the risk of waiting three months until a purchaser who lives far away, and whose personal character may be practically unknown to them, has secured his expected return and redeemed his promise. It is almost impossible to estimate how much loss the average firm

suffers annually from bad debts, litigation, and extra bookkeeping, as a result of the system of purchase on credit. Quite obviously, to purchase on credit is to bring into commerce the present worth of a future profit; the operation being performed to-day, however, by an unprofessional individual from a distant town instead of by a local banker. With a less restricted note issue and a development of credit, most commercial transactions could be carried out on "cash" payments, the speculative nature of commerce being thereby largely reduced.

Various symptoms of our industrial evil thus point to the fundamental disease of credit restriction. We must conclude that there is something wrong with the channels through which labour and capital meet, namely, banking.

CHAPTER XII

AN INVARIABLE UNIT OF VALUE

In the course of this work I have occasionally used the expression "standard of value" when referring to the function, at present allotted to gold, of determining the price of other commodities. Strictly speaking, however, there can be no standard of value in the sense in which the expression is ordinarily used, namely, a commodity the value of which remains constant. Such a commodity does not exist. I have used the popular expression in the previous chapters of this book merely in order not to divert the attention of the reader from the questions then under examination.

With the introduction of exchange arose the need for measuring, not only the quantity, but the desirability (as compared with the available quantity) of goods produced. It was therefore but natural that men should select some commodity which was, roughly speaking, generally desired, and, by agreement, compare the desire for ordinary goods with the desire for this one commodity. They would say that they desired the selected commodity, silver for instance, fifty times as much as bread, and twenty-five times as much as meat. This would mean that 1 lb. of silver would be worth 50 lbs. of bread or 25 lbs. of meat; hence the baker and the butcher could advertise the price of their provisions without needing to be able beforehand to value the various wares of all those who desired bread or meat. It will be noticed that I have said that the use of a standard enabled the *valuation* of goods. The statement that silver is worth fifty times as much as bread simply means that *if* I desire silver I must pay fifty times as

much for it as for bread; the statement does not necessarily require that payment for the bread be made in silver. I have sufficiently dealt with this point in Chapter IV., and it is therefore only necessary for me to point out here how far astray are those economists who declare with Bonar, in his *Elements of Political Economy* (p. 15) that:—

> "To play the part of money it is not enough for an article to be generally wanted; and there must not only be fitness to serve as a measure of value, but fitness to serve as a means of exchange."

Note the old confusion here of many distinct functions under the one title of money: we have remarked the part played by this conception in bolstering up our present legal tender laws. It is necessary to repeat incessantly the distinction between the functions of gold, (1) as an exchange medium, and (2) as a standard of value: the former depending upon popular willingness to receive the metal in satisfaction of debt, the latter upon common agreement to refer to it in measuring the demand for and supply of particular commodities. We have seen how desirable it is to cheapen the medium of exchange: but it is equally desirable that the worth of the standard of value should be protected from fluctuation. Hence, as long as there is believed to be some necessary connection between the value measurer and the medium of exchange, all efforts to cheapen the latter will be met by the cry of fear that the "standard of value" is being endangered.

The obvious defect of the use of a valuable metal to measure values is the very fact that the metal is itself the object of human desire—a notoriously fluctuating force—and that it may, moreover, be artificially monopolized. It is precisely as though our yard-stick were made of gutta-percha and could sometimes be stretched to 40 inches in length, and at others reduced to 30 inches.

No measure should vary in that quality which it is designed to measure. Few of the millions of people who exchange ordinary commodities actually desire gold; yet, when gold becomes cheaper, prices of all goods must increase, to the confusion of all debt contracts.

In Chapter VII. I have shown that scarcity of gold operates to depress prices through the screw action of the bank rate; and in Chapter IX. attention has been drawn to the disastrous effects of retaining fixity in the price of the metal which forms the basis of our exchange medium, such fixity of price permitting financiers to purchase abroad at a time of general high prices here, with a commodity rendered artificially cheap. The export of this one cheaper commodity, gold, inevitably tends to restrict our home exchange of goods, and to throttle prosperity. Moreover, should gold, through use in a new invention, or through scarcity of supply, ever become dearer than the present sovereign, no amount of legislation will keep the gold coins out of the melting-pot, and those of our value standard enthusiasts who declare that the standard metal must simultaneously function as exchange medium would be in a pretty quandary.

Of the desirability of some more stable value unit than gold there can be little doubt; the time spent on the question by so able and practical a thinker as Professor Jevons should alone be a sufficient proof of its importance. Jevons remarks that the price of gold, measured in ordinary commodities, rose 145 per cent. between 1809 and 1849. Between 1789 and 1809 it fell 46 per cent. Fluctuations of from 10 to 25 per cent. occur in every credit cycle. It is perceived by most students that the defect of Professor Jevons' tabular standard is its cumbrousness: the system necessitates a periodical averaging of the prices of a list of staple commodities, any one of which commodities might con-

ceivably vary in price independently, much discussion being accordingly entailed as to the composition of the chosen list. In the words of Professor Sidgwick:[1]—

> "The result obtained by this method [tabular standard] is likely to be different for different individuals even at the same place. Suppose, for instance, that at the end of the time, corn has risen in price and the finer kinds of manufactures generally have fallen; we shall probably find that a rich man has got to pay less for his habitual consumption and a poor man more."

Moreover, as Laughlin accurately remarks, the tabular standard is at best merely a method of correcting the deficiencies of the gold standard in the liquidation of debt contracts; it offers no means of pricing ordinary commodities except in terms of gold. I propose, however, to demonstrate that it is possible to establish a simple unit of value in which all commodities may be priced, and which shall remain unaffected by the price fluctuations of any one commodity whatsoever. The subject is of course one around which considerable controversy has raged. I will endeavour to deal with matters theoretical and practical from as many points of view as possible within the limitations of my space. I would only ask that those who already hold strong views on the subject of Value will be patient and not skip the chapter at the first proposition with which they disagree. Towards the end of the chapter will be given historical examples of the working of the invariable unit, and a demonstration of the manner in which these examples support the theoretical portion of my reasoning.

The practical details of the proposal for an invariable unit of value may be briefly sketched as follows: On some definite date let gold coins be withdrawn from

[1] *Political Economy* (London, Macmillan, 1883), p. 67.

circulation by the substitution of £1 and 10s. notes, issued by the Bank of England, or preferably, by ordinary banks. All that is then necessary is that the price of gold *expressed in bank-note pounds* shall thereafter be permitted to fluctuate according to the supply and demand conditions of the metal. Under such a system, the bank-note pound becomes an invariable unit of price, and, let the supply or demand conditions of gold fluctuate as they will, the prices of ordinary commodities will be altered only when the market conditions of the commodities alter. The important feature of the system is that when the foreign demand for gold increases to such an extent as to endanger the supports of the home credit system, the banks will raise the bank-note price of the metal and thus prevent the ruin of home commerce. All the present coin denominations could be retained, the sole difference under the new system being that a bank note would no longer represent a claim upon a bank for a certain *weight* of gold, but a claim for its face *worth* of gold according to the market conditions of the metal. The bank note would thus be rendered a more perfect storer of wealth than is the case under the present system. A bank note to-day, being a claim upon a certain *weight* of gold, is equivalent to a varying worth of gold and consequently of ordinary commodities—a worth which varies in proportion to every fluctuation in the conditions of the international bullion market. Under the invariable unit system, on the contrary, the bank note becomes an unvarying claim upon its face *worth* of gold, and hence, of any commodity on the market. Any new and hitherto unpriced commodity introduced on the market after the introduction of the new system would be priced by comparison with some already priced commodity as is now the custom. Gold could be retained as legal tender for such time as, in our paternalistic wisdom, we deemed people incapable of contracting for themselves the form

of repayment of debts: the apology we now use to justify our maintenance of the laws that were originally introduced only to compel commerce to use the debased coins issued by monarchs and governments.

The relation between the bank-note pound and the pound sterling would remain fixed as long as the demand and supply conditions of gold remained unchanged; if, however, these varied, the fluctuations would immediately be shown in the change of the bank-note price of gold, and instead of the prices of all other goods changing in sympathy as to-day, *they* would remain stable. The use of this invariable price unit, the bank-note pound, eliminates the disturbing factor of time from the measurement of value. We have found it necessary to eliminate variations of temperature from our length measurement by setting up a fixed temperature at which readings from the standard measure are to be taken; it is yet more necessary that the unit of value, the measure of demand and supply relationships of all commodities, should be preserved from the fluctuations which *time* effects in the demand and supply relationships of every known commodity. In other words, in order to preserve stability in the unit of value it is necessary to fix upon and standardize the worth of some particular commodity *on some particular day or at some particular time*. Value represents the measurement of the respective *worth*, not the respective *weight* of commodities. Hence, if we indicate the *worth* of a sovereign on a particular day by the number 1, merely calling this number 1 "bank-note pound" in order to indicate that worth or price is referred to, we may register all subsequent fluctuations in the market conditions of the metal upon this bank-note pound *number*, the prices of all other commodities being thus unaffected by variations in the market conditions of gold.

Gold acts as the "standard" of value to-day only by reason of the law which compels the Mints to increase

the exchange medium by converting any quantity of the metal offered them into purchasing power at a fixed rate, and similarly compels the banks to sell the metal for purchasing power at a fixed rate to anybody who demands it. When the supply of gold increases, prices are raised, not by producers comparing the worth of ordinary commodities with the changed worth of gold, but by the circumstance that the increased supply of gold is automatically enabled by our laws to become purchasing power and thus cause an increased demand for ordinary goods. Similarly, scarcity of gold depresses prices, not on account of any comparison made by ordinary producers between the present supply of ordinary commodities and the present supply of gold, but for the reason that the State has compelled banks to yield up gold at a fixed bank-note price to any financier who brings notes for redemption in gold. Hence scarcity of gold is invariably followed by a drain of the metal from the banks, and, since a reduction of the gold reserves in banks places the latter in a dangerous position, they are obliged to reduce their loans and thus contract the volume of exchange medium, whereupon sellers of ordinary commodities are forced to sacrifice their wares at reduced prices in order to dispose of them at all.

The layman seems to imagine that ordinary people fix the price of any commodity whose worth has changed by comparing its changed worth with the worth of gold. This is an error. Only the smallest minority of ordinary persons in our midst has any desire or need for gold at all. The actual process which obtains in fixing fresh prices is that as purchasers of goods, people measure their desire for the commodity of changed worth with their desire for any other commodity of which they have frequent need. Let us suppose, for instance, that the normal human sacrifice of comfort required to produce sugar has been increased by reason of disease in the beet crops. Producers thereupon demand, let us say,

three units of purchasing power instead of two for one pound of sugar. Now, the purchasers of sugar do not compare the satisfaction which they expect from a pound of sugar with the satisfaction which they expect from the possession of three units worth of gold; they simply compare their desire for sugar with their desire for bread, meat, clothing, or any other commodities for which they have an every-day need, and proceed to consider if they can afford to allot the required portion of the purchasing power in their possession to the purchase of sugar. The problem which faces them is that they possess a certain *number* of units of purchasing power, representing a claim to a certain *worth* of commodities, and realizable into a variable quantity of actual commodities according to market prices of goods. Again, as producers of goods, manufacturers do not measure the sacrifice of comfort to produce a commodity of changed worth with the sacrifice required to produce gold. Ninety-nine out of a hundred ordinary producers are ignorant of the processes of gold production. When any raw material becomes scarcer, the producer measures the increased sacrifice of comfort required to produce a given quantity of purchasing power in the article in question with that required in other directions. His problem is that he possesses a certain quantity of productive ability realizable into a certain quantity of commodities; and the price of his real product—the number of units of purchasing power obtained in exchange—will, after the higgling of the market, express the relation of the normal human desire for that product and the normal sacrifice of human comfort required in supplying the same. In other words: *in the primary pricing of commodities* we compare their respective worth with that of one standard commodity whose worth we fix at 1, and when once these numbers are assigned, any change in the worth of particular commodities is effected by

higgling between purchasers and producers of the commodities in question without any necessary reference to the standard commodity whatsoever, the higgling simply representing the process of ascertaining the normal desire and sacrifice in respect of commodities in common requirement by the people in question.

The root error in our establishment of the gold standard system is that instead of selecting the *worth*, the human feeling, in respect of a certain commodity as the unit of value, we have ignorantly chosen a certain commodity itself. The *worth* of the commodity might have been recorded in a number, and all other values calculated proportionately, whereupon the price number of the standard commodity might have been permitted to follow all the fluctuations of the market conditions of the commodity itself without thereby causing any inflation or contraction of exchange medium.

The confusion set up by the use of a commodity "standard" of value is similar to that which would arise if, having selected the height of a certain young tree as a unit of length measurement, we were to continue to refer to *that particular tree* for measuring purposes, instead of standardizing its *height on a certain day*. We are compelled to distinguish carefully the standard length from the actual tree used as a standard, by calling the length, not a *tree*, but a *yard*. If we continued to call the standard length a tree, and referred to the actual tree as the standard, the growth of the tree would confuse all measurement. As Mr. Whittick says:[1]—

> " 'Are not two sparrows sold for a farthing?' A money system could be built upon this starting point. If two sparrows are sold for a farthing, prices of all commodities whose values were determinable could be expressed in farthings. The farthing might

[1] *Value and an Invariable Unit of Value* (Lippincott, Philadelphia, 1896), p. 86.

be a myth, and yet from it the proportions of all wealth might be determined. How absurd it would be to attach the sparrows in perpetuity to the farthing!"

The "farthing" in Mr. Whittick's illustration is simply a name arbitrarily chosen to indicate the unit of value—the *worth* of two sparrows.

In the first scheme above sketched for the establishment of an invariable unit of value, the price of gold was chosen as the starting point for reasons of convenience only, prices to-day being tabulated in terms of this metal. Under the gold standard system we have arbitrarily chosen a certain weight of gold, the sovereign, and called its worth 1; when, for instance, we say that the price which we are prepared to pay for a particular picture is £6 we mean that our desire for it is six times greater than that for the quantity of gold (or, more accurately, for the amount of purchasing power over general commodities) contained in a sovereign. The exchange relationship of the weight of gold contained in one sovereign and the picture, would remain unchanged whether we called the worth of the sovereign one pound, one "George", one "X", or one anything else. The essential relationship is that its worth is *One*, whilst the worth of the picture is *Six*. The important feature of the statement is the price number. In setting up the invariable unit system, except for the labour of establishing afresh the comparative desire for various commodities, we might use a specified quantity of any valuable commodity as a starting point, and call its *worth* the unit, or "One". When once we have allotted such numbers to the various commodities as will indicate the relative intensity of human demand for them in relation to the supply, we may reject all reference to the commodity against which we originally measured them, since the numbers

themselves thenceforward indicate the exchange relationships of all commodities.

It will be noticed that, so far, I have abstained from insisting upon any particular definition of value. I shrink from giving a definition, preferring rather to confine myself to that which, to five out of six people, is far more satisfactory than much theory, namely, a demonstration of the working in actual practice of an invariable unit of value. The wording of a definition only too often causes mere linguistic wrangling. Yet, to satisfy the scholastics, I will now resume as briefly as possible the theory of the invariable unit. I do not propose to traverse the realms of controversy upon existing theories of the nature of value. The curious may study these elsewhere. Gide has an admirable chapter on the subject in his *Principes d'économie politique*.

The definition adopted by most economists since Mill is that "Value is the exchange relationship existing between commodities." As an example of the subtleties which beset this question we may note that Gide immediately objects that the existence of value does not necessarily imply *exchange* between objects: value would persist even in a state of communism, where exchange would be absent. At first sight one is tempted to agree with this criticism. Reflection, however, reveals that if there be objects of different value under communism, it can be only because society compares them, that is, society weighs up its feelings at the presence or absence of its various possessions, and similarly estimates the discomfort of obtaining them—which is all that is done when the *exchange* relationship of commodities is determined. The determination of the exchange relationship of commodities does not necessitate the actual exchange of the objects under consideration, but merely their classification on a basis of comparative human desire for, and sacrifice in acquiring them. Gide him-

self defines value as the comparative intensity of human desire for various forms of wealth; adding that the intensity of this desire increases in proportion both to the pleasures which men expect from an object of wealth as long as they do not possess it, and to the sacrifices which they would have to make to replace it if they were to lose it. This brings me immediately to the point I wish to make, namely, that *the determining factor of value is the normal human mind.*

Value is dependent firstly upon the comparative average human desires for various objects, and secondly, upon the average sacrifices of comfort which must ordinarily be made to replace those objects. Both desire and sacrifice are affections of the mind. An object may be desirable at one time, and undesirable at another. An expenditure of energy may be a sacrifice of comfort at one time, and pleasurable activity at another. Sacrifice is a description of human sentiment or feeling in connection with an expenditure of energy. In ordinary economic language these two factors of value, desire and sacrifice, are expressed by demand and supply. Demand is evidently the result of unsatisfied human desire; supply, in the case of a valuable object, represents the result of sacrifice of comfort. Hence we may define value either as the comparative demand and supply relationships of various commodities, or as the comparative human feelings of desire and sacrifice in respect of various commodities.

In length measurement we record that a certain distance is one, ten, or twenty *yards*, greater than another. The yard is an arbitrary distance, chosen in order to secure a basis of comparison. Any other distance might equally well have been chosen. Similarly, the unit of weight, the pound avoirdupois, is arbitrarily chosen. Length and weight are concrete qualities, and, although perceptible only by comparison, are inherent, so to speak, in objects. Hence the units of length or weight

may be standardized in certain material objects. Let me not be accused here of venturing into the domain of metaphysics. I do not assert that length or weight exist independently of human perception; but merely that these qualities do not fluctuate with human feeling to the same extent as does value. When once we have established that a metal ruler is one foot in length, or one ounce in weight, so long as the object itself remain unchanged, we may safely assert that on any future occasion, other circumstances (temperature and altitude) being equal, its length and weight will remain unchanged. The values of various objects, however, depend simply upon the comparative average human feeling in respect of them. Value cannot be said to inhere in objects. Yet, *upon one particular day*, or *at some particular time*, the average intensity of human feelings in respect of exchangeable objects enables us to assign certain price numbers to the various articles indicative of the relative intensity of those feelings at that time. These price numbers we fix by comparing the respective normal human feelings in regard to the various commodities on the market, with the feelings (desire and sacrifice) in respect of one particular commodity. But when once these numbers are fixed to ordinary commodities, it is of the highest importance that no one of them should be changed except when the supply and demand relationship, i.e., the human feeling in respect of the ordinary commodity in question, is affected. It would obviously be wrong to change the price numbers of commodities, indicating thereby a change of human feeling in respect of them, when only the commodity against which we originally measured the comparative human feeling for other articles had fluctuated in normal estimation. The correct course must evidently be to allow the price numbers of all other articles to remain unchanged, and simply to alter the price number of the "standard" commodity.

Let us now turn from Value to Price. We obtain a close definition of Price if we look upon it as the monetary expression of the demand and supply relationship of a particular commodity, since the purchasing power of an object is obviously dependent upon the relationship of its demand and supply conditions. Having established this definition, we proceed to examine it further. Demand and supply have previously been shown to be the economic expressions of the human feelings of desire and sacrifice respectively. Hence, in order that we may determine the respective positions of two commodities in order of value, that is, in order that we may determine the exchange relationship of the commodities—their respective purchasing power—we must represent each by a single symbol which shall express the relationship between the normal human desire and sacrifice in respect of the object concerned. Hence we may define Price yet more closely as *the monetary expression of the intensity of average human feeling (desire, and sacrifice necessary to obtain) in respect of a commodity.* When we price commodities in terms of gold, under either the Gold "Standard", or the Invariable Unit system, we select the relationship of the average desire and necessary sacrifice for a particular commodity, namely, gold, and call the relationship "1"; under the Gold "Standard" system we call it 1 pound sterling, under the Invariable Unit system, 1 bank-note pound, or 1 unit. In proportion as the normal desire for other commodities is greater than that for gold, while the sacrifice entailed in acquiring them is the same as that for gold, their prices are greater than 1 (pound sterling or unit). If the average sacrifice necessary to obtain them be less than that for gold, while the desire for them be the same as that for gold, their prices are proportionately less than 1 (pound sterling or unit).

Having now established that Price is an indication of feeling, it is important to observe that when a seller

states that the price of his commodity is, let us say, 6 "pounds", he means that he will exchange it only for such a commodity or promissory token to pay such a commodity, as will evoke in him the same intensity of feeling as the commodity in his possession, the "pressure", so to speak, of which feeling he expresses as 6 pounds. The important factor in the exchange is the equality of the intensity of feeling. Hence, since no known commodity continuously evokes the same intensity of feeling, the monetary unit must not be a commodity, nor a promise to pay a definite weight of any commodity whatsoever, but a claim upon a certain satisfaction, which must be represented by a fluctuating quantity of commodities, according to the market conditions of the commodities concerned. Accordingly we select the *feeling* for a certain standard commodity, and call it one unit. The *feelings* for all other commodities are measured against this standard feeling, and their respective intensity indicated numerically. Henceforward we measure the fluctuation of human feelings in respect of the various commodities upon their various *numbers*, and the price *number* of any commodity whatsoever is always an exact increase or fraction of the number that represented the average human *feeling* for the standard commodity on the day the system was introduced.

One of the commonest defects of the primitive mind, however, is its inability to conceive of abstractions. The feeling (desire and sacrifice) experienced in respect of a belt, for instance, is perhaps four times greater than that experienced in respect of the quantity of gold contained in one sovereign; yet the price of the belt is not called 4 "bank-note pounds", "units", "feelings", "emotions", "spasms", or any other word which may be confined to the indication of feeling, but 4 "pounds" or "sovereigns", thus confusing the feeling with the *object* of the feeling! The error here is just as gross as that

which would be committed if, in the measurement of weight, we used the *weight* of a metal key as the standard (at a time when all keys were of equal weight), and instead of calling its weight an "ounce", a word which may be reserved to the indication of weight, we were to call it a "Key". Obviously now, if keys subsequently varied in weight, all weight measurement would be confused unless it were borne in mind that the word "key", when used as an indication of weight, was simply the *weight* of a particular key which had been used as the standard. If the word "key" were used as an indication of weight without the qualification above-mentioned, and the weight of a particular hammer were fixed at 20 "keys", a sudden twofold increase made by manufacturers in the weight of this type of key would cause the nominal weight of the hammer to fall to 10 "keys", without its actual weight having changed at all. And this would occur not only in the case of the hammer, but in the case of every article the weight of which was measured in "keys". This is precisely what happens to value measurement by the continual use of a commodity "standard" of value. The relative values of commodities are expressed by their prices. The price *numbers* of commodities, not the commodities themselves, are the indication of the respective intensity of human feeling in regard to them. The physical qualities of a particular commodity may remain absolutely unchanged while its price number oscillates considerably —the price number, not the commodity, is the indication of value. But, instead of using the real indicator of the relative intensity of feeling in regard to a particular commodity, namely its *number*, as its price, the primitive mind continues to attach the "standard" commodity to the number. The result is that when the worth of the "standard" commodity rises relatively to other commodities, this system necessitates a proportionate fall in the prices of all other commodities, indicating thereby

an alteration of human feeling in regard to all these commodities, whereas we know that it is the feeling in respect of the "standard" commodity which has fluctuated.

We may actually trace the origin of this confusion in history. The "pound" sterling was originally a pound avoirdupois weight of fine silver. But instead of calling this standard *worth* of one pound weight of silver by a name which would indicate that worth, not weight, was thereby indicated, men actually continued to call the worth of the pound weight of silver "one *pound*", thus originating that controversy "What is a pound?" (which occupied so much of the time of politicians during the early part of last century), and directly causing the enactment of the deplorable Bank Charter Act of 1844. Price is not a certain quantity of a "standard" commodity, but the indicator of the intensity of human feeling in regard to a certain commodity. The price of the belt above referred to is not the quantity of gold contained in four sovereigns. One commodity cannot be the *price* of another. One commodity will *exchange* for another which is similarly priced; but the price *number* is the indicator of the intensity of human feeling with regard to the commodity.

Of course the establishment of the error of a commodity standard of value is directly due to the fact that the use of a valuable exchange medium dates from a time when a paper exchange medium was impracticable on account of lack of social security. When the sole medium of exchange was a valuable metal it will readily be seen how important was the fixing of purchasing power of that metal, and the only method for preserving its value was for the State to continue to convert the "standard" metal into a fixed quantity of purchasing power irrespective of its market conditions. The fluctuations in value of a commodity exchange medium could have been measured only by the adoption of either another

commodity, or paper, as additional exchange medium. The adoption of another commodity as exchange medium might have entailed much hardship to commerce; and the times did not permit the use of a paper exchange medium. In this way, probably, did the error of a commodity "standard" of value crystallize around our exchange system.

In discussing the Invariable Unit system, the question has frequently been put to me: "But when your unit or bank-note pound has parted company with gold —when gold has become scarcer—what does your unit represent?" In order to answer this question, let us take up the discussion of Sir Robert Peel's famous query: "What is a pound?" Peel himself answered by declaring that a pound was a quantity of the precious metals of certain weight and certain fineness. Peel here errs profoundly. His definition would serve partly to describe a pound avoirdupois, but not a pound price. Let me immediately add, however, that his error is that of practically every economist who has written upon this subject. Men have ignorantly attached the "standard" commodity to its price number, not perceiving that, as I have previously demonstrated, they thereby confused all price measurement.

The "pound", considered as a price unit, is the index number of human feeling in respect of—or the supply and demand relationship of—the weight of gold contained in one sovereign *on a particular day*, or *at a particular time*. Let us suppose that diminution of the supply of gold causes gold miners to demand 250 instead of 240 pence for the weight of gold contained in one sovereign; then 250 might be called the index number of the *contemporary* supply and demand relationship of that quantity of gold; the increase of price number infallibly indicating that *since the time when the invariable unit system was established*, the supply of gold has become smaller relatively to the demand. Let it not be

hastily assumed that this shows that *copper* has become the standard of value. The copper pence are of course mere counters indicating a certain fraction of purchasing power, and are quite unrelated to the actual worth of the metal copper. The place of the copper coins could be taken by paper notes without affecting the system, were it not that small coins which receive much wear are more economically represented by worthless metal tokens.

If my interlocutor remain unconvinced, I put a question to him: With what does an inch remain invariable? The reply must be: With that which it has measured. In other words, in length measurement we wish to be sure that when we have seen by comparison that a certain length is twelve times as great as that which we have arbitrarily chosen as our unit, it will remain twelve times the unit length during such time as its own length remains unchanged. The unit of any measurement whatever must remain invariable in that quality which it measures. Hence our unit of length must not be a *growing* tree. The unit of length measurement may, however, be the *length* of a certain tree *at a particular time*. This length we record upon other objects. But when the tree has grown, what is our unit of measurement? With what is it invariable? The reply must be that it is invariable with the length of a certain tree at a particular time in the past, which length is now recorded upon every object which has been measured. But I persist: How do you know that the unit length recorded upon other objects is the same as that originally chosen? The reply must obviously be that we know hat a metal object which is ascertained to be of a certain length will remain of that length as long as the temperature of the surrounding atmosphere remain the same, and that even if the original object chosen as the standard of length were lost, we should retain the standard length recorded upon every metal object of

measured length. The recorded length of an object is varied only when its length varies.

Now, value depends upon comparative normal human *feelings* in respect of various objects. Feelings cannot be expressed by commodities, but only by numbers indicative of the respective *intensity* of the feelings themselves for various commodities. We select the normal feelings ("supply and demand" in economic language) in respect of one particular commodity at a particular time, and call them "1" (unit). We affix price numbers to other objects by comparing their supply and demand relationships with those of the standard commodity. When once these numbers are fixed, the intensity of feeling which was chosen as the unit is recorded upon every object which is so priced. I am asked how I know that these numbers are an invariable indication of the intensity of feeling experienced in respect of a certain commodity on a certain day in the past. I reply that commodity prices were evidently an exact increase or subdivision of the intensity of feeling experienced in respect of the standard commodity at the time when the unit system was established, and we know that price numbers under the unit system are altered only when the human feelings in regard to them alter, and then in exact proportion to the alteration. Hence the price numbers remain exact indications of the contemporary purchasing power of the objects concerned, each price number representing an exact increase or subdivision of the feeling experienced in respect of the standard commodity at a particular time in the past. Just as we knew that the recorded length of an object would be changed only when its actual length changed, and we could verify this by comparing any two similar recorded lengths, so we know that the price of an object, the indication of human feeling in respect thereof, will be changed only when that feeling changes, and we may verify any one price by comparing the normal feelings

in respect thereof with the normal feelings in respect of any other priced commodity.

In length measurement, of course, we may retain a standard length, and even if the whole community were suddenly to alter and falsify yard measures, so long as the standard object of length were retained it would still be possible to ascertain the correct yard by referring to the standard. Price, however, as I previously pointed out, is a measurement of feeling, and cannot be permanently embodied in any one object. But if bread be priced normally at 3 pence per loaf, and a particular baker price an average loaf at 4 pence, we know that he is setting a price on his bread which is not indicative of the contemporary human feeling in respect thereof. If, however, all bakers raise their price to 4 pence per loaf, we conclude that either the normal desire for bread has increased, or there is scarcity in the corn harvest. If neither of these causes, but a "combine" of bakers, be operating, flexibility of competition, or free import of foreign goods will reveal it. But if all bakers are seized with insanity, and jerk the price of bread about in a haphazard way, we obviously lose the *normal* element in price. The unit of value will not have varied, but individual bakers will have respectively estimated the normal feelings for their bread at a different degree of intensity as compared with the feeling experienced in respect of the standard commodity at a particular time in the past. As soon as bakers again become uniformly sane, a normal price will again become ascertainable. We can, in the interim, secure a correct basis for the price of bread only by comparing our feelings in respect of bread with our feelings in respect of any commodity the price of which we believe really expresses the normal human feelings. We can find no more concrete standard of price than this. We do not remedy matters by fixing upon a certain commodity to act as a perpetual "standard". Under the invariable unit, price measure-

ment is disturbed only when the whole community deliberately falsifies prices—a practically impossible occurrence. As long as any considerable portion of the community retains prices expressive of the market conditions (supply and demand) any abnormal prices will immediately be corrected by loss on the part of the abnormal traders, since traders evidently lose if their prices are too low, and they suffer from competition if their prices are too high. The gold unit system, on the contrary, falsifies prices by fluctuations of its own unit "standard" when ordinary commerce is being conducted upon a perfectly sound basis.

All that normal folk require in value measurement is that so long as the supply and demand relationship of a particular commodity remains unchanged, its price shall remain unaltered. Hence, if we will but use the *number* which indicated its comparative supply and demand relationship at the pricing time, it is obvious that we have a measure which is absolutely invariable in relation to that which it measures, the supply and demand relationship of the commodity which has been priced—the human feelings in respect of that commodity. The price number of the commodity will vary only when the relationship of the demand and supply of the commodity itself fluctuates. The number "1", by which we indicated the normal human feelings in respect of the standard commodity at a particular time, is an invariable unit of price, the real subject of this chapter. On the contrary, under a commodity "standard" system, prices are disturbed by the fluctuations of the supply and demand relationship of the commodity which we chose years ago to act as the standard.

Looking back over this exposition, I perceive that it contains a considerable amount of repetition. My only excuse is the importance of the subject, and the fact that experience leads me to distrust popular ability to grasp a new theory after merely one presentation thereof.

Value is to-day conceived of in terms of only the *contemporary* feelings in respect of a standard commodity, and, since every known commodity fluctuates in human estimation, our "standard" is no standard at all. Under the invariable price unit system, the stability of the value unit would be unaffected by any excessive issue of paper exchange medium in terms of the unit. Commodity prices would rise on account of the excessive issue of purchasing power as compared with the production of commodities; but the unit would remain the expression of the normal desire and sacrifice feelings in respect of gold on a certain day in the past. The purchasing power of a given weight of gold at the time of the introduction of the unit system was, for example, 1; after the inflation of general prices, the purchasing power of the same weight of gold would be, perhaps, 3. This would indicate that the normal desire for gold, *expressed in purchasing power*, had increased threefold since the time of the establishment of the unit system. All other prices would similarly have risen, indicating simply that the supply of commodities had not kept pace with the demand. It may be objected that in this case human desire for commodities had not risen, that it was merely the volume of exchange medium which had been inflated. I reply that the volume of exchange medium would never have been introduced into the channels of exchange if the desire for commodities had not suddenly increased. Somewhere there must have been an individual, or individuals, who were desirous of consuming inordinately—whose desire to consume exceeded considerably their contemporary power of production. These individuals borrowed purchasing power from the banker. Again, they would not have been able to raise prices with this purchasing power if the vendors of all ordinary commodities had not accepted the offer of increased power of consumption conveyed in the increased offer of units of purchasing

power by the first borrowers. Finding suddenly an increased demand for their goods, the vendors had the opportunity either of selling out quickly at their former prices and consuming slowly at their old rate, or of increasing prices in order to secure increased power of consumption. The fact that general prices rose, is proof that they chose the latter course—that they suddenly increased their desire to consume. Hence the unit of price, the normal feeling in respect of a specified quantity of gold at a particular time in the past, remained unchanged after the general rise of prices, the cause of the rise of general prices being the general increase of demand for commodities as compared with the supply.

Under the gold price unit system, a general increase of prices is immediately followed by an export of legally-cheapened gold, and the home exchange system is wrecked by the withdrawal of the basis of its credit system; whereas, under the invariable unit system, the sole result of the inflation of prices is that creditors may suffer by the redemption of their debts returning less consuming power to them than they advanced to the borrower. If, however, the community, apprehensive of the possibility of such price fluctuations, were to insert a clause in long-date debt contracts enabling these debts to be liquidated by a greater or lesser quantity of purchasing power according as prices were higher or lower at the time of such liquidation, the harm caused by price fluctuations would be reduced to very small proportions.[1] In due time the borrowers who were responsible for the rise of prices would either produce wealth in proportion to their excessive loans and send prices down again, or their returns would not equal their expectations, in which latter case either the banker

[1] The adjustment of fluctuations of general prices at the period of settlement of debt contracts is the subject of an interesting and useful work by Mr. Jas. C. Smith, entitled *Inter-temporary Values* (London, Kegan Paul, Trench, Trubner & Co., 1906).

would recoup himself out of their security, or he would stand convicted of unsound issues and would be dealt with by the community accordingly (this subject is dealt with in closer detail in the next chapter).

The difference that I wish to emphasize between the two systems is that under the invariable unit system, prices can be affected only by an alteration of the demand and supply relations of commodities themselves, although such alteration may be the result of excessive issue of exchange medium on the part of the banks; whereas, under the gold price unit system, general prices may be affected by the same causes as affect the invariable unit prices, and, in addition, by fluctuations in demand or supply conditions of the one "standard" commodity. Under the unit system, excessive issues by the banks may be checked by closer surveillance of their issues by their customers; whereas it is practically impossible to prevent fluctuations of the "standard" under the gold standard system.

By most economists the disadvantages of the gold standard of value are held to be comprised in the tendency for long-date money contracts to be disturbed by fluctuations in the price of the metal. There is, however, a far graver reason why the commodity gold should be discarded as a permanent value standard. The credit of this country—that upon which commerce depends, and by which alone the wheels of our mills are kept turning —the credit of this country depends at present upon the quantity of gold which lies in the vaults of the Bank of England. We maintain a free gold market, that is, we permit any person who can obtain possession of a five-pound note to exchange it for five sovereigns at the counter of the Bank of England, whereas almost every other civilized country places hindrances in the way of those who would export gold from its banks in times of scarcity of the metal. I have previously described the disadvantages of this institution. The reasons put

forward for the maintenance of a free gold market in England are: (1) that it causes London to be "the financial centre of the world"; (2) that it cannot be abolished without either introducing the silver basis as in France, or bringing embarrassing pressure to bear on the offending parties as in Germany. Statement (1) has been dealt with in a previous chapter. To meet the objection (2) has been the aim of this chapter. If commodities be priced in terms of the invariable unit, the price of gold, measured in these units, may be permitted to fluctuate according to supply and demand conditions, banks being thereby enabled to discourage the demand for gold for purposes of export abroad and to retain precisely the quantity of gold necessary to support public confidence in their credit.

The abolition of the fixed price of gold enables the equitable exchange of goods for goods between nations, and it is on the equitable exchange of *goods* that human welfare depends. The fixed price of gold, on the other hand, offers only a delusive facility to exchange; for, under our present system, with the credit superstructure so tightly bound to its gold basis, the fixed price of gold, although intended as an aid to exchange, actually operates largely as a hindrance. At present the price of gold is fixed only in theory, since, in practice, the price of the *exchange medium*, which is the only gold price that concerns most of us, and in which stability is a vitally necessary quality—the price of the exchange medium varies, not only with every fluctuation in the home demand for credit, but with every alteration in the international demand and supply relations of the metal gold as a basis for credit. So long as gold is retained at its fixed price as standard of value, the exchange medium consisting of notes, etc., made out in terms of gold, the fixed price of gold operates simply as a bounty to foreign manufacturers, enabling them to withdraw the basis of our credit system and check every effort on the part of

our own manufacturers to obtain a more just equivalent for home produced goods. The abolition of the fixed price of gold, therefore, offers a sure form of Protection to a progressive country. The maintenance of the fixed price of gold aids only those financiers who seek to make a profit out of the unfortunate credit fluctuations of the various countries; and, although I am perfectly willing to admit that, under our present system, these men frequently perform a useful function in distributing the gold which we have rendered so necessary to our exchange system, yet the adoption of the invariable unit in place of the gold standard extracts the sting from their services. They will still be able to move gold when the country can afford to let it go; but the abolition of the fixed price of the metal will render the banker a really free agent in that he will thereby be enabled to retain his gold when he sees fit and thus steady exchange relations.[1]

[1] Whilst this chapter is still in MS. (February 1913), Professor Irving Fisher, of Yale University, sends me literature containing his plan to steady prices by means of a "compensated dollar". Briefly outlined, this scheme is one to permit the paper price of gold to fluctuate in a manner somewhat similar to that set forth in this chapter, except that Professor Fisher would regulate the price of gold, not by the supply and demand conditions of the gold market, but by the index number of general commodity prices. This divergence is, however, in my opinion, a serious defect in Professor Fisher's scheme. His method of regulating the price of gold would probably work well if prices were never disturbed by causes other than fluctuations in the supply of gold from the mines; but it is an acknowledged fact of economics that an era of trade prosperity usually causes at least a temporary rise of general prices. In face of such a rise of prices Professor Fisher would lower the price of gold legally and encourage export of the metal. But the demand for gold as a basis for bank credit is at its highest during periods of trade prosperity, and to encourage the export of gold by making the metal cheaper at such a time would be to throttle commercial prosperity even more rapidly than under present conditions when gold is at least always kept at a fixed price. Conversely, general prices may fall by reason of widespread invention of labour-saving machinery, as well as by scarcity of gold; yet, whether the demand for gold had increased or not, the mere fall in general prices would be a sufficient sign for Professor Fisher to offer an increased paper price for gold, and the country might be burdened with a costly store of gold for which it might have no need. But I rejoice that the gold "standard" of value is being criticized by so able an economist as Professor Irving Fisher.

Professor Jevons states:[1]—

> "Some persons have argued that it is well to have a paper money to form a home currency, which cannot be drained away, and will be free from the disturbing influences of foreign trade. But we cannot disconnect home and foreign trade, except by doing away with the latter altogether. If two nations are to trade, the precious metals must form the international medium of exchange by which a balance of indebtedness is paid."

Thus briefly does Professor Jevons dismiss the case against the free gold market. The reply to Jevons is that if gold were drained from England only when she had imported goods required here to a greater amount than those exported, and when she could afford to yield the gold in exchange, there would be little complaint against the free gold market. But the system is not quite so harmless. When the foreign demand for gold increases sufficiently, it pays financiers to "dump" ordinary commodities upon us at excessively cheap rates, merely in order to obtain profit by the abstraction of our legally cheapened gold. The free gold market enables financiers to export the basis of this country's credit system in loans to other countries, whether the home system can afford the drain or not. There is, of course, no reason for prohibiting financiers from investing their savings abroad whenever they see fit; but Great Britain is not a gold-producing country; those who desire to exchange the results of their labour for gold at home should be compelled to pay a price for the metal commensurate with the demand for it at home. When all prices are high here, owing to a sudden period of trade expansion, the foreigner is able to deal an unfair blow at our industry by exporting cheaper goods to us. He would not

[1] *Money and the Mechanism of Exchange* (H. S. King & Co., 1875), p. 237.

be able to do this if the free gold market did not enable him to obtain in exchange an artificially cheapened commodity, namely, gold. So long as gold is required to settle ordinary foreign trade balances, it will be to the interest of certain brokers or goldsmiths to retain a store of the metal, just as stores of the bills which are required to settle foreign debts are now retained by brokers. Should the supply of gold here ever prove insufficient to satisfy the demands of the import trade, it is preferable that importers should offer a higher price for the metal upon the market here, and that prices of imported goods should accordingly rise, than that financiers should be able to dislocate the whole of home industry by withdrawing the basis of home credit to purchase abroad.

The gold standard system appears the more deplorable when we observe that it leads most of the orthodox economists to use reasoning similar to that of Bonar previously quoted, and to affirm that the token used as exchange medium *must* be that which is used simultaneously as the value standard. Now, the price of any commodity may fall in any of three ways: by reason of (1) an alteration in its demand and supply relations, (2) an increase in the price of the article used as a standard (while a commodity standard is used), or (3) a shortage of exchange medium, causing men to offer their goods on the market at reduced prices in the endeavour to obtain the means of liquidating their debts. The latter has been a frequent cause of falls in prices, but our economists, with however the notable exception of the bi-metallist school, have always either overlooked or been unwilling to admit the fact. Sudden falls in price have been attributed to over-trading, to the "swing of the pendulum", to what not; but rarely to deficiency of the exchange medium. Yet it has been noticed that prices were high when "money", i.e., gold, was cheap, and men have accordingly rushed to the conclusion that

merchants adapt their prices to the fluctuations of gold as standard of value, overlooking the fact that prices are being adapted simply to *the offer of units of purchasing power* as expressed in gold—the exchange medium.

The truth of this statement may be proved by a reference to history. Most countries have at some time used an inconvertible paper currency, usually State paper. As regards England, the period of the Bank Restriction Act (1797–1819) immediately rises to the mind. Gold had been drained from the country by Pitt's war expenditure and purchase abroad. The Bank of England supplied home commerce with medium of exchange after the restriction of cash payments as before; and the price of bullion, reckoned in the notes, gradually rose. Few critics have asserted that the Bank's issues were in excess of the needs of commerce; opponents of the Restriction Act have usually confined themselves to insisting that the needs of commerce were not a proper indicator for the issue of paper, pronouncing the doom of commerce by contending that advances should rather have been regulated by the quantity of bullion in the Bank. Here was a time when the dividing line between the home and the export demands for gold was clearly in evidence.

Events during the period of the Bank Restriction Act showed that people were willing to use, in place of gold for purposes of home exchange, any medium which they believed had been prudently issued, i.e., loaned to such persons as would repay the advance in due time; the high price of bullion was noticed and resented only by those who required the metal for profit-seeking export abroad. The evidence before the 1810 Bullion Committee sufficiently proved the fact that in domestic exchange no two prices were demanded for ordinary commodities: the mass of purchasers of ordinary commodities offered only one price for goods, the paper bank-note price: they had no gold to offer. The theory of the

standardization of the bank-note pound instead of the specie pound as a unit of price, was thus brought home to the people by actual experience. I have instanced the evidence of Mr. Chambers. When asked before the Bullion Commission if the fact that the weight of gold indicated on the bank note could not be obtained in exchange for the paper did not prove the depreciation of the paper, he replied that he could not conceive gold to be a fairer standard for Bank of England notes than indigo or broadcloth, implying of course that the value of the paper in relation to indigo and broadcloth was unchanged. The real objection of the Bullion Committee was not that goods were priced in terms of the bank-note pound, but that the use of the bank-note price unit enabled the country to dispense with gold, and that the metal accordingly travelled abroad. The Committee still laboured under the delusion of the Mercantile Theory, according to which the possession of a large quantity of gold is a necessary basis of prosperity in a nation. To retain gold in the country, the Committee was prepared to prevent the due exchange of goods at home by compelling merchants to sacrifice goods at abnormally low prices to holders of gold in order to afford the latter some inducement to refrain from exporting the metal to countries where it would have greater purchasing power. Adam Smith has incontestably demonstrated the fallacy of the Mercantile Theory. It only remains to add that the sole use for gold in a nation's home exchange system is as a means of supplying the lack of mutual trust between the community and its bankers. The use of the invariable unit enables the banks to raise the price of bullion when the foreign demand increases unduly. Customers of the bank—the producers and distributors of ordinary commodities—have, as a rule, no need of gold. So long as they have confidence that their banker is making only sound issues, it matters little to them whether gold can

be obtained at a high or low price in exchange for notes. On the other hand, the use of the invariable unit enables bankers to apply the much needed deterrent to those financiers who would export the supports of the country's credit system in times of high prices at home.

It is interesting to notice how men sought for a theory to explain a practice which experience had proved to work well. In moving the rejection of the recommendation of the Bullion Committee for a return to cash payments, Vansittart denied that Bank of England notes had depreciated in public estimation; he asserted that the paper was still equivalent to the *legal* coin, doubtless meaning, although he did not say so, that the State, in permitting the suspension of cash payments, had legalized the high price of bullion. This remark of Vansittart's, however, gave Canning opportunity for a speech, since become famous, in which he twitted the government with the use of that nebulous standard of value, the "legal coin"—what could a legal coin mean if not a definite weight of bullion? So completely is the science of value misunderstood, even to-day, that such a modern economist as Mr. Sydney Buxton can describe Vansittart as

> "a man with a mind as narrow as a vinegar cruet, because, in face of the evident depreciation of the paper he could solemnly move a resolution declaring that in the public estimation the notes were held as equivalent to gold and accepted as such."

Professor Jevons, also, states:[1]—

> "During the restriction of specie payments in England, gold was bought and sold at a premium varying up to 25 per cent., yet Fox, Vansittart, and other leading men of the times, declared it to be absurd to suppose that paper was depreciated. So

[1] p. 231 of work previously quoted.

unaccountable are the prejudices of men on the subject of currency that it is not well to leave anything to discretionary management."

Ruding, however, who is perhaps the greatest authority on coinage, is of different opinion. Speaking of the Bullion Report, he states :[1]—

"The nature of my work does not require that I should enter into an examination of this Report (which indeed was entirely set aside by the determination of the House of Commons in the following year); but this much I must observe, that the Committee omitted to state what to me is the chief cause of depreciation (for doubtless many subordinate ones exist), namely the legal regulations of the Mint which confine the bullion, after it has been coined into money, to a certain value, but which have no power upon marketable bullion, and therefore leave it to find its price according to the quantity and the demand, as many other commodities are permitted to do without exciting the interference of Parliament.

"As the coin is thus fixed at three pounds seventeen shillings and tenpence halfpenny the ounce, it is rather a matter of wonder that the Committee should be surprised at the ounce in coin not being equal to the ounce in bullion when that happens to be worth four pounds and upwards; and that they should conceive such inequality to be occasioned by a superabundance of paper, when they might have seen that if the coin were freed from the restraints of the Mint regulations, it would instantly become of the same value with standard bullion.

"The Committee assumed that the gold coin is the measure of value, and on this assumption founded the most essential points of the Report. But a measure implies something fixed and unchangeable, which

[1] *Annals of Coinage* (London, Hearne, 1840), vol. ii. p. 106.

the material of coin can never be so long as it is an object of traffic. The truth is that the pound sterling is our actual measure in this kingdom, and that the coin is only an instrument by which that measure is applied. So long as it (the coin) remains, or is supposed to remain, precisely equal to its prototype, so long only is it an accurate substitute for it. Whenever it exceeds or falls below the value of the pound sterling, it equally becomes an incorrect resemblance of it. Thus twelve inches are a certain determinate and unalterable space which may be represented by a foot rule. That instrument, however, being made of materials which are liable to extension and contraction, will never be at all times equal to its original, and consequently must be sometimes an inaccurate measure. These variations are too small to render it insufficient for common purposes; but could they be supposed equal to those which bullion is liable to; could they amount to at least one inch, either in extension or contraction, then the foot rule must, like the coin, be perfectly useless as a measure."

It is to be regretted that Ruding gave no explanation of what he meant by a pound sterling in the foregoing. The reader who has followed the reasoning in the earlier part of this chapter will doubtless grasp the meaning of the phrase; but, to his contemporaries, Ruding's "pound sterling" must have been as nebulous a conception as was Vansittart's "legal coin". Yet, for most people at all events, theory is tiresome, and on Vansittart's arguments, poor as they were, the House rejected the recommendations of the Bullion Committee, fear of a drain of gold by Napoleon being undoubtedly a stronger motive than much argument.

In 1811 Earl Stanhope actually moved a series of resolutions in the House of Lords to abolish gold as a standard of value in favour of the bank note standard-

ized on a particular day and rendered legal tender, the State to fix the maximum of the volume of issues at the beginning of each session of Parliament. Stanhope's arguments were forcible: — Gold was a barbarous medium of exchange, more fit for Hottentots than for a civilized nation. Its use as a basis of credit was even dangerous, for if we had not abolished it by the Restriction Act, Napoleon would have been able to crush our commerce by simply withdrawing our gold. Furthermore, gold was no *standard* of value since its value continually fluctuated. His later speech (April 28th, 1812, Hansard report) proceeds quaintly thus:—

> "The noble lords seem not to know in what a pound sterling consists. He would tell them first what it was not, and then he would tell them what it was. It was not a pound troy, or a pound avoirdupois—these were measures of weight: *a pound sterling was not a measure of weight but of value.* In not attending properly to this distinction lay the greater part of the fallacies of the arguments of the other side. It was impossible for him to say that one of his hands was raised and the other depressed without comparing them to something that was fixed in position" (italics mine).

A large portion of the criticism which followed the moving of Earl Stanhope's resolutions was purely sentimental. Gold was the medium of exchange of our fathers and should be ours. An honest man paid his debts in gold, and the country had a right to demand gold from its banks. The criticism stiffened a little when it proceeded: How could paper measure values? Surely a measure of value must itself have value. And how was it proposed to regulate the issues of the Bank? Stanhope's reply should have been that values would be measured by comparison of *human feelings* in respect of ordinary commodities with the same human feelings in respect

of gold. But his actual replies did not convince the House of Lords, and the matter was dropped.

There is no doubt that Stanhope's proposals were in the main sound. The one point of danger lay in the method adopted for fixing the amount of the Bank's issues. Under Stanhope's system, Parliament was to receive a report from the bank directors at the beginning of each session as to the state of commerce during the last session, and upon this report the issue of a certain quantity of notes was to be authorized. The disadvantage of this system lay in its inelasticity. If the authorized quantity of exchange medium were insufficient, the resulting fall of prices would entail much hardship to commerce; if it were excessive, the Bank would be left with a quantity of purchasing power on its hands with perfect liberty, and indeed Parliamentary authority, to raise prices by introducing it into the channels of exchange, in excessively long-date loans, either to government or to individuals, Stanhope's proposals containing no provision for checking the character of the Bank's advances. The evil of this State-controlled issue could, however, have been minimized, although not overcome, by observation of the average prices of a list of standard commodities, due regard being paid to the disturbing effects of scarcity or invention on the said prices. Be it remarked that these fluctuations of price would not have been due to imperfection of the unit of price measurement, *but to the imperfect method of issue of exchange medium*. This will be discussed more fully in the next chapter. The tabular standard will be a convenient method of detecting general fluctuations of prices so long as industry is subject to sudden periods of prosperity, or bankers to epidemics of excessive credit issue. Whereas, however, the use of the tabular standard with gold prices offers no protection to the home gold reserve of the banks (since so long as gold is maintained at a fixed bank-note price the foreigner can

drain the metal away), the use of bank-note unit prices protects the home credit system, and necessitates the employment of the tabular standard merely as a method for settling long-date debt contracts.

As early as 1767, nine years before the appearance of *The Wealth of Nations*, Sir James Steuart wrote in his *Political Economy* (p. 529):—

> "Money, which I call of accompt, is no more than an arbitrary scale of equal parts, invented for measuring the respective value of things vendible. . . . Money of accompt performs the same office with regard to the value of things that degrees, minutes, seconds, etc., do with regard to angles, or as scales do to geographical maps, or to plans of any kind. In all these inventions there is constantly some denominator taken for the unit. In angles it is the degree, in geography it is the mile or league, in plans the foot, yard or toise, in money the pound, livre, florin, etc.
>
> "The degree has no determinate length, so neither has that part of the scale upon plans which marks the unit, the usefulness of all these inventions being solely confined to the marking of proportions.
>
> "Just so the unit in money can have no invariable determinate proportion to any part of value, that is to say, it cannot be fixed in perpetuity to any particular quantity of gold, silver, or any other commodity whatever. . . . Money, strictly and philosophically speaking, is, as has been said, an ideal scale of equal parts. If it be demanded what ought to be the standard value of one part? I answer by putting another question. What is the standard length of a degree, a minute, a second? It has none; and there is no necessity of its having any other than what, by convention, mankind think fit to give it. But as soon as one part becomes determined in the nature of a scale all the rest follows in proportion. . . . That

money, therefore, which constantly preserves an equal value, which poises itself, as it were, in a just equilibrium between the fluctuating proportion of the value of things, is the only permanent and equal scale by which value can be measured. . . . Money of accompt, therefore, cannot be fixed to any material substance, the value of which may vary with respect to other things."

Mill writes in the very opening paragraphs of his chapter on *Money*:[1]—

"The advantage of having a common language in which values may be expressed, is, even by itself, so important, that some such mode of expressing and computing them would probably be used even if a pound or a shilling did not express any real thing, but a mere unit of calculation. It is said that there are African tribes in which this somewhat artificial contrivance actually prevails. They calculate the value of things in a sort of money of account, called macutes. They say, one thing is worth ten macutes, another fifteen, another twenty.[2] There is no real thing called a macute: it is a conventional unit, for the more convenient comparison of things with one another."

Had Mill pursued this thought it had led him directly to the discovery of the invariable unit. The macute is an invariable unit, being no commodity whatever. Whether we build up our scale of prices by calling the price of the standard commodity 1 bank-note pound, unit, macute, feeling, or spasm, the result is the same: the unit of price, being a simple unit of feeling, remains absolutely invariable. This, however, was a mere fleeting thought on the part of Mill. He proceeds immediately to the discussion of the best commodity to be chosen as a *permanent* "standard" of value.

[1] *Political Economy*, Book III. ch. vii. I.
[2] Montesquieu, *Esprit des lois*, liv. XXII. ch. 8.

Professor Sidgwick strikes very close to the truth when he remarks:[1]—

> "Some economists have confusedly spoken as if the problem was to find a concrete identical standard, some actual thing that did not vary in value. But the difficulty lies much deeper. For our present purpose it would not matter how much gold, or any other concrete standard, varied in value, if we had the power of accurately measuring its variations; since this power would give us an ideal invariable standard, which is all that we require for the exact measurement of wealth."

Again, however, this is only a tentative thought on the part of Professor Sidgwick; he adds immediately that such a unit has not yet been found, and that the closest approximation is a *commodity* which shall vary in worth as little as possible. I trust to have proved that it is quite possible to measure the variations of the standard commodity by means of the invariable unit previously described.

Among the earliest to draw attention to the fundamental evil of the gold standard, namely, the bounty on imported goods afforded by the fixed price of gold, in times of high prices at home, was the banker, James Taylor of Bakewell, previously referred to, an energetic propagandist who wrote in the beginning of last century (in 1828). He proposed that when the price of goods at home rose, the Bank of England should raise the bank-note price of gold, that is, should demand more bank notes for a given quantity of gold. Of course the question immediately arose: "What is to become of general prices if we permit the price of gold to fluctuate?" Taylor replied that commodity prices would be measured in bank-note pounds. The paper bank note, standardized at the time of the fluctuation of the price of gold,

[1] *Political Economy* (London, Macmillan, 1883), footnote to p. 71.

was to become the unit of price. The proposal was, however, beyond the economic science of those days, and the matter was dropped.

The much abused Assignats of France are a second notable example of the practical abolition of the gold standard of value. The French Assignats were issued partly, doubtless, in order to supply the government with funds; but there is little doubt that their issue was also rendered necessary by the drain of gold exchange medium from the country by the *émigrés* and war expenditure, the paper being required to effect the ordinary home exchanges of the country. Yet, when the Assignats were already circulating at a considerable discount compared with gold, and were being cited in England as an example of the depravity of governments in "foisting a paper currency upon the people", Mirabeau could say in the French Chamber[1] that an Assignat of 200 livres would purchase at that date the same amount of goods as would 200 livres of gold before the issue of Assignats. It is important to notice that although the notes were at a discount in relation to gold they were freely accepted by the ordinary people; just as our own "depreciated" notes were accepted in England during the period of the Bank Restriction Act. The French people did not need gold but merely a token which would be accepted at the price indicated thereon in the market-place. When the metal currency became scarce, and gold dear, men continued to measure prices in undepreciated notes, since these became the vehicle of expression of the public demand for goods. The price of gold reckoned in these notes certainly rose, that is, a note would not exchange for its expressed worth in gold; but this was due to the increase in the price of gold, not to depreciation of the note, as was proved by the fact that the notes continued to exchange for the same quantity of ordinary commodities as was custom-

[1] *Record of Proceedings in the Chamber*, 1790.

ary before their depreciation relatively to gold. The notes themselves depreciated *in worth* and caused prices of commodities to be artificially enhanced only when the quantity issued began to exceed all reason, and when public confidence that the paper represented its face worth, i.e. could be exchanged for the same quantity of goods as was given for it, began to be shaken. This depreciation was quite unconnected with the movements of gold, and depended simply upon the quantity of notes issued and upon public faith in the issuers; for, let it be noted that the Assignats were not issued as a true credit medium should be, namely, in advances to capable producers, but were issued to pay government debts, thus necessitating no balancing production of commodities and retirement of the paper. No depreciation of paper occurred, however, while men's faith in the stability of the government remained unimpaired, while the government did not abuse its privilege of issue, and was willing to accept its paper back in payment of taxes. The important fact for the science of value in the above example lies in the circumstance that up to the time of the real depreciation of the Assignats, the paper franc—an abstraction, since it was at par value with no metal franc—functioned perfectly as the unit of price.

Further evidence of the use of standardized paper as a price unit might be quoted from the history of the United States during the period of the Civil War and restriction of cash payments; also from Russia, where gold has frequently been scarce and dear in comparison with the government paper, exchange within the country being nevertheless conducted by means of rouble notes which were practically inconvertible. It is also noteworthy that in the Caucasus travellers frequently experience similar treatment to that met with in the old days in Scotland, goods being dearer when payment is offered in gold than when notes are tendered. The notes are familiar—the gold is strange.

The introduction of the invariable unit system would involve but little change in present institutions. The practical application of the system will be detailed more closely in the next chapter. The abolition of the fixed price of gold and the consequent removal of the danger of unforeseen drains of gold abroad would considerably strengthen our present deposit banks and enable them to issue credit on a much wider range of security than is the case to-day. The maintenance of the prohibition of small notes, however, with the consequent compulsion to use gold in domestic exchange, would cause considerable distress whenever an increased wages fund was required by commerce, especially if foreign nations also protected their gold in a similar manner. Moreover, as I have previously remarked, the prohibition of small note issue prevents due competition between bankers by obstructing the avenue to the establishment of new banks. Hence some more radical reform of our present system than the mere abolition of the gold standard of value is required for the establishment of a rational credit system. The use of gold coins in home exchange would also involve difficulty. Commerce would be exposed to the possibility of fluctuations of the market value of the sovereign around the bank-note pound point according to the market price of bullion. Obviously it would be inconvenient to use in exchange a token of varying purchasing power. In the absence of liberty of note issue on the part of private banks, this difficulty would be best overcome by the issue of pound and ten shilling notes by the Bank of England as a substitute for gold on the day the new system came into operation, the gold thus economized to be used to strengthen the Bank of England gold reserves.

Let me hasten to add that this is no revolutionary proposal.[1] Lord Goschen is among the economists who

[1] We have, of course, since had a limited issue of £1 and 10s. Treasury notes.—H. M., July 1917.

have advocated the issue of £1 notes with a view to rendering the quantity of gold now circulating as small change in the pockets of the community, and a large portion of that held in bank tills, available for banking reserves. The prominent bankers opposed Lord Goschen's suggestion, contending that such an issue of paper would inevitably drive gold out of the country. Lord Goschen replied that gold would not leave the country unless money were made cheaper, and that according to his proposal the Bank of England was to allow the gold economized by the issue of paper to accumulate in its vaults without reducing the bank rate, in order that its reserves might be strengthened. I have never seen an effective reply to this statement. Yet, in the report of the United States Monetary Commission of 1910 we find that the Commission was solemnly informed by the Governor of the Bank of England that the objection to the circulation of £1 notes is based on the opinion that such notes would take the place of gold in the pockets of the people and tend indirectly to drive gold out of the country! Lord Swaythling, the prominent banker, however, declared himself to the Commission as being in favour of the issue of £1 notes, and the protest against the prohibition of small notes is decidedly growing. Hence, with a considerable backing of comparatively orthodox economic authority, I would propose that, if the government be unable to see its way clear to grant freedom of note issue to commerce, the change to the invariable price unit be accompanied by an issue of notes to displace the gold coins now in circulation, the gold to be accumulated in the manner proposed by Lord Goschen. The notes, being thus separated from gold, would be unaffected by any subsequent fluctuations in the price of specie, and the abolition of the fixed price of bullion would protect the Bank reserves even more effectually than Lord Goschen's measures.

In this chapter I have referred to the propaganda of bimetallists in drawing attention to the harm caused to commerce by the legal restriction of exchange to the use of gold as sole legal tender. The bimetallists saw that if silver were equally rendered legal tender, an export of gold could be counterbalanced by an import of silver, and home exchange proceed within certain limits, as usual. Fluctuations in supply of the two metals rarely occur simultaneously. The Gold Standard Defence League, however, protested that in some countries silver was very cheap and that to permit debts to be paid in that metal would be to swamp this country with silver; prices would rise and the creditor class be defrauded of its just dues. Great Britain was a creditor and a rich gold-owning country, her debtors were frequently rich silver-owning countries who, however, were compelled to pay their debts in gold. British financiers were not slow to notice the advantage which this gave them in the markets of the world, and the powerful Gold Standard Defence League was the result. Bimetallists pointed to the low prices and congestion of industry at home as indicative of scarcity of exchange medium, and urged that the evil was sufficiently serious to call for an international commission to settle the conditions upon which silver might be admitted as legal tender. A $15\frac{1}{2}$ to 1 relation between silver and gold would, it was judged, obviate the possibility of any nation profiting unduly by the introduction of bimetallism. The last International Monetary Conference was held in Paris in 1881, and, while France, the United States, Italy, Austria, the Netherlands, and India were in favour of concerted action to make silver legal tender money, the rest of the Powers, including Great Britain, stood out against the proposed agreement, insinuating that the decision of the conference was influenced by debtors' desires to serve their own interests. Mr. Moreton Frewen writes that Senator William Evarts, of the

United States Commission, thereupon said to the representatives of Great Britain: "Very well, gentlemen, you will soon learn that this is not Uncle Sam's funeral", and I would add that although the British gold-owning classes had secured their pound of flesh from their debtors, in the dark days that followed, when, as Giffen states, financial stringency occurred every year, our producing classes harvested the bitter fruit of their legislators' obstinacy.

My sympathy with the efforts of bimetallists to enlarge the basis of credit must be evident from the preceding chapters of this work. It is to be regretted, however, that the bimetallists did not see that the path of progress in exchange expedients lay from metal to paper, not merely from metal to metal. Let the demands of home commerce be supplied by *paper credit* issue according to the proposals in the following chapter of this work, and the gold basis of that credit protected, not by a wall of silver, but by the abolition of the fixed price of gold and the introduction of the invariable unit. Thus will stability in exchange be attained without prejudice to the claims of creditors.

I cannot close this chapter without acknowledging a debt to Mr. Arthur Kitson's work *The Money Problem* (Grant Richards, London, 1903). A comparison of Mr. Kitson's treatment of the theory of value with my own, will reveal differences in our respective points of view; and our proposals for reform of the banking system are different; but I have found his work stimulating and helpful.

CHAPTER XIII

REFORM

THERE has existed in France for some time, and latterly in Belgium, Switzerland, Germany, and Austria, a system of banking which English economists have called the *banquier* system. Messrs. Hake and Wesslau give an admirable account of it in their work *Free Trade in Capital*.[1] The *banquier* system is a form of the bill of exchange system; but is extended to quite small manufacturers. The manufacturer in Lyons, for instance, who has sold goods to Toulouse, draws a draft on his customer and takes it to his banker, who discounts it for him at a small charge. The banker then forwards the draft to a Toulouse bank, which credits him with the amount. The Toulouse banker returns drafts drawn on Lyons and the neighbourhood which have collected in his hands; these the Lyons banker presents for payment at maturity, and thus supplies himself with cash which he holds at the disposal of his customers. There are thousands of such *banquiers* in the country, and the system is spread like a network over the land. This is another example of the great process of bringing into commerce the present worth of a future profit. Previously, a manufacturer had to limit his business to the small amount of capital he actually possessed or could borrow from someone against mortgages or other securities; his purchases of raw material were therefore necessarily small, and generally from some middleman at a high price. When he had manufactured goods up to the extent of his means, he had to restrict his production until his goods were sold and paid for; and as he

[1] London, Remington, 1890.

generally wanted cash quickly, he had to sell to another middleman, often at a low price. By the aid of the *banquier*, however, the manufacturer can now buy in bulk, on the best terms, and in the best markets—independently of the middleman—for the *banquier* will at once discount the seller's draft upon him. He can manufacture largely, because, as soon as his goods are out of the works, he can draw drafts upon his customers, and against these drafts his *banquier* renews his capital at once.

As is remarked of the *banquier* system in *Free Trade in Capital*:—

> "Commercial men will readily appreciate the advantages derived from this system. In all business there are large expenses which remain the same whether the turn-over be large or small; such expenses as rent, interest on machinery, living expenses, clerks, foremen, models, patterns, travellers, advertising, experiments, dies, etc. There are small factories where these expenses amount to as much as raw material and wages; and in many businesses these are the chief expenses, while raw material and wages are insignificant. If a man have 70 per cent. such expenses and a small turn-over, and can, by better financing, produce ten times more, his goods cost him 63 per cent. less."

This illustrates the great advantage which the bill of exchange system gives to our large manufacturers, and further accounts for the unfair crushing out of the smaller man.

The keystone of the French *banquier* system is confidence—confidence between the manufacturer and his banker, and confidence again between the banks. The English critic will immediately point out the danger of a manufacturer defrauding his banker by discounting bills of fictitious sales; yet, in practice, the French manufacturer will go to almost any sacrifice to meet his

own bill when he happens to have sold to a bad customer, rather than weaken the banker's confidence in him. English tradition is an obstacle to the extensive use of the system here. The majority of English firms seem to think that the acceptance of a three months' bill conveys an unfavourable impression of them to the banks, although many of the same firms have no hesitation in asking three months' credit of the house which sells to them. It should, however, be remarked that it is principally the abolition of the free gold market in France which *permits* that confidence between banks necessary for the free working of the *banquier* system. There is much less danger of credit stringency in France than in England, since the Banque de France reserves the right to pay its notes in silver should it prefer to do so. Hence the *banquier* can work with a smaller cash reserve than can the English banker, and the stability of the money market enables him to perfect his connections with these smaller customers. In other respects, however, as has previously been pointed out, the French system has all the vices of our own.

An interesting example of the power of mutual confidence in enabling the development of credit is shown in the working of the Raiffeisen banks in Germany, in the modifications of the system in the Banche Popolari in Italy, and in the Banques Populaires of Belgium. The Raiffeisen banks are purely co-operative undertakings. A number of prominent philanthropically disposed men of a certain locality meet, and invite working men to take up shares for the formation of a bank. Only those men who are known to be of upright character are permitted to join, and the aim of the scheme is to keep the number of members of each bank low, in order to afford as perfect mutual supervision as possible. The names of the prominent men and the generally safe reputation of the members of the association attract deposits from outside, and the bank begins to make long-date loans

of one, two, or even five and ten years to its members, at a rate of 4, 6, or 8 per cent. The members meet in committee, and supervise all loans made by the bank. I would recommend Mr. H. W. Wolff's book on *People's Banks* for the proof it affords of the extent to which mutual guarantees of credit in these banks can be developed. The criticism of the principle of co-operation, however, which I have inserted in the latter part of this chapter, applies equally to the continental co-operative banks. Moreover, Mr. Wolff shows no understanding of the fundamental evolutionary principle of credit, namely, the development from a commodity to a paper exchange medium, and of the desirability of a reform of banking along the lines of greater freedom for individuals to provide a substitute for gold in the channels of exchange in whatever manner they find most convenient. The co-operative banks borrow gold and lend gold, their advances being limited to a severely proportionate relation to their specie deposits. Mr. Wolff also omits to remark that it is undoubtedly the abolition of the free gold market in continental countries which permits such long-date loans to be confidently made by the co-operative banks.

An interesting feature of the aids to mutual confidence in these banks is their publication of a detailed balance sheet. Many years ago Mr. A. J. Wilson raised considerable newspaper correspondence on the subject of the inadequacy of bank balance sheets. At present we are usually quite unable to ascertain from the perusal of a bank balance sheet what proportion of its loans is made upon any one of the various classes of security. A bank's advances may be made upon the riskiest of security, whilst its depositors remain in entire ignorance of the matter. The bankers protested against Mr. Wilson's proposals for greater publicity, saying that to publish details of their advances would ruin them. This objection will be dealt with later on.

It is an ominous sign of the temper of the age that in his book on *Banking Reform* Mr. Wilson, although not socialistically disposed, looks for reform in the direction of compulsory bank balance sheets, governmental inspection of accounts, and what not coercive measures, but never once takes the simple course of advising the depositors themselves to insist upon the publication of adequate statements. To such an extent is reform at the present day divorced from sound principles of political economy.

Sir R. H. Inglis Palgrave, an acknowledged authority on banking, writes:[1]—

> "It is Scotland that has, relatively to population, the greatest number of banking offices, and the greatest number of deposits. It is Scotland that gives greatest publicity to details. It is, hence, clear that publicity is a help and not a hindrance to banking business. It is much to be regretted that Sir Robert Peel did not in 1844 prescribe a uniform plan of balance sheet for the joint stock banks of the United Kingdom, and require a uniform publication of accounts. Sir Robert Peel's reason was that no form could be devised which the fraudulent might not evade. This is true; still, a carefully considered and well drawn form could but be of service, and, when uniformly adopted, would show what banks were, or were not, attending to the leading principles on which banking business should be conducted."

Again the appeal to the arm of the law to enforce what it is to the interest of both bankers and their customers to do! I would, however, ask that the distinction between the Scottish and English banks' publication of balance sheets be duly noted here; I must have already made it clear that it is in this direction that I look for the introduction of substitutes for the inelastic and unwieldy

[1] *Notes on Banking*, p. 120.

1844 Act. This principle will be the keynote of the proposals which now follow.[1]

The manner of reform which will be introduced in England will depend upon the direction in which public opinion shows itself most capable of assimilating new ideas. In the last chapter of *Lombard Street*, Bagehot states:—

> "I know it will be said that in this work I have pointed out a deep malady, and only suggested a superficial remedy. I have tediously insisted that the natural system of banking is that of many banks keeping their own cash reserve, with the penalty of failure before them if they neglect it. I have shown that our system is that of a single bank keeping the whole reserve under no effectual penalty of failure. And yet I propose to retain that system, and only attempt to mend and palliate it.
>
> "I can only reply that I propose to retain this system because I am quite sure that it is of no manner of use proposing to alter it. A system of credit which has slowly grown up as years went on, which has suited itself to the course of business, which has forced itself on the habits of men, will not be altered because theorists disapprove of it, or because books are written against it. You might as well, or better, try to alter the English monarchy and substitute a Republic, as to alter the present constitution of the English money market, founded on the Bank of England, and substitute for it a system in which each bank shall keep its own reserve. There is no force to be found adequate to so vast a reconstruction, and so vast a destruction, and therefore it is useless proposing them."

[1] It is noteworthy that the 1931 Macmillan Report recommended the publication of fuller details by clearing banks. They of course recommended a compulsory legal form of bank statement—again the bureaucratic instead of the educational method.—H. M., March 1934.

But Bagehot wrote in 1873, before socialism had become the force in English politics which it is to-day. The demand for reform was not nearly so strong in 1873 as it is to-day. In socialism we are threatened with a movement which, if successful, will mean the triumph of mediocrity (I may make this assertion without thereby committing myself to the frequently assumed corollary that the present system invariably brings the most capable man to the front). I am convinced, however, that the majority of present economists of the country would support this criticism of socialism—they fear the onward march of socialism precisely for this reason. There is no doubt that the dangerous increase of socialist opinion has induced a large number of sincerely benevolent people in this country to search more determinedly for a reform of present social miseries along the lines of increased personal liberty. This encourages me to do the thing which Bagehot dared not attempt, namely, propose a reform of the British monetary system.

The review of the history of banking in this country set forth in the earlier chapters of this book showed that the efforts of banks towards reform have invariably been in two main directions: (1) the invention of methods to protect the bank's gold store in times of strong foreign demand; (2) the economizing of gold in the channels of circulation by the issue of paper substitutes. It has, I think, been sufficiently proved that the State prohibition, firstly, of the option-clause note, and secondly of the ordinary note itself, stopped both these movements. Hence we are to-day in the position that no nation dare allow the price of credit to suffer any real reduction, because, having prohibited the free increase of effective substitutes for gold coin, it would then be faced with the alternative of either seeing its gold drained away to the less progressive nations, or of suddenly raising its discount rate and bringing matters back to their original

condition. France is the one nation which has at least frankly abolished the free gold market and which, in times of strong gold demand, firmly offers silver in place of gold to those who bring notes for conversion in any quantities. Yet, during the 1907 crisis the demand from New York for gold was so strong that it already became profitable to collect gold from large stores and railway companies in Paris for purposes of export. The mere economizing of gold by a paper circulation, the gold being allowed to accumulate in the banks without giving rise to more liberal credit advances, would be of little advantage to commerce however much it might strengthen the central reserve in preparation for times of stress.

But cheap credit enables cheap production, and it might be contended, as do Messrs. Hake and Wesslau in *Free Trade in Capital*,[1] that the trade activity and consequent increased export of goods under a system of free banking would cause gold to return. But although cheap money increases prosperity, goods will rarely be freely exported from a low to a high discount country while the free gold market exists: the tyrant Gold stands between, and, with the power obtained from the fixed price which we legally accord it, confuses all the simple rules of political economy. International exchange under our present system is regulated to a great extent by the relative prices of credit or gold. In the different capitals of the world are groups of merchants watching the various national discount rates. The fall in the price of money must precede the period of prosperity by some considerable space of time. But a fall in the price of money of sufficient magnitude to induce prosperity in any one country is instantly followed by an export of goods thither, firstly to obtain the legally cheapened gold, and secondly to obtain profit from the sale of

[1] They propose a system of free banking, making, however, no criticism upon the free gold market, nor advocating option-clause notes.

cheap goods in a dear market: a low discount rate causes high prices before it causes increased production of goods, purchase necessarily preceding production. Hence, although our trade and production are stimulated by a low discount rate here, we do not reap the full benefit, since the foreigner exports goods to us as long as he can obtain cheap gold here. As the number of bills seeking discount in London increases, there grows the demand on the Bank of England for gold. When this demand reaches a certain point the Bank directors consider it their duty to protect their gold store by raising the bank rate until the demand for gold and credit is discouraged. The decrease in the demand for gold will occur only when the discount rate here has reached the level of the exporting countries; such an increase in the discount rate effectually stops the budding prosperity at home, and leaves us in as bad a plight as before.

That indefatigable bimetallist, Mr. Moreton Frewen, criticizes the Hake-Wesslau school thus:[1]—

> "Some authorities consider that issues of legal tender paper in the form of one pound notes not represented by Gold or Silver in reserve would avail to remedy the contraction of the legal tender currency. But such a makeshift as this I believe would be wholly mischievous. Pound notes *representing Gold in reserve*, while exercising no influence whatever on prices, would form a convenient form of currency, and would save the sovereigns they represent from loss of weight by friction, that is all: but beyond this an issue of ten millions of pound notes, *not* represented by Gold in reserve, would serve merely to slightly expand the currency at home, and would therefore raise prices in *Great Britain alone*. And the effect of such a rise of prices in a Free Trade country is immediately to increase the volume of the imports of

[1] *The Economic Crisis* (London, Kegan Paul, 1888), p. 86.

that country, without any corresponding increase in exports. These augmented imports would require to be paid for, not in pound notes, but in Gold; the effect therefore of the issue of ten millions of unsecured paper money would be to drive out of England an equivalent number of sovereigns, so that instead of stopping our present drain of Gold, the proposed issue of pound notes would accelerate that result" (italics Mr. Frewen's).

With certain qualifications respecting this theory of the cause of the rise in prices under such conditions—qualifications which will be made later on—I think this statement is incontrovertible. Hence I am of opinion that it would be of little use to grant increased facilities for note issue, before protecting the banks' gold store against depletion. The early Scottish bankers evolved the option-clause note for this purpose, but, even if liberty of issue of such notes were restored to the bankers, in the present state of public unfamiliarity with the use of paper money it might be some considerable time before the option-clause note system obtained sufficient vogue to constitute an adequate defence of the country's gold, and the interval would be a dangerous time for the banks' reserves.

The best scheme for present finance politics would undoubtedly be the abolition of the gold standard of value by the introduction of the invariable unit. In comparison with the advantages it offers, this reform would involve the least change in public habits. It provides at one stroke the advantages for which early Scottish banks struggled for many years with their option-clause notes. Adam Smith remarks[1] that the directors of the Scottish banks issuing option-clause notes

"sometimes took advantage of the option clause [and

[1] *Wealth of Nations*, Book II. ch. ii.

> postponed payment], and sometimes threatened those who demanded gold and silver in exchange for a considerable number of their notes, that they would take advantage of it, unless such demanders would content themselves with a part of what they demanded."

This circumstance indicates the path of transition from the gold standard of value to the use of the bank-note standard. When, under the invariable unit system (the bank-note standard), the demand for gold increases, and bankers can redeem their notes only in a diminished quantity of gold, they are doing exactly the same as the early banker who offered the reduced present value of a note which was redeemable in gold only after the expiration of six months. The option-clause note was accepted at par by all ordinary producers who had no need of gold, and afforded an excellent means of expressing values. The one disadvantage of the system lay in the promised redemption of the note in a fixed *weight* instead of a fixed *worth* of gold. The bank-note standard avoids this difficulty by promising redemption in gold at the current worth of the note only. Upon the introduction of the bank-note standard, credit could be cheapened, prosperity could bring along its increased prices, and as soon as the tendency towards a drain of gold for payment of cheap imports showed itself, the banks could raise the price of gold and effectually protect the basis of the home credit superstructure. All the present denominations of coins could be retained, the public could still reckon its purchases in pounds, shillings, and pence, the only difference being that gold coins would be gradually withdrawn from circulation, their place being taken by pound and ten-shilling notes, and that the pound note would no longer indicate a certain weight, but a certain *worth* of gold at the market price of the metal, whatever that price might be.

Ordinary people, who with difficulty accustom themselves to change, would scarcely notice the introduction of the new unit. History shows that the demand for gold on the part of the ordinary public is very small, as long as tokens are obtainable which will circulate in domestic exchange. In practically every civilized country an equivalent to the pound note is circulated at the present day, although, of course, the issue is usually severely restricted. I do not anticipate the least difficulty in introducing the new system if, for instance, the Bank of England will begin by issuing a quantity of pound and half-sovereign notes as a substitute for the present circulation of gold. The class which has deposits in banks is usually of sufficient intellectual calibre to appreciate the practical advantages of the new system, and to submit to the small inconvenience of the change. Most depositors would simply sell their gold to the banker on the day of the change, receiving in its place an equivalent quantity of Bank of England or private paper which would be deposited with the banker as before. Any further demands for gold on their part would be satisfied by the banker at the market price of the metal. When he judged that his gold store was becoming dangerously low, he would either replenish it from the bullion dealers, or, if this were found to be impossible owing to strong demand, he would raise the price still further. Any bank which should raise its bank-note price for gold above the market rate would be dealt with according as its clients believed its high gold price to be justified by probable future events, or to indicate an unwisely low gold store. Lack of public confidence in a bank to-day results in a run of depositors to withdraw gold. The last-comers lose their deposits except when the winding-up of the bank yields a certain amount to creditors. A discredited bank would be bankrupted in a similar manner by the withdrawal of Bank of England notes or gold by its

creditors after the establishment of the invariable unit system.

It is most probable that the banks will prefer to purchase their depositors' gold with Bank of England, or perhaps their own, paper after the introduction of the invariable unit, rather than guarantee to return a certain weight of specie when required, irrespective of the market price. The latter course would expose their gold stores to depletion by depositors when the demand for gold became great. By purchasing the gold outright with promises to return an equivalent *worth* of gold on demand they would of course take upon themselves the risk of fluctuation in the price of bullion. But seeing that the new arrangement would enable them to dispense with a considerable part of their gold reserves, they would be compensated for the risk incurred. If the gold standard were simultaneously abolished in other countries, and paper similarly substituted for gold coins, there would probably result a temporary fall in the price of the metal. But if, as is indeed desirable, the change were shortly followed by the conferment of freedom of note issue upon banks, the growth of competition among fresh banking companies, each requiring gold reserves, would tend to restore the value of gold. The apportionment of the risk of fluctuation in the value of gold will, however, depend upon expert calculation, and can well be left until the change comes within the range of practical politics.

The dangers of the abolition of the free gold market will now be examined. The free gold market is to-day defended partly because it is said to render London the financial centre of the world, and partly because it affords an automatic check upon general inflation of credit by our banks. I have previously dealt with the first of these contentions. With regard to the second, there is no doubt that the benefits are too dearly purchased. The action of the free gold market, let it be

admitted, is automatic; but it is quite indiscriminating: it comes into operation immediately upon the appearance of any demand for gold here, regardless of the cause or extent of the demand. The legally cheapened gold is abstracted from our banks, which action causes a rise in the bank rate here, and all industry is checked. This method arrests the operations of prudent and imprudent banks alike; it bankrupts prudent and imprudent industrial concerns; and the ever-present danger of its unforeseen occurrence compels banks continually to charge more for loans than would otherwise be necessary, and to refrain from making long-date loans except upon gilt-edged security. The demand for gold may ordinarily have two causes: (1) the financing of foreign industry, or an unduly large purchase of foreign goods; (2) a rise of prices at home, and consequent import of cheaper foreign goods. We have seen that the protection of our gold against (1) is an unmixed blessing whenever that demand threatens to endanger the supports of our home credit. As regards (2), a rise of home prices may spring ordinarily from three causes: (1) failure of production (harvests, etc.) at home, (2) a burst of industrial activity here, involving a sudden extension of long-date loans, and (3) inflation of home credit by our banks. The abolition of the fixed price of gold would, in all these cases, stop the outflow of the metal. Its action in remedying high prices would be slower than is the case under the present system; but it would leave the nation time to deal with the various causes on their own merits. High prices here would of course slacken our export and stimulate our import trade in ordinary commodities. Gradually the foreign exchanges would move against us. Under the gold standard such a position would cause an outflow of gold, and the bank rate screw would be tightened until our prices fell again. The stoppage of gold exports, however, would allow the movement to correct itself.

The difficulty of obtaining the means of paying for foreign goods would slacken the excessive foreign import, and normal foreign trade would proceed as usual, since foreign money would be worth more here. But high prices here would encourage production and stimulate those producers that began operations before the rise, helping them to cancel their debts to the banks. The nation would be forced to develop its own resources; and since high prices, whatever their cause, indicate an excess of consumption over production of goods, development of home industry is the fitting remedy. For to import cheap foreign goods on such occasions in exchange for the gold which is our chief tool of production at home—thus increasing consumption still further and actually crippling our power of production—this way makes straight for ruin. If the cause of high prices were failure of production here, time would enable sufficient accumulation of goods to permit import of foreign products to supply the deficiency of those lacking at home; exchange of goods against goods—not exchange of the means of production against goods—being the prudent course alike for the nation and the individual. If home production were unable to recover itself, emigration would doubtless set in. If the cause of the high prices were a burst of industrial activity here, protection of the home credit system would enable those borrowers that by their operations had caused the rise of prices, to produce their goods, market them, and repay their loans. The simultaneous retirement of purchasing power and production of goods would cause prices to drop again, and the community would benefit by the addition to its industry.

If, however, the cause of high prices were unwise issues on the part of the banks, time would show that particular borrowers were unable to produce their expected profit. If an adequate check upon bank balance

sheets were maintained, this circumstance alone should suffice to cast discredit upon the banks that had fostered this unwise speculation, and lead to their speedy elimination. The bankers themselves who have to receive the paper of other banks can be trusted to keep a pretty close watch upon the operations of their fellow bankers. But, even should the offending bankers be able to conceal the evidences of their indiscretion, time would expose them. Their debtors would be unable to return sufficient sums to them to balance the paper instruments returned upon the bankers through the Clearing House. Hence, either the bankers' stocks of gold would be gradually reduced, or they would be compelled to raise their paper price for gold above the market one, thus in either case revealing their weakness. If they were unable to retrieve their positions, they would be forced into bankruptcy. The suffering would thus be confined more strictly to the unwise bankers and their supporters than is the case under the present system. The one disadvantage of the proposed system is that the nation would be exposed for a longer period than is the case at present to the action of high prices. This would tend to harm both the creditor classes, who would suffer in redemption of loans, and the wage-earning classes. The harm to the former, however, would be minimized by the adjustment of debt contracts in the manner suggested in the previous chapter (p. 259); and the increased demand for labour set up by the more stable credit system would enable wage-earners to demand and secure higher wages in times of high prices.

Both Liberals and Conservatives have at length noticed that the recent institution of legal power to acquire small holdings of land is practically useless in the absence of a provision of cheap capital, and we accordingly find frequent proposals for State aid in the establishment of banks to make long-date loans to

agriculture, it being recognized that present banks are unable to-day to make such loans with due safety. It is much to be regretted, however, that before State compulsion and taxation were invoked, it was not seen that it is precisely the legal exposure of existing banks to the danger of unforeseen drains of gold which is chiefly instrumental in preventing them from making long-date loans. It is still more to be regretted that it has not been perceived by these Land Bank enthusiasts that a cheap long-date loan is also an urgent need of the masses of smaller manufacturers and tradesmen, whom State restrictions on banking have at present placed at an unfair disadvantage as compared with their richer competitors. It has been justly said that the greatest struggle for the modern employer is to earn his first thousand pounds or so. Afterwards his profits roll in with very much less effort on his part. If we remove the danger which now prevents bankers from making cheap long-date loans, we will render the path to the first thousand as easy for the capable man as the acquirement of subsequent thousands. Or rather, the provision of capital to enable the man of ability to employ his talents, will ensure such competition in the higher ranks of industry as will render the rapid multiplication of huge fortunes a much more difficult process than is the case to-day, while, at the same time, it will materially assist the attainment of moderate fortunes. There will thus be introduced precisely that sanity which is needed in our present system, where the distribution of wealth seems inevitably to tend to the two extremes of wealth and poverty. The prospect of such an amelioration of present social conditions should surely be a sufficient inducement for us to make the change in our financial institutions required for the abolition of the gold standard of value.

The present wave of socialistic thought may have awakened the community to a more vivid appreciation

of the value of liberty, and, in the hope that the arguments will not fall on entirely deaf ears, I will now proceed to examine the advantages and dangers of freedom of note issue. Sir R. H. Inglis Palgrave writes:[1]—

> "I have always regretted that Sir Robert Peel did not employ the country's note circulation, as he might have done, as a link to unite the country's banks together. Had Sir Robert Peel, instead of aiming, as he did throughout, to extinguish the country note circulation, endeavoured to strengthen it; had he facilitated, instead of hindering, the transfer of the right of issue from one country bank to another; had he given greater freedom to this form of association, we should, I believe, before this time, have seen a simple but sufficient number of powerful banking institutions arise, formed in the best manner that such institutions can be formed, by the union of existing but separate banks into one well-compacted body."

Apart from the benefits of flexibility in the supply of medium for domestic exchange, the case for freedom of note issue depends chiefly upon the facility it affords for promoting competition in the ranks of bankers. This was illustrated in the passage quoted from Bagehot's *Lombard Street* on p. 190. It was there pointed out that the establishment of a deposit bank requires a considerably greater accumulation of capital than does an issue bank with a small note circulation. Indeed, Sir Robert Peel supported the 1844 Act by pointing out that freedom of banking enabled the establishment of small new banks and was therefore bad! But until the profession of banking is open from the smallest beginnings we shall never be sure that the service is being performed as cheaply and as efficiently as it might be. Until we permit freedom of competition in banking

[1] p. 120 of work previously quoted.

we shall never be sure that all forms of productive ability are receiving capital as freely as they might.[1]

The dangers attending freedom of banking are those which have been predicted of every extension of freedom in the past, namely, error and fraud. The general arguments for freedom as opposed to "protective" legislation have been unceasingly insisted upon throughout this book, and I shall not return to the subject here. It remains to consider the special dangers connected with freedom of banking.

During the discussions preceding the Act of 1844, the restrictionists continually maintained that, the urgent demands of commerce notwithstanding, it was the duty of banks to restrict their issues when gold began to flow abroad. Hence, any issue of credit which enabled this efflux of gold to proceed was an "over-issue". In those days the economists were aware of the method of preventing the outflow of bullion by permitting the price of gold, reckoned in bank notes, to rise, but to adopt this system was to "upset or endanger the gold standard of value". To be without a standard of price was conceived, and, I think, justly, to be a national calamity. Hence there was acquiescence in that grim law which decreed the restriction of home commerce whenever a foreign nation saw fit to make a demand for gold upon us. We may, however, reasonably hope that it will hereafter be recognized that the bank-note pound is actually a more scientific unit of value than the pound sterling. The spread of this opinion may remove the central objection of the older economists to freedom of note issue.

The second objection raised was the danger of an excessive rise of prices caused by "wild" issues of notes. The adherents of the Banking Principle protested in

[1] See also the Blue Book figures quoted on p. 380. The increase there shown in the number of banks in Scotland is evidence of the effect of small note issue in aiding the establishment of new branches of banks.

reply that a banker's reputation was acquired only after years of patient care in placing his loans. He was exposed to the criticism of the whole community. An excessive note issue could not be made without attracting public attention. The loss of the banker's reputation would mean absolute ruin to him. Was it likely that he would risk this reputation for the sake of the mere interest to be derived from even a large over-issue of notes? Although the upholders of the Currency Principle could find but few instances of such an extraordinary over-issue in the crises of the past, they replied naïvely that the fact of the frequent drains of gold from the country was an incontrovertible proof of over-issue, thus assuming a causal connection that required proof. I have sufficiently dealt with the confusion surrounding the two definitions of the word "over-issue" in this discussion. Let it suffice now to point out that the promoters of the Bank Charter Act thought that in giving the Bank of England a secure hold over the note issues they were giving it control over the country's credit issue, and consequently preventing the danger of wild issues; whereas the demand for more credit than was allowed by the 1844 Act immediately found an avenue of escape in the direction of cheque issue. Through this loophole has swelled an enormous mass of paper credit, enough to make Lord Overstone turn in his grave, could he but see its present proportions. Be it further remarked that this mass of credit is entirely unsupervised and unrestricted. It is quite open to banks to-day to make such advances to speculative undertakings as would increase prices in the country beyond bounds. It has actually happened in the past that prominent banking houses have advanced cheque credit so lavishly to speculative enterprises that the former were at length unable to meet the ordinary demands upon them for gold (I need only instance the failure of Overend, Gurney & Co. in 1856).

The failure of these firms was undoubtedly hastened in most cases by the sudden appearance of a strong demand for gold from abroad; but every tradition of banking at the time warned the bankers of the possible occurrence of such sudden demands, and there is not the least doubt that generally these firms had speculated more than was prudent. Happily for modern commerce, these failures, serious as they were, did not cause the imposition of further restrictive legislation: it was recognized that the downfall of these firms was a sufficient deterrent to other bankers who were likely to be similarly tempted. The real remedy, which undoubtedly was not sufficiently insisted upon at the time, lay in the publication of a more detailed periodical statement by the banks. In most cases of bank failure the banks have engaged in speculation entirely without the knowledge of their customers. The secrecy practised by banks in regard to their loans is a relic of the days when it was deemed shameful for a man to require a loan. When enterprise was small it was considered possible for a man to undertake all legitimate business on his own savings; it was held to be indisputable evidence of extravagance if he applied for a loan. Doubtless also the business man of to-day prefers the world to think that his industrial extensions are being carried out upon the profits of his past undertakings, rather than upon a loan from his bank. Yet, for the sake of this secrecy he permits his bank to conceal from him all record of its loans, thus imperilling even his own stability, since the failure of a bank compels the sudden return of all outstanding "call loans".

Bagehot remarks:[1]—

> "Our great joint stock banks are imprudent in so carefully concealing the details of their government, and in secluding those details from the risk of dis-

[1] p. 264 of work previously quoted.

cussion. The answer, no doubt will be, 'Let well 'alone; as you have admitted, there hardly ever 'before was so great success as these banks of ours: 'what more do you or can you want?' I can only say that I want further to confirm this great success and to make it secure for the future. At present there is at least the possibility of a great reaction. Supposing that, owing to defects in its government, one even of the greater London joint stock banks failed, there would be an instant suspicion of the whole system. One *terra incognita* being seen to be faulty, every other *terra incognita* would be suspected. . . . If the real government of these banks had for years been known, and if the subsisting banks had been known not to be ruled by the bad mode of government which had ruined the bank that had fallen, then the ruin of that bank would not be hurtful. The other banks would be seen to be exempt from the cause which had destroyed it. But at present the ruin of one of these great banks would greatly impair the credit of all. Scarcely any one knows the precise government of any one; in no case has that government been described on authority; and the fall of one by grave misgovernment would be taken to show that the others might as easily be misgoverned also. And a tardy disclosure even of an admirable constitution would not much help the surviving banks: as it was extracted by necessity, it would be received with suspicion. A sceptical world would say 'of course they say they are perfect now; it would not 'do for them to say anything else.'

"And not only the depositors and the shareholders of these large banks have a grave interest in their good government, but the public also. We have seen that our banking reserve is, as compared with our liabilities, singularly small; we have seen that the rise of these great banks has lessened the proportion

> of that reserve to those liabilities; we have seen that the greatest strain on the banking reserve is a 'panic'. Now, no cause is more capable of producing a panic, perhaps none is so capable, as the failure of a first-rate joint stock bank in London. Such an event would have something like the effect of the failure of Overend, Gurney and Co.; scarcely any other event would have an equal effect. And therefore, under the existing constitution of our banking system the government of these great banks is of primary importance to us all."

These remarks on the constitution of banks apply with force to bank balance sheets. It may be that secrecy as to details of loans is of more advantage to the customers of a bank than greater publicity; but it is certain that in the present monopolistic state of banking most people are *obliged* to deal with existing banks, and the directors are able to conduct many a piece of risky business without the knowledge of their customers. Only freedom of competition will prove which system is the best, and the system which permitted Overend, Gurney & Co. to speculate without the knowledge of their customers was certainly not a free one. The fact, however, that most bankers to-day are withheld from making wild advances by the fear of failure and the consequent loss of their customers' confidence, even under our present primitive methods of checking the stability of banks, proves that the framers of the 1844 Act were wrong in thinking that the temptations to over-issue were too strong for the banker to be able to resist them unless he were "strengthened" by legal restriction.

We have seen, however, that fear of an unforeseen drain of gold from our free gold market is largely instrumental to-day in preventing our bankers from making extensive long-date loans. The abolition of the

gold standard will free them from this danger. What checks will remain?

Before answering this question let us examine present conditions a little more closely. We have seen that the outstanding features of modern industrialism are: (1) The volume of goods which might be produced is limited by legal restrictions on the growth of loanable capital. (2) There is a constant tendency for even the limited volume of goods now produced to remain unconsumed owing to legal restrictions on the growth of that competition between employers which is necessary to reduce shareholders' profits to their lowest and increase wages and organizing returns to their highest. The free introduction of credit into such conditions will enable production to be extended up to the limits of the productive power of the community, while simultaneously, by reason of competition between banks, facilitating the path from the position of employee to that of employer. But primarily, an injection of fresh credit is an injection of fresh *purchasing power*, and prices would tend to rise. An issue of credit, however, is not to be confused with the discovery of a gold mine, since it implies a future repayment of the loan, and a consequent future withdrawal of a precisely similar quantity of purchasing power from the market, which withdrawal prevents any permanent inflation of prices.

Let us dwell upon this point for a while. Basing themselves upon the imposing authority of the Quantity Theory, economists assert that "an increase of money tends to raise prices", and this is judged a sufficient reply to those who imagine that prosperity can be increased by merely adding to the amount of the medium of exchange. It is of course obvious that if freedom of banking meant merely that prices were to be increased proportionately with every injection of fresh credit, it would not only fail to remedy but would actually intensify the social evil; for the classes which are near

starvation point, the very classes we desire to assist, would suffer first from an increase of prices. But the economists who uphold the above theory have wrought much evil upon society by failing to distinguish between the effects of a fresh supply of money from a *gold mine* and that from a *bank*; hence they omit to remark the difference between a permanent and a temporary rise of prices.

As has been insisted upon unceasingly throughout this book, credit is not a commodity or a material object; credit is not capital, but an arrangement whereby wealth is transferred to one who promises to use it in production of fresh wealth. Credit can appear only when there exist simultaneously wealth offered for sale, and willing unemployed productive ability. It is conceivable that a rich gold mine might be discovered at a time when there was no demand for an increase of credit; it might happen that gold could be literally picked up. Such an injection of purchasing power into the market by those who had presumably no desire to produce ordinary commodities but wished merely to consume, would undoubtedly inflate prices permanently; or at all events, the inflation would persist until some increase in the volume of industry and exchanges absorbed the fresh exchange medium. A banker's credit advances, however, are made only to those who desire to produce wealth and repay the loan. The primary injection of purchasing power in the shape of credit undoubtedly tends to raise prices in a precisely similar manner to the discovery of a gold mine; but the production of wealth which results from an issue of credit, exercising as it does a demand upon the purchasing power in the market, followed by the final withdrawal (in redemption of the loan) of a quantity of purchasing power superior, to the extent of the interest paid, to that issued, prevents any permanent inflation of prices. Moreover, in a large community, wherein considerable

loans are continually being issued and repaid, the issue and withdrawal of purchasing power would usually balance each other, thus preventing any see-sawing of prices.

As long as we retain the gold standard of price, we expose our exchange system to all the hazards of gold discovery. Cheaper gold to-day increases prices permanently; whereas the sole permanent effect of cheaper credit is to cheapen production, and cheaper production needs only to be accompanied by freedom of competition among producers for the price of goods to fall proportionately. Hence although the first effect of an injection of cheaper credit must be an increase of prices, as soon as the goods produced by the fresh industrial activity begin to be introduced into the market, prices will again tend to fall, the fall proceeding until the price of credit has sunk to its lowest point and the whole of the present idle productive ability is employed up to the limit of its powers. The net result of the introduction of freedom of credit will be a decided fall in the prices of commodities, and a decided increase in the consuming power of producers.

To return now to the dangers of freedom of note issue. The one argument in favour of our present system is that the shorter period of circulation of our present credit token, the cheque, places a more automatic check upon over-issue than is possible when notes are used. I reply again that we purchase these benefits too dearly. The action of the present law is again too indiscriminating. The prohibition of note issue prevents all long-date loans, whether the bankers and borrowers be stable business men, or men of straw. This circumstance causes glut of goods, closes the avenue for the capable man to the possession of machinery, and consequently causes monopoly of the means of production, low wages, and unemployment. The restriction also prevents the establishment of new

banks and thus fosters banking monopoly. Under our present system, no doubt, our chief credit instrument, the cheque, is usually returned immediately upon the issuing bank and, if unbalanced by corresponding payments into the bank, causes a reduction of the banker's gold reserve. Small notes circulate longer before being paid into the bank. Under a note-issuing system, therefore, the automatic detection of the offending banker occurs only when his notes begin to be returned upon him through other banks, and in the meantime he will have had time to issue a larger quantity of credit than is possible under the present system. Hence more people are likely to suffer from his imprudence. But I reply that the people that would suffer most from a banker's imprudence are the shareholders and depositors of the bank. Notes are rarely held in large quantities by ordinary people; but are almost invariably passed on or paid into a bank. Now the banks receiving these notes may be trusted to watch vigilantly their fellow bankers' operations. If an adequate inspection of balance-sheets is maintained, any imprudence on the part of a banker should be quickly detected. If the shareholders, depositors, and other bankers allow a banker to speculate unwisely, they have only themselves to blame.

If losses to note-holders should prove to occur frequently, it will be possible to insure note-holders against loss in the manner suggested by Professor J. L. Laughlin.[1] The bankers themselves will probably insure their note-holders and charge an extra rate for credit advances. The individuals of the community should be left free to judge if the danger of unwise issues by banks is sufficiently grave to warrant the payment of the extra charge for advances.

But the history of banking shows that the danger of imprudent issues has been greatly exaggerated. As was

[1] See Report of the Indiana Monetary Commission (Washington, 1910).

pointed out when dealing with the passing of the 1844 Act, restriction of note issue was not imposed on account of any suspicion that banks were issuing credit to incapable producers. The Act was passed because notes enabled more gold to be dispensed with, and thus, it was held, gave rise to more frequent financial crises. It is, however, to be hoped that the abolition of the free gold market will demonstrate that the chief cause of banking convulsions in the past was not an incurable habit on the part of bankers of issuing credit to incapable producers, but unforeseen withdrawal and export of the country's gold reserves.

We have seen that credit has to-day been rendered artificially dear by State restrictions upon banking. Upon the removal of these restrictions there will occur slight fluctuations of prices while the rate of interest is finding its lowest level. The cost of obtaining money, however, can, in the final resort, fall only to the cost of the banker's labour in valuing normally safe security, the price of such labour having been reduced to its lowest by competition. When the rate of interest reaches this point, prices will remain comparatively stable.

As the banker's reputation spreads, he will be able to work with a decreasing quantity of gold, and will consequently be able proportionately to reduce the charge for advances. As his gold reserve becomes smaller in comparison with the credit superstructure, however, the danger of the withdrawal of even a small quantity of gold will become greater, and the banker will accordingly be compelled to guard against loss of public confidence by giving even greater guarantees of the soundness of his issues. As a means of further reducing the demands upon him for gold he will probably at this stage issue option-clause notes, rendering them at first redeemable in gold a short time after demand, and gradually increasing the period of deferred pay-

ment as his reputation extends. The process will of course necessitate an improvement in the system of surveying the banker's issues; but, as has been unceasingly maintained throughout these pages, it is to the interest of both the banker and his customers that the use of gold in exchange should be diminished, and it may be confidently predicted that freedom for experiment will result in the adoption of an adequate system. At a later stage the banker will be able to circulate notes that are not redeemable in gold at the bank of issue at all, as did the Bank of England upon the passing of the Restriction Act of 1797. Under this system a pound note will not be a promise to pay a pound's worth of gold, but will be marked simply "Worth one pound". The holder of these notes must apply to the goldsmith when he desires gold. The banker will be able to introduce these notes into circulation, when sufficient confidence obtains, by offering credit in them at a reduced rate, and, as was previously demonstrated in the case of ordinary notes, it will be to the interest of the employer and tradesman to promote their circulation. The banker will then be using as capital his reputation only, and will be precisely in the position of the ideal valuer of integrity described in Chapter IV. It is when competition has reduced the price for the use of the reputation of the banker to its lowest that comparative stability of prices will have been attained.

Anything more than comparative stability of prices cannot be assured, however, if we wish to retain the benefits of freedom; since freedom to introduce improvements implies freedom to err. The abolition of the gold standard of value, however, would enable the cause of a rise of prices to be more automatically detected than is the case to-day. An influx of gold to-day causes a reduction of the discount rate quite independently of any increase in the needs of commerce, and our experts wrangle incessantly over the question whether the sub-

sequent increase of prices is due to excessive issues from the banks, or whether the growing prosperity of commerce attracted the gold to this country. In a system like our own, wherein credit can be extended only when gold happens to reach our shores—a system wherein quantities of perfectly sound productive ability continually remain unmonetized, and wherein the banks maintain such profound secrecy as to the nature of their advances — such a question cannot be satisfactorily decided. The removal of the artificial disturbances set up by the gold standard, and the due publication of accounts by banks, would enable the cause of the rise of prices to be more definitely ascertainable.

When notes are redeemable in gold on demand, or bear an option clause, any lack of confidence in the bank is shown by the return of a quantity of its notes for redemption in gold, or by the action of cautious people who will accept its paper only at a discount. If the bank is really unsound, the wise people will thus have saved themselves, and the unwary must pay the penalty. With notes not redeemable by the banker in any one commodity whatsoever, while credit may thereby be cheapened and extended to wider ranges of productive ability, the check upon the banker is reduced, and must be made good by a closer examination of his accounts. The report of unwise issues will then simply cause the suspicious notes to circulate at a discount. If the banker be subsequently able to retrieve his reputation, the notes will return to par; if his reputation fall still lower, his notes will be refused altogether. He will be made bankrupt through the failure of borrowers to repay his loans, as previously described. The receiver will collect debts due to the bank, receiving its notes at their depreciated worth only; and will finally buy in, at their depreciated rate also, such notes of the discredited banker as may remain in the hands of non-debtors, giving genuine notes (of other banks) in return. The fact that the notes

of the bankrupt are in the hands of those who are not his debtors implies of course that the actual debtors can meet their liabilities only by obtaining a certain quantity of genuine notes; the amount of genuine notes paid in being further increased by the sum which each debtor must add in settling his account in order to balance the depreciation of the bankrupt's notes. When the whole of the offending notes have been retired they will be destroyed, and the business of the community will proceed as usual.

The suffering entailed by the failure of an unsound bank will thus be confined chiefly to the unwise members of the community. It is doubtless inconvenient that notes should circulate at a discount; whether this system will obtain, or whether the community will absolutely refuse the notes of any banker to whose name the least breath of suspicion attaches, is a matter which must be left to the future and natural selection to decide. In proportion as people are harsh with their bankers the latter will be more cautious in the risks they undertake, and a greater proportion of credit advances will fall to the money-lender at high rates. Competition between communities which adopt this system, and those which are willing to accept notes of particular banks at a discount in order to enable the latter to retrieve their position, must decide which is the more suitable commercial method for the state of society in which it is adopted.

Hence it may be affirmed with truth that freedom of banking entails no risks which may not be adequately guarded against by the normally prudent members of society without State interference. If the State wish to interfere, let it be merely in the form of education of the public in the principles of banking. The State, however, provided no such education for the unlettered people of Scotland two hundred years ago; the mere knowledge that fraud was possible has always been a fairly efficient

instructor in the past: the actual cases of fraud invariably hastened the invention of improved methods.

From the day when freedom is introduced, let the banks themselves maintain respectively their own gold reserve to the amount which they individually consider necessary to support public confidence in their note issues. Let them no longer rely on the Bank of England to save their gold reserves for them by refusing the risky (and profitable) investments which most of the joint stock banks occasionally undertake. The first notes issued by the free banks will doubtless be returned upon them almost immediately for redemption in coin; this must be provided for, and, as time goes on, confidence will gradually be established. Above all, let not the forced currency of legal tender be given to these notes: those of the Scottish banks have acquired more popularity than gold without this support. It has been well said that legal tender adds little virtue to a good currency, and is entirely vicious in the case of a bad one. The history of most countries shows that the institution of legal tender was introduced only when the State wished to give currency to its own debased coin. Furthermore, although it may seem a hard doctrine in these days of increasing compulsory inspection, I am of opinion that it is inadvisable that the people should be lulled into a sense of security, and be tempted to relax their vigilance, by governmental inspection of the banks, since such inspection is generally inadequate; the people who rely upon it lose their primitive enterprise and power of choice, and progress is hindered. Paragraph 37 of the Report of the Banking and Currency Committee of the Association of Chambers of Commerce of the United Kingdom (1908) runs thus:—

> "It appears to your Committee that the remedy [for inadequate cash reserves in banks] does not lie in legislative provisions enforcing upon the banks the

keeping of cash reserves bearing a fixed proportion to their obligations. Any attempt to do this by legislation bristles with difficulty, and is open to the pregnant objection that all such proposals defeat their own object by tying up the cash at the very time that the banker most requires it to meet a sudden demand on his resources. This is the chief vice of the system in force in the United States."

Paragraph 38:—

"The force of public opinion is probably one of the best weapons. In *The Economist* of November 22nd, 1890, figures were given which showed that eleven principal banks, other than the Bank of England, whilst their liabilities to the public were £169,623,000, had cash in hand and at the Bank of England amounting to £17,438,000 or a percentage of cash to liabilities of 10·3. Similar figures for twelve similar banks in March 1908 show that the percentage of cash to liabilities had increased to 16·05. This improvement is doubtless owing to the public attention which has recently been given to the question."

The Committee recommended, amongst other things, the more frequent publication of bank accounts, and the issue of £1 notes by the Bank of England, such notes to be issued, four-fifths against bullion, and one-fifth against securities. Furthermore, the Committee recognized the evil of the absolute limitation of note issues enforced by the 1844 Act in that it recommended that the Bank of England should be given an increase of its powers of issue against securities in times of emergency, on payment to the State of a rate of interest to be fixed by law, such rate of interest to be neither so high as to make the permission inoperative, nor so low as to encourage rash speculation. This scheme is similar to that which obtains in Germany.

The recommendation that banks should not be compelled by law to maintain a fixed cash reserve is a most important one. Progress in banking is entirely dependent upon the increase of mutual confidence. Mutual confidence increases coincidently with the spread of general prosperity, social sympathy, and the establishment of such a system of judicial administration as renders violations of confidence unprofitable. But the spread of mutual confidence among individuals depends upon the guarantees which can be afforded by either side, since, although confidence promotes facility of relations, it simultaneously increases risk. Confidence is a shy and peculiar blossom, which often brightens places where one would least expect it. The guarantees which satisfy one man of another's integrity are frequently rejected by a third person. In the sale of ordinary commodities we perceive the utmost diversity of methods employed in order to secure public confidence in the reliability of the goods exposed for sale: declarations by public analysts, free inspection of factories, printed testimonials from grateful recipients of benefits, publication of names of prominent people who deal with the firm in question—these and a hundred other schemes testify to the diversity of the public demand for guarantees. Under freedom it is to the advantage of the trader to invent methods of proving the reliability of his wares, and the most efficient system tends to be repeated and preserved.

It is manifestly true that these voluntary methods are those by which progress in banking has been attained. From the most primitive beginnings of exchange we perceive a gradual increase of mutual confidence, a gradual increase in the risks taken, and a process of "natural selection" operating among the various methods of guarantee against such risk. It therefore seems advisable to permit the banks to act upon their own discretion in the matter of the amount of their cash

reserves. Let each banker educate his own community. The fewer the calls for gold that are made upon him the more he can extend his system. The banks may therefore be relied upon (apart from individual cases) to select the most effective methods of securing public confidence in their reliability. It has previously been pointed out that the various employers who use the notes of the local bank in payment of wages know that they can help their bank by circulating its paper as long as possible, and it will therefore be to their interest to induce their employees to circulate the bank paper rather than return it for redemption in gold. Progress in the direction of the gradual displacement of gold by paper is thus assured. It is of course inconvenient that the community should have to choose between the notes of many banks and be exposed to fraud. Freedom of choice guarantees progress, but, as has been well said by G. B. Shaw: "Freedom involves responsibility; that "is why most men dread it." I am, however, confident that the capable members of the community will be prepared to take the risk of free note issue as soon as they are aware of the advantages to be obtained from the flexibility of such a credit system. It is undeniably inconvenient that in some cases local notes may not be accepted in distant towns: a Bath local note, for instance, may be refused in Carlisle. But a system of note exchange or clearing will doubtless be set up, or certain bankers of widespread reputation will issue notes for circulation over the whole of the country. Those traders who care to set up the rule of refusing all strange notes may do so; experience and freedom of competition alone will prove whether the gain in safety thereby secured outweighs the loss of custom simultaneously entailed.[1]

Our chief need is for freedom for any type of bank to

[1] It should here be noted that Scottish notes are accepted in London by experienced tradesmen.—H. M.

be set up which can command confidence in the district where it operates. I have previously quoted from Bagehot's evidence before the 1875 Select Committee on Banks of Issue, wherein he urged that the easiest way to develop credit was to issue notes. If, upon the grant of freedom of note issue, our present monopolized banks do not supply the credit required, it will be easier for smaller banks to establish themselves. I see no reason also why industrial firms of repute should not issue their own notes in wages to their work-people. As the demand for labour increases, the bargaining power of the wage-earner will be strengthened, and he will be unlikely to accept from his employer notes which do not command confidence among local shopkeepers. But these are practical details which may well be left for discussion until freedom of banking receives popular support.

To resume — under primitive conditions, absence of social security compels the banker to use a valuable token in publishing the individual's ability to the community; and he accordingly exacts a high interest, and excludes all but the most valuable security as a basis for loans. Given freedom from directive State interference, together with a gradual perfection of social security and consequently of voluntary mutual trust, the banker is impelled by competition to use a cheaper token, to lower the rate of interest, and to extend his advances to the less valuable forms of security. In proportion as social conditions become more peaceful, as the military stage is gradually superseded by the industrial, the value of personal reputation rises relatively to material possession. As the wealth of society increases, there arise many opportunities for the individual to make a temporary show of wealth the cover for deception and fraud. Hence, in the industrial stage, commerce relies for safety rather upon the *reputation* of its participants. Reputation is of slower growth and more to be depended

upon. The great spread of enquiry and reference agencies is evidence of the desire of modern business men to ascertain the reputation of those with whom they intend to hold commercial relations, although, as has been previously remarked, these agencies are to a great extent, the excrescence set up by our refusal to permit the banker to extend the area of his operations. Bagehot, speaking even of the modern short-date loan market, says:[1]—

> "No one can be a good bill-broker who has not learnt the great mercantile tradition of what is called 'the 'standing of parties', and who does not watch personally and incessantly the inevitable changes which from hour to hour impair the truth of that tradition. The 'credit' of a person—that is, the reliance which may be placed upon his pecuniary fidelity—is a different thing from his property. No doubt, other things being equal, a rich man is more likely to pay than a poor man. But on the other hand, there are many men not of much wealth who are trusted in the market, 'as a matter of business', for sums much exceeding the wealth of those who are many times richer. A firm or person who have been long known to meet their engagements, inspire a degree of confidence not dependent on the quantity of his or their property. Persons who buy to sell again soon are often liable for amounts altogether much greater than their own capital; and the power of obtaining those sums depends upon their 'respectability', their 'standing', and their credit, as the technical terms express it, and more simply upon the *opinion* which those who deal with them have formed of them."

An adequate credit system is the great equalizer of opportunity in the community. Integrity and productive ability are to be found among the poorest, and it is the

[1] p. 283 of work previously quoted.

function of credit to search out the possessors of such qualities, and put them in position to exercise their faculties for the good of the community.

In reviewing now the various objections to freedom of banking, we find that there is only one which has any real foundation in fact, namely, the danger of excessive issues. This danger we have resolved into two factors: (1) that of "wild" issues by a particular bank, i.e. issues to a person who is quite incapable of producing wealth, (2) issues at excessively long dates. Let it be again remarked that both these dangers have been unduly exaggerated by the majority of orthodox economists. Our financial theorists have seen the occurrence of crises. They have, for the most part, overlooked the effect of State restrictions in causing the export of gold and consequent automatic crisis in times of temporary high prices following upon a perfectly legitimate expansion of trade activity at home; and the part played in many crises by an increase of legitimate trade activity abroad and consequent export of British savings in the form of gold to support that industry. Hence they have endeavoured almost invariably to explain crises by the imputation of excessive issues and unwise speculation to banks and manufacturers. There is no greater sinner in this respect than that economist whose word possesses such great weight in orthodox circles, Mr. Bonamy Price, professor of Political Economy in the University of Oxford. In his work *Currency and Banking* he continually insists that the one cause of a financial panic is the sudden increase of consumption out of all proportion to production either at home or abroad. Now it may be true that consumption, i.e. credit, frequently increases beyond the legally restricted limits of the available safe credit medium, and may then be called unwise; but this is not Professor Price's meaning; he means that panic occurs because we have consumed more than our arms and machines can produce. I rejoin emphatically that

such unwise consumption has scarcely ever been a sufficient cause for general financial panic. There is no case on record of a general financial panic which was not preceded by a drain of gold from the country, and a consequent restriction of credit on the part of the banks. "Precisely so", Professor Price will interject, "and the cause of the drain of gold was either excessive speculation abroad with home gold on the part of our financiers, or excessive speculation and a consequent rise of prices at home." But this is a pure assumption on the part of Professor Price. It has been sufficiently demonstrated during the course of this work that *any* decided increase of trade activity at home—however legitimate—causes a temporary increase of prices at home, and that any increase of perfectly legitimate prosperity abroad causes our financiers to export the gold basis of home credit to secure profit abroad. It is rather the legal compulsion upon banks to redeem their notes in gold upon demand, or their inability under the gold "standard" system to raise the price of gold in times of strong foreign demand, which is responsible for the export of gold by financiers, and the resultant financial panic. It is scarcely conceivable that all bankers and financiers should be simultaneously seized with insanity and make excessive issues and loans. We saw recently that the Birkbeck Bank suspended payment. There resulted no diminution of confidence in other banks on the part of the general community. The Birkbeck Bank went quietly into liquidation, but the other banks continued operations as before. Why? Because there was no drain of gold, and the rest of the banks were accordingly spared the necessity of refusing discounts to business firms of acknowledged reputation. "No", Professor Price will rejoin, "it was because the customers of these other banks knew that their banks had not made excessive issues." But under our present primitive banking system, the customers of a bank keep no check upon its issues. Their

one guide is the maintenance of normal discount operations on the part of the bank. The refusal of advances to firms of known integrity may have *two* causes under our present system: (1) previous excessive issues on the part of the bank, (2) a drain of gold abroad. The second cause may come into operation unaccompanied by the first; but the first cause never operates to any extent without introducing the second. When a simple drain of gold abroad, consequent upon either a legitimate increase of trade activity at home and resultant rise of prices, or an opportunity for investment abroad, has caused the banks to restrict advances and ruin all those firms who simply happen to have large liabilities falling due at that time, it is perfectly natural that those economists who have overlooked the fact that legitimate increase of trade activity can to-day set up a drain of gold will assert that the cause of the general failure of confidence in the banks is excessive advances on the part of the latter.

Professor Bonamy Price sets forth the doctrine in all its primitive simplicity when he states:[1]—

> "What is the test of the existence of excess, or to use popular language, of inflation [of bank note issues]? What effect is generated which leads to the discovery of the cause? A fall in the value of the paper compared with the value of the coin which it acknowledges to be due. The supply of them is too great; many persons have more of them than they know what to do with; to get rid of them they are willing to part with them at a reduced value. It may be difficult to specify the case of a definite holder of them who goes through this process of thinking, and then resolves to reckon them as worth less; but it is impossible to doubt that this is what takes place in practical life, and that the depreciation of the

[1] p. 81 of work previously quoted.

notes, whether expressed in the United States by the premium which gold bears compared with paper dollars, or as formerly in England, by the discount attached to the notes, is the result purely of an excess of supply, which lowers the value of all commodities alike. Each additional issue adds to the depreciation and to the disorder which it creates in all money transactions."

Throughout his work Professor Price omits reference to the possibility of the drain of gold being due to a legitimate growth of prosperity. If any issue of credit cause gold to emigrate from our legally created free gold market, it is an excessive issue. A true disciple of Lord Overstone is Professor Bonamy Price! Yet he has noticed that it is difficult to specify the case of a definite holder of the notes who goes through this process of finding that he has more notes than he knows what to do with, and who accordingly parts with them at a reduced value. It would indeed puzzle Professor Bonamy Price to find a single such person on occasions when the drain of gold has been caused by a simple export of gold abroad by our financiers in foreign investment. The cause of the discredit which attaches to paper at such times is the withdrawal of gold and the consequent refusal of the banks to discount further commercial paper. The refusal of bills of exchange by the banks starts the run for gold. The actual run may be an indication of loss of confidence in the bank on the part of its customers, but this loss of confidence was not spontaneous on the part of the latter: it was set up by the refusal of the banks to discount paper. The fundamental cause was the unforeseen drain of gold. My book is an endeavour to show that if the State had withheld itself from unwarranted interference with commerce, unforeseen drains of gold might have been prevented. Under freedom, and the abolition of the gold standard,

an excessive issue of credit by the banks would cause only a temporary rise of prices, and, if the issue had been made to persons who were actually incapable of producing wealth, the failure of the unwise borrowers, and perhaps also of the unwise bankers. The epidemic of excessive speculation would rarely be so general as to compel all holders of bank notes to rush to their own banks. Such general runs are caused only by a circumstance which compels *all* banks suddenly to restrict their advances, namely, a drain of gold abroad, and under a rational banking system such a drain of gold would never occur, let the banks issue to the utmost excess conceivable.

It will be observed that all through this chapter I have laid special emphasis on the need of establishing a means whereby the banks may protect themselves against demands for gold from abroad in times of prosperity and high prices here, or of increased trade activity abroad. There is good reason for this insistence. All defenders of free banking hitherto who have not simultaneously attacked the legal exposure of the banks' gold reserves to the danger of depletion have been confronted with this difficulty. Their opponents have invariably asserted that an increase of note issue in this country has always caused, and must infallibly cause, an undue export of gold. The defenders of free issues have usually replied (see Wilson, Tooke, Gilbart, and Macleod) that undue export of gold in the past, when not due to increased purchase abroad on the part of this country, or to financial disturbance, was due to injudicious issues on the part of the home banks. Inevitably the query then arises: What constitutes a judicious issue? Many and strange are the theories then advanced. Wilson, Tooke, and their school declared that the volume of credit must fluctuate with the quantity of gold in the country, but that there was no need to prohibit the issue of bank notes, as the extension of bank-note credit had no effect

on the export of gold. Messrs. Hake and Wesslau, in their more recent work *Free Trade in Capital*, are of the same opinion, and believe, moreover, that the issue of bank notes redeemable in gold on demand will protect the banks against sudden demands for gold. I am unable, however, to find any grounds for either of these beliefs. The extension of credit from its present restricted state must automatically cause an export of gold as long as the fixed price of the metal is maintained and there remains a better market for gold abroad, since the financiers will always find a means of obtaining the specie while the circulation consists of notes redeemable in gold on demand, and while cheap credit or high prices here invite the export of gold.

Adam Smith, in spite of his clear insight into the question, replies:[1]—

> "What a bank can with propriety advance to a merchant is not either the whole capital with which he trades, or even a considerable part of that capital; but that part only which he (the merchant) would otherwise be compelled to keep by him unemployed and in ready money, for answering occasional demands."

The connection, however, between the amount of capital which a merchant is obliged to keep by him unemployed in ready money for answering occasional demands, and the amount which he could profitably use on certain occasions, is not obvious. Some merchants need scarcely any ready money, others need much; but one of the former class could perhaps occasionally obtain a substantial profit in a short time if capital were loaned to him. Why refuse it him? What would become of the profits of any bank existing to-day if its overdrafts and discounts were limited in this manner? But Adam

[1] *Wealth of Nations*, Book II. ch. iii.

Smith wishes to account for the fact that even during the most prosperous period of Scottish free banking there was a constant flow of gold from Edinburgh to London, and Scottish banks were periodically compelled to call in loans, at a cost of considerable suffering to their borrowers, and also to import gold from London. He notes that even those Scottish banks which never distinguished themselves by their extreme imprudence were occasionally obliged to employ this ruinous resource, and he sets up this law of the relation between credit and the amount of ready money required by a merchant to account for the phenomenon. It is a matter of regret to us that the fact of the high reputation of these banks did not induce Smith to reconsider if the export of gold to England were really due to imprudent advances on their part. For the truth is that this export of gold was due partly to the frequent crises and consequent demands for gold set up by the wretched system which obtained in England; *and partly to the fact that under freedom of note issue Scotland was continually tending to evolve a cheaper credit system than was possible under the restricted English régime.* Cheaper credit meant cheaper gold, and the gold accordingly emigrated from the Scottish free gold market (legally created, be it noted) to England where the severer restrictions on banking caused the metal to be in greater demand. It is therefore certain that, even if freedom of banking be introduced, as long as the fixed price of gold be maintained the danger of exports of gold will persist, and under such conditions the full extension of credit will be possible only when either option-clause notes are introduced and find general acceptance, or when other countries also adopt free banking and thereby lessen their demand for gold. Progress along these lines must be slow.

Against all theories of the necessary connection between credit issues and the available quantity of gold,

however, we declare that the metallic reserve is no test at all of the note-holding capacities of a market. The only proper limit to credit is the ability of a people to use capital in the production of wealth within a due time, which ability may be backed by the possession of saleable security or not, at the discretion of the banker.

The "Mutual Bank" school, which, under Tucker's influence, has obtained considerable following in the United States, proposes a system whereby a circle of manufacturers shall agree to form a bank and accept its notes at par, the notes not being convertible into gold at the bank of issue. The pamphlet which explains this system is entitled *Mutual Banking*, by Colonel W. B. Greene. I would recommend it for its clear exposition of the evils of a commodity exchange medium; but Greene makes several errors in his theory of money.

In the first place, Greene proposes to introduce the Mutual Banking system into the midst of the present restricted system, and yet declares that its introduction will not result in the expulsion of specie from the country's gold-using banks. But if the Mutual Bank actually find favour and give credit at cheaper rates than the gold-using banks, the latter will lose custom, their rate of discount must consequently fall lower than that of countries wherein no Mutual Bank exists, and gold will inevitably travel abroad. Greene proposes to retain the fixed price of gold and to use the metal as a standard of value. At the same time he admits that the issue of his money must cause an increase in the price of general commodities. I would like the adherents of the Mutual Bank theory to state whether, when all prices in any one country rise except that of gold, the financier will not import cheap goods from abroad and pay for them in the one commodity the price of which is legally prevented from following the general rise, namely, gold.

In the second place, the vice of this mutual system is that of all co-operative undertakings in which em-

ployers' returns or "profits" are abolished, namely a rejection of the benefits of division of labour. In co-operative production and distribution the consumer is made to assume the functions of the organizer of labour. The consumer and the machine worker, however, can never hope to become as expert in this direction as one who specializes as an employer, and is permitted to reap the pecuniary results of improvements introduced by him. Similarly in Mutual Banking, the client is made to assume the function of appraiser of credit. Greater publicity of operations than our present banks afford is indeed desirable; but when all the clients of a bank have a voice in the decision as to what forms of security shall serve as a basis for credit advances, progress is hindered. There is more hope for progress in a system of competing bankers. Let any suspicious client transfer his custom from one bank to another; if his suspicions are justified, others will follow his example. Co-operative production and banking may be practicable in a society wherein men are all equally wise on all subjects and can be trusted to labour as diligently for the common good as for their private welfare—not merely, be it noted, for the common good as the individual perceives it, but for the common good as decided by majority opinion, even though such activity be contrary to both the opinions and interest of the individual.

Let me digress for a moment to remark that it is an entirely unwarranted assumption on the part of Co-operators and Socialists that because certain scientists are to-day willing to labour without pay for the common good, we may immediately abolish the system of private profit and make all men servants of the State, trusting that they will thereafter labour as diligently as before. Those who make this assumption fail to realize how unstable and wilful a quality is the philanthropic spirit. The Spencers and Darwins claim to labour in that manner and in those hours which suit their whims, and

in that special sphere only to which they "feel themselves drawn"; they are the first to protest against any interference with, or directive control of their activities. Such service may not be depended upon to form the basis of a social system.[1] Moreover, cases are quite common of men who will give freely to some little charitable cause in which they are interested, but will take advantage of any sharp practice in business to secure profit to themselves. It was for this reason that the older economists set up the conception of the "economic man", that is, they arranged their systems on the assumption that each man would seek only his self-interest. Men obviously do not seek exclusively for personal material gain; but on such a theoretical basis only could stable institutions be raised. Co-operation demands for its efficient working a considerably more socially sympathetic type than is the rule to-day, and it is even doubtful whether the type that is so sensitive to public opinion is really of most use to present society. Progress demands destroyers of conventions, and such destroyers will evidently be needed until perfection arrives. In any case, however, the method of developing social sympathy does not consist in reducing the individual incentive to labour, but in the free contact of independent individuals, and in the perfection of the means of assuring as far as possible to the individual the results of his actions—in other words: in a more perfect individualism. In proportion as men discover

[1] Mr. James H. Carey, in reading the MS. of this work, made the observation that desire for fame undoubtedly co-operates to a great extent with the sympathetic instinct in many of our prominent men to produce their social activities. But the performance of the fundamental everyday labour of society is not, and can never be, attended with any award of fame for the ordinary worker, since fame implies *unusual* merit. Consequently the performance of such labour on the part of the normal man as we now find him requires the further stimulus of material reward, together with the fear of the diminution of such reward in the event of any slackening of his efforts. A man may go to great trouble occasionally to acquire fame, but the average man will endeavour to earn his living with the least possible expenditure of energy. I agree with this observation, and have pleasure in inserting it.—H. M.

that it is *necessary* to perform socially useful actions in order to enjoy the pecuniary and sympathetic favour of society, they will gradually develop a pleasure in such activity. The vice of all premature co-operation is (1) that it diminishes the activity of the industrious types, since, by introducing a fixed wage for service, it reduces the stimulus of private profit, leaving only the stimulus of moral satisfaction which makes but little appeal to the majority of people to-day; (2) that it shelters the anti-social type from the wrath of society. In co-operative societies the consumers continue to purchase at their store even when inferior goods are sold, and endeavour to improve the service by the very indirect and imperfect method of committee meetings. In private industry, however, the transfer of custom to a competitor is considerably more effective in causing "sympathetic" production. In Mutual Banking the members bind themselves to accept the bank's notes at par, relying upon committee meetings to remedy any improper administration of the bank. With social morality and mutual trust at their present stage, however, it is safe to state that no note, not issued by the State, has a chance of circulating among the working classes unless it be redeemable in gold on demand. The Mutual Bank school is, however, and justly so I think, strongly opposed to State banking.

Yet co-operation (in the sense in which the term is usually employed) is preferable to socialism in that it is voluntary; just as Mutual Banking is preferable to monopolistic State banking. We demand only that co-operation shall *prove* its superiority over free competition, that is, that co-operatively owned industry shall compete with present industry in the open market. The more useful type of industrial organization will then survive. But, even as I believe that in industry men must pass through generations of more perfect individualism before they are able to use a system of co-

operation, so in banking I believe that men must be gradually educated to the use of inconvertible bank notes (that is, inconvertible into gold at the bank of issue) through the use of a note redeemable in gold on demand at the bank of issue. The preliminary abolition of the fixed price of gold, however, will enable the more speedy education of public opinion, since it will enable the banker to retain precisely that amount of gold in his vaults which he judges necessary to support public confidence in his issues, and he will thus never need to restrict his credit advances on account of sudden drains of gold abroad.

Freedom for experiment, and education in the science of value, will undoubtedly result eventually in the banishment of gold from our exchange system; but we must permit the mutual trust which is required to effect that end to evolve in freedom from *present* conditions. To attempt to introduce, either by coercive State action, or by the proposal of "visionary" schemes,[1] a more advanced state of mutual trust than society is prepared for, retards the development of mutual trust itself, since the inevitable failures draw exaggerated attention to the current defects of human nature. In our banking legislation, however, we have proceeded to the other extreme. We have prohibited a development of mutual trust which the normal members of society were quite prepared for, and were actually initiating. Let us remedy our legislative error and grant freedom in this direction. On the banker's side there is the incentive of added profit to induce him to educate his clients in the science of credit; on the community's side is the profit to be gained from every successive step in the process of obtaining a more automatic present realization of a future profit. For regular production is an important aim of industry. The expenses of most machines are

[1] i.e. schemes which presuppose greater mutual trust than currently exists, without proposing a means of ensuring the development of such trust.

almost the same whether the machine be active or idle. When the manufacturer has produced his goods he needs fresh raw material. He cannot wait until he has sold all his goods, and he would lose much by buying small quantities spasmodically as his returns come in. Hence that movement which we have traced through all improvements in the mechanism of exchange—the endeavour to secure steady and regular satisfaction of desire by means of extensions of mutual confidence. In proportion as wealth is more widely distributed, and the administration of justice becomes more infallible, the individual tends to value his reputation more highly in comparison with personal possessions. Hence the gradual abandonment of the use of gold in more perfect exchange systems.

Gold will undoubtedly be required for the settlement of foreign trade balances long after its use in home commerce has been discontinued.[1] International trust is still in so primitive a condition that nations use the method of trial by combat to settle disputes, a method long since discarded in disputes between individuals, even in quite backward countries. The establishment of a central power in each nation to enforce justice in disputes between its members has enabled the growth of that security requisite for the establishment within its frontiers of a system of paper evidences of indebtedness. Credit has overstepped the frontiers of nations in the system of international clearing of bills of exchange. The one relic of primitive times is that any balance of indebtedness must still be settled in gold, even though the debtor nation be one whose credit is quite beyond suspicion. It is precisely as though in ordinary commerce we were to prohibit credit—that we were to refuse to accept any man's promise to pay at a future date, unless we had occasion at that precise time to require him to accept our similar promise. Such a state

[1] Written in 1913.

of affairs would evidently imply a considerable diminution of mutual trust between individuals; and it is precisely lack of mutual trust between nations which is responsible for the lingering use of gold in international exchange. So long as the nations of the world fancy they may profit by hurling armed forces at each other, so long the possibilities of a sound credit system and cheap transfer of goods—the crowning blessings of the industrial stage of society—will remain incapable of realization. When the nations have grown tired of fighting, the establishment of an international court of arbitration, with power in men and arms to enforce its decisions, will enable gold to be dispensed with in the settlement of international indebtedness.[1] Pioneers in the theory of international finance have frequently during the last century, however, recommended the establishment of an international Clearing House either in Switzerland or at The Hague, where the representative banks of the world might keep their gold stores, and settle their accounts by the mere alteration of ledger accounts. This is undoubtedly a progressive step; but international security has not yet developed sufficient stability to permit the realization of the scheme.

Progress in banking is thus seen to follow the growth of mutual trust. From simple barter to the use of a gold exchange medium, thenceforward through the use of paper transfers of gold, paper promises to pay gold on demand, and finally, paper documents convertible into

[1] Certain currency reformers have exerted themselves to secure the repeal of the legal tender laws. Personally I do not think this would help us much. So long as our laws restrict the issue of exchange medium, the creditor classes have the whip hand, and can exact such conditions from borrowers as to secure themselves from loss in times of crisis. Moreover, if freedom of banking were granted, lenders would be compelled to guard against the liquidation of debts in undesirable medium, and the conditions stipulated to secure this would tend to constitute legal tender laws, even though voluntarily agreed upon. The chief thing to establish, it seems to me, is that the supply of exchange medium shall be equal to the demand, and freedom of banking will suffice to secure this.

gold not at the bank but at the goldsmith's at the market price of the metal—through these successive stages the growth of mutual trust has been traced. The path leads onwards, of course, through the circulation of the *individual's* I.O.U. without the endorsement of any banker, and finally to pure communism, which latter system entirely dispenses with the use of an exchange medium. But these are "dreams out of the ivory gate". It is sufficient for us to note this fundamental principle of *voluntary* mutual trust on which improvements in the mechanism of exchange are founded, and to give it due weight in our studies of political economy. Pure communism is undoubtedly a worthy ideal for the strivings of mankind, but it should always be borne in mind that if any given measures of communism are not to produce more harm than good they must be voluntarily undertaken by the individual members of the community, and not imposed by majority vote. To compel A to put his product unconditionally into the "Common Pot", regardless of whether he is satisfied with what will return to him out of the same Pot; to permit B to take what he will out of the Pot, regardless of the quantity or quality of that which he put in, can only increase social discord and prevent that very growth of mutual trust which is a necessary prelude to communism. Co-operation must be voluntarily undertaken by the individuals concerned, otherwise it becomes slavery, and entails all the inefficiency of production, and degradation of character implied by that system. Our economists have professed themselves sentimentally inclined towards communism; but they have prohibited the voluntary effort of individuals to trust each other in the circulation of paper tokens of mutual trust. They have compelled producers to limit their exchange of commodities by that evidence of primitive mutual suspicion—the gold exchange medium. The consequent glut of commodities on the one hand, which confronts a starving and underpaid

population on the other hand, causes mutual hatred and bloodshed, and perpetuates those primitive qualities of deceit and aggression which must disappear before communism can approach the confines of practical politics.

Let us now turn to the results which may be expected from the introduction of free banking in this country. Our industry is already in an abnormal state, since possession of machinery is held by a comparatively few great firms, while, at the other end of the scale, the workers receive unfairly low wages and are frequently unemployed. Certain reasons have been given in the earlier chapters of this book to account for this state of affairs; they may here be resumed:—

(1) At the industrial revolution the banking partnership restriction clause together with the prohibition of various credit instruments prevented the growth of credit necessary to enable the establishment of sufficient factories to use up the available labour. By 1844, deposit banks had been freely permitted to establish themselves; but the cheque, which was virtually the only credit instrument then permitted, has been shown to be an unsuitable substitute for the note.

(2) Decennial crises (again largely caused by banking restrictions), by bankrupting firms which were growing into competition with existing employers, have yet further caused monopoly of machinery in the hands of the few, and over-competition among employees. The four or five years of stagnation which followed each crisis caused the bankruptcy of yet more small firms which were unable to stand the strain.

(3) Foreign adoption of our monetary unit in 1873 enabled unfair foreign competition with us and caused further stagnation here during the following twenty years or so. These years witnessed the first serious spread of socialist ideas in England. The international adoption of the gold unit compelled the progressive

countries to limit their prosperity to the level of that of the most backward of the nations which could find a use for gold.

(4) The fear of unforeseen gold stringency to-day compels the banker to confine long-date credit advances to those few very wealthy firms whom he dare not refuse, and to those who possess gilt-edged securities. Therefore, when a firm attains a certain prosperity, it suddenly obtains access to bank credit and is given a great advantage over its weaker competitor; hence lack of competition among employers and over-competition among employees.

(5) The gold-owners (dividend receivers) consume a large portion of the results of the labour of the industrial classes, because governmental restrictions prevent the banks from financing industry at a lower rate. The result is that one portion of the community must labour without consuming as much as it might.

(6) The revivals of industry which have occurred at intervals have invariably worked their own ruin and destroyed even previous prosperity by tightening the money market and causing an increase of the bank rate.

(7) I have said that the predominant evil of our system is an inability to find markets. It follows that only those firms which are sufficiently wealthy to survive long periods of stagnation can exist. All goods must consequently go into the possession of such wealthy middlemen as can afford to store them for indefinite periods. There exists everywhere a hunger for money. Among manufacturers this is shown by desire for quick payments, and they are consequently everywhere willing to sell at great reductions to wealthy middlemen who will take quantities of goods off their hands, and whose bills can be discounted for purposes of fresh production. This accounts to a great extent for the excessive number of middlemen in our industrial scheme and for the superior terms which the Trust can

exact in its purchases. The small manufacturer is being continually pressed for quick payments; any stoppage of his sales, therefore, at once brings him to the verge of bankruptcy. This renders it easy for the Trust to "freeze him out", that is, by temporary undercutting to ruin him. I have referred to the handicap of the small manufacturer which results from his property being an unsuitable security for credit advances under our present restricted system. Let us remember that small manufacturers are invariably pressed to make quick payments to the wholesale firms, while at the same time they must frequently wait an incredible time before obtaining their own returns. On all such occasions the wealthier merchant can obtain overdrafts and credit from his banker, and is thus enabled to weather the periods of "tight" money. Moreover, our present system legally causes great fluctuations in prices; and fortunes are more often made by speculations upon rising and falling markets than by patient production. The speculators receive the benefits of the present banking system, and with their increasing wealth grows also their monopolistic hold.

(8) The peculiarly vicious feature of restriction of credit is that the harm thereby caused is always two-fold. The manufacturer who cannot sell is not only forced to work short time himself, but he cannot buy, and thus compels others to slacken; hence the snowball nature of all stagnation of industry.

(9) Finally, there is the comprehensive defect, from which most of the previously enumerated evils might be inferred, namely, that owing to the general prohibition in civilized countries of the one *effective* substitute for gold in the channels of domestic exchange—the bank note—it is practically possible to extend credit only when fresh supplies of gold enter the market. Hence, side by side with the accumulation in few hands of the means of establishing fresh industry, there exists the

continual evil that general prosperity is not as it should be, considering the growth of fresh labour-saving devices. The contention may be true that an equal distribution of the total present income would not benefit the poorer classes to any considerable degree; but it is undeniable that existing restrictions on the growth of credit prevent that blossoming of industry which would at once tend to allot to ability its reward and to spread the benefits of cheapened production throughout the community.

All governmental and private philanthropic efforts to provide employment hitherto have actually increased the evils they sought to remedy. The evils are the involuntary retention of goods by producers, and involuntary idleness of productive ability. By establishing industry upon exchange medium withdrawn from our artificially restricted money market, these official and private bodies rendered it more difficult to carry on other industry, and consequently set up more congestion and unemployment. The *creation* of exchange medium — the creation of paper credit titles to the wealth which now stagnates in the hands of producers —and the distribution of these paper titles to those who are considered by the professional judges of commercial ability, the private bankers, to be capable of producing fresh wealth, this remedy attacks the evil at its root. The creation of exchange medium can be accomplished by the issue of credit in notes, and by the removal of the legally created danger of unforeseen export of gold. In the present abnormal state of industry the first effect of these measures would be that existing firms would pay their wages in notes instead of gold. Quantities of gold would thus be freed and used as a basis for credit to stimulate trade in all directions. It should be noted that with the first introduction of such credit the present twofold evil would be converted into a twofold benefit, since not only is the manufacturer who receives credit

set to work more vigorously, but he buys, and the ripple of activity spreads over the whole surface of industry. Manufacturers whose trade was previously stagnant begin to find orders coming in, they employ more labour, and the purchasing power of the employee class is increased. Such revivals of industry have occurred before; indeed, such is the buoyancy of the human spirit, that after every crisis in the past, although men had seen the strongest firms totter, yet, the years of stagnation past, and the discount rate still low, their hopes revived and they again began the Sisyphean task of rolling the stone of industry uphill. At such times of trade revival the cautious spoke warningly of the danger of "production outstripping the available capital". Their warnings were invariably unheeded in the joy of cheap credit and the gradual growth of purchasing power of the market. Their prophecies of crisis, however, were fulfilled with fatal regularity, not on account of any undue strain upon the supply of real capital, but on account of the inelasticity of the State-restricted credit market; and in the fluctuations of the money market the hopes of the struggling manufacturers were ground to powder.

When that revival occurs which must accompany the introduction of free note issue and the protection of the gold market from legally encouraged foreign demand, the sages will again spread their warnings; but if the banks are able to educate the community in the manner suggested in the earlier part of this chapter, men will witness for the first time in history a trade revival which need have no fall, but can continue in a strong, steady, upward sweep. With a steady bank rate the purchasing power of the market will be more definitely ascertainable, and men will produce confidently for a market which can be depended upon. As the evil of stagnation is gradually removed, and the purchasing power of markets increases, it will be possible, if found necessary,

to form fresh combines of the capital thus rendered available to compete with present combines. The competition which to-day invariably destroys itself by hardening the credit market will then eventually doubly increase prosperity by reducing the price of goods and simultaneously increasing the demand for labour. Increased demand for labour means higher wages for the workers and a further increase in the purchasing power of markets.

If, with the increase of prosperity, the community become more educated in the principles of credit, and take steps to moderate its demand for gold by setting up other checks upon its banks—examination of bank accounts for instance—there is no reason why, with the development of credit thereby enabled, competition among employers should not increase until wages are as high as employers can *afford* to give, and until it is not to the interest of the next most capable employee to assume the risks and responsibilities of an employer. That this state of affairs is no mere dream on my part was amply shown in San Francisco after the last earthquake. There occurred in that city an extensive demand for building labourers. The demand was so great, and wages rose so high, that men were sometimes employers and sometimes employees, according to the class of work on which they were engaged: it became so difficult to obtain labour that the profits of building contractors were frequently not large enough to induce the highly paid employees to undertake the responsibilities of the employer position. To the sociologist this is the ideal reform of industry—not the abolition of the private employer—but the removal of the hindrances which prevent the capable employee from becoming in his turn employer. This system, by assuring to every man the fullest possible scope for his ability, together with the greatest possible personal reward for his efforts, provides that stimulus to enterprise which ensures pro-

gress, invention, and increasing comfort in the future. The social ideal is not the abolition of competition but the removal of unfair stress of competition from the workers. For, as I have elsewhere remarked, competition among employers is at most merely competition for more wealth among those who already possess the means of existence, and can be slackened at will; whereas excessive competition among employees becomes competition for bread, and must be continued to the point of starvation.

We are but too familiar to-day with that form of competition which consists in a reduction of wages by the employer with the aim of cheapening production. This is but a further evidence of the congested state and restricted purchasing power of present markets. Every hardening of the credit market to-day brings with it a two-fold slackening of industry, since, not only is the manufacturer compelled to put his factory upon short time, owing to the reduction of the merchant's purchases, but the reduced wages of the employee class tend to cause a still greater quantity of commodities to remain unsold. The greater the difficulty for the employee of finding a market for his labour, the more he falls into the employer's power, and must accept a reduction of wages. With every injection of fresh purchasing power into the market, however, the flow of goods is facilitated, and the employer becomes more dependent on his employees; for, with an elastic credit system, the supply of employers can be increased as fast as the growing purchasing powers of consumers invite the establishment of fresh factories; whereas the supply of labour becomes more restricted with each revival of industry. Reformers have at last agreed that the real evil to-day is under-consumption. We affirm that under-consumption results from legal restriction of the means of exchanging commodities between those who would consume and are willing to labour. Men cannot pur-

chase goods to-day because they are prevented from monetizing their powers of purchase to the extent justified by their *aptitudes and the existing quantity of saved capital.* Purchase has been made to depend upon the possession of a scarce metal instead of upon character.

It should be remarked that the difference between our present system and one in which free banking were well established is not merely the difference to the manufacturer between a 4 per cent. and a 1 per cent. rate on bank advances, but the difference between a system in which the total volume of production is legally restricted, and one in which it can be increased up to the limits of human demand—between a system wherein the greater part of productive industry is entirely excluded from cheap long-date bank advances and pays an enormous tax to comparatively idle dividend receivers and middlemen, and one in which the worker will receive the full result of his labour—between a system wherein the majority of producers is practically excluded from the possession of machinery, and one in which credit will be cheaply obtained by every capable man or trustworthy body of persons. The large share of profit which at present flows to financiers and middlemen is noticed in the following statement which appeared in a report (1911) of the California State Country Life Committee:—

> "The large proportion of the farmers of the State are not making much more than labourers' wages in actual profits, while consumers continue to pay high prices for most staple and perishable commodities."

And in his interesting little book on *Voluntary Socialism*, Francis D. Tandy quotes the following example from the First Annual Report of the United States Commissioner of Labour:—

> "A man who weaves cloth for which he receives less than four cents a yard as a producer, may have to

> pay seventy-five cents a yard as a consumer, the profit to the retailer in such case being at least twenty-five cents a yard; that is, the retailer, for handling one yard of goods receives twenty-five cents compensation, where the weaver, for weaving the same yard of cloth, received less than four cents compensation."

The great difference in the rewards obtained in these two branches of labour respectively has been ascribed by Mr. Mallock and his school to the superior value of brains as compared with mere physical skill. We now find, however, that the value of "brains" (he should rather have written "capital") has been artificially enhanced by State restrictions upon the purveyors thereof. We have legally hindered the banker from putting capital into the hands of the man of ability (brains). The difference in these two rewards is rather to be ascribed (1) to lack of competition among possessors of capital, owing to legislative interference, and (2) to the legal restriction of purchasing power. The consequent anxious search for markets on the part of present organizers of labour compels the consumer to pay for the quantity of superfluous middlemen and advertisement used in the search for markets. If we consider that at every step in its production every article has to pay excessive rent to capital, to middlemen, and, in many cases, to landlords, we see that the sum of "surplus value", to use the Marxian phrase, must be considerable. To quote Tandy again:—

> "When we consider that those who to-day live from the toil of others would, under a more equitable system, have to produce for themselves, we see that the total product would be considerably increased. When we also take into consideration the fact that the productive power of those who now labour would be greatly increased when each performed the labour

best adapted to his ability,[1] and that, the occasion for strikes being removed, men would not waste their energies and means in that direction, some idea of the possibilities of the new system begins to dawn upon us."

It is further to be remarked that a cheap and flexible credit system would go far towards solving the problem of the immigration of cheap coloured, Chinese, and Japanese labour which is so formidable a danger to the working classes in certain civilized countries to-day. The introduction of such cheap labour to-day is harmful to the working classes of these countries because it undercuts them without providing a fresh avenue for their labour. Yet, theoretically, it would seem to be an unmixed blessing for a country to be provided with labour by men who are willing to work for little return. The key to the problem lies in the credit restrictions which to-day prevent the due utilization of any fresh productive ability which appears. Banks have been prevented from bringing into commerce the present worth of a future profit. With a flexible credit system, any appearance of cheap labour would immediately cause a general increase of industry, the movement proceeding until the new labour were being utilized up to the limits of its ability, and at the highest wages it could command. Those who were previously employees would either become employers of the cheaper labour, or, the reduction in the price of commodities consequent upon the utilization of cheaper labour would enable the more skilled labour to find an extensive field for its activity in producing the more valuable manufactured articles, the one disadvantage of the process being the preliminary transfer of labour — a small price to pay for such a blessing.

[1] A result of the increased purchasing power of the community and consequent increased demand for labour.—H. M.

From the present inability to sell, the change, under freedom of banking, would gradually be to a state wherein production would be unable to keep pace with the effective monetary demand for goods—the only natural state among a people whose desires are continually in advance of their physical ability to satisfy them. The sting would thus be taken out of present competition in a socially beneficial manner.

There are those among us who would like to see a reduction in the fierceness of the present competitive struggle for wealth. Let us not imagine that the self-assertive instinct in mankind will be lessened by legal prohibition of industrial competition. By such interference we merely close up one avenue of its expression. When we have removed the personal stimulus of private profit from exertion, self-assertion will show itself either in shirking, or in the race for those lucrative positions which involve little labour. The path to such positions will be through political jobbery and back-stairs influence—ways difficult to expose and the exposure of which involves danger to the bold critic in a society wherein the bureaucracy is supreme and all men are servants of the State. It is unwise to expect that the many "have-nots" we see around us to-day will less eagerly desire wealth, luxury, and leisure when we merely transfer the ownership of machinery from the individual to the State, since by such a change we do but shelter the idler, the shirker, and the man of unscrupulous ambition behind the politician, and render their identification more difficult. Let rather the man who wishes to accumulate wealth do so, lest his ambition find vent in more harmful directions. By making ability instead of gold the basis of credit, we deprive the rich man of all coercive power over his fellows. An accumulation of wealth will then represent great social service, and will simply enable great consumption; its monopolistic power—its power to impose unfair conditions

upon labour by its control over credit and the creation of industry—will be shorn away. Freedom of banking—the liberty of individuals to co-operate freely in the circulation of any type of credit token which may be found suitable, the State merely compelling reparation in cases of deceit and fraud—is thus seen to be necessary to the industrial system in order that competition may produce that beneficial result which was predicted of it by the earlier Manchester school of economists.

I would lay especial stress upon the perfection and cheapening of the administration of justice. But for the somewhat strictly economic nature of this book I would have devoted a separate chapter to the subject. In the *Principles of Ethics* (§ 250) Spencer observes:—

> "This, then, is the law of sub-human justice, that each individual shall receive the benefits and the evils of its own nature and its consequent conduct";

and in the postscript to the *Study of Sociology*, in words which might be engraved in granite over the portals of our law courts:—

> "If punishments follow transgressions with certainty, and if the temptations to transgress are, by the prospect of certain punishment, more effectually repressed, such temptations must diminish in strength. Energies directed to the illegitimate pursuit of advantages, will be turned to the legitimate pursuit of advantages; and with the decrease of those antagonistic relations among citizens caused by injustices, by the fears of injustices, and by the precautions against injustices, will go a growth of good feeling and more sympathetic social relations."

I would have liked to draw attention to the cumbrous machinery of our present judicial administration, and to have shown how many poor people are prevented from obtaining redress of their wrongs on account of

the expense, length, and subtleties of judicial procedure. I would have liked to enquire why a judge should allow only a member of a single close corporation to defend me in court. Why should not the profession of submitting or defending a client's case in court be thrown open to free competition?

I have discussed this subject with many members of the legal profession, and here again find the influence of the evil principle of "protection". These men defend their monopoly on the grounds that if people were permitted to choose their own defenders, or lawyers, they would choose incapable men who would waste the time of the court and probably not even do justice to their client's cause. But people can now choose their own dentist, their own physician and their own architect, and so far from exhibiting an incurable tendency towards the selection of incapable men, we find from experience that this freedom of choice has been a most potent factor in inducing the members of these professions to keep themselves abreast of the latest discoveries of science. In all these professions choice proceeds on recommendation. The person who has little knowledge in the branch concerned applies to a friend whom he can trust and who possesses the special knowledge. Thus the capable man is recommended from one to the other. Why then should people choose an incapable muddler to represent them in court?

Our lawyers' corporation is a relic of an outworn guild system, which has survived solely by reason of the potency of its members; for it must be remembered that our judges themselves spring from the lawyer class. Our judicial system remains a relic of the days when justice was a favour to be begged from rulers. At present we view the subject from a different standpoint. The State compels us to pay heavily for the protection it accords us (whether we agree with its methods or not). When we have been the victims of physical aggression the State

rightly defrays the cost of prosecution of the offender out of the funds taxed from us. Why then, in cases of fraud, should the victim himself bear the expense of bringing the offender to judgment, when he has already paid for protection? Surely, if it is intended that justice shall not be merely sold to the rich, a court should be established, as Spencer suggested, wherein men could, in person or through any agent, show how they had been wronged. If the judge decided that a wrong had been committed, the State should forthwith pursue the offender free of charge to the victim. If it was decided that the plaintiff had no case, he should pay a portion of the court's expenses for the time occupied in hearing him. Furthermore, it is but just that the offender when caught, should be compelled to indemnify his victim in money for all damage committed and expense incurred; and if the former have no means, he should be detained in a prison workshop until he have earned the amount. There will of course remain the initial expense of providing witnesses in cases which demand such evidence; but, in the first place, plaintiffs who feel themselves strongly in the right will bear such expense willingly if they are certain of its reimbursement at the end of the case; secondly, there are countless cases, e.g., County Court actions, wherein the greater part of the expense is for legal procedure, the guilt of the offending party being manifest at the outset; for such the establishment of the above-mentioned court is urgently necessary.

It is contended that the free prosecution of civil offenders would give rise to a multiplication of petty charges which are discouraged by the present expensive procedure. Paternalism again! The unwise are prone to abuse; therefore the prudent must suffer serious offences without being able to obtain redress. If it were left in the hands of the judge to decide whether the time of the court were being wasted or not, and if, in the case of actions dismissed as too petty, the plaintiffs were

compelled to pay a certain indemnity for the time lost in considering their cases, there would remain no ground for complaint. It has been left to private enterprise to provide that most effectual aid to justice, the record of the failures of private firms—a record which has done more to induce commercial integrity than many legal statutes. I rejoice, however, to see that from May 1st, 1914, our judicial system has been so altered that any "Poor Person" is now entitled to take any kind of legal proceedings free of cost. The term "Poor Person" is held to mean one who does not possess £50 excluding wearing apparel, household effects and tools of trade. Whilst I hold that it would be more just if some portion of the cost of the proceedings were recovered from the litigant against whom judgment is given, I welcome this measure as a step in the direction of the free prosecution of civil cases. This is not the place, however, to discuss this topic further. I have merely introduced it in order to show the possibility of fresh blossoms of commerical confidence when the community determines upon a really cheap and automatic system of obtaining redress of wrongs.

It will be noticed that I have treated the industrial and land questions as two separate problems. To establish free exchange is no solution for land monopoly. Yet a word upon the subject of land may not be out of place, and I have added an Appendix for that purpose.

CHAPTER XIV

STANDARD OBJECTIONS

Two classes of objectors to the scheme of banking reform proposed in the foregoing chapters are commonly met with. The one declares that it is unwise to promote production in a system which already shows over-production, or, fearful of "unrestricted competition", protests that the Trusts will continue to reap their profits in spite of any alterations in our credit system. The second class attacks the technical side of the scheme and affirms that an unrestricted note issue is "too dangerous a proposal".

I will deal with the former critic first. He is usually a Socialist. One might reply to him that his own creed proves the fallacy of the first contention. The Socialist proposes that the State or the municipality shall set up industry in competition with present employers, and, by offering better conditions to workers, gradually assume control of industry. Obviously this is a scheme to increase production, and simultaneously to cut out all employers who, in the Socialist's opinion, are drawing unfairly high profit. Free banking proposes to secure the benefits of socialism along lines of increased individual liberty, and should thus secure the support of every Socialist who places sociology before socialism. But the question may be approached on other lines. If we suppose the present number of employers still further reduced by a restriction of credit, a certain number of employees will be thrown out of employment and the wages of the rest reduced by competition from the unemployed. Industry will then present the spectacle of a still closer monopoly of great combines and a yet

greater number of underpaid workers. The purchasing power of the community being thus further reduced, there will still exist the tendency for the goods of even the few remaining factories to be unsaleable, and this fact would doubtless be cited as an insuperable objection to any proposals for increasing the number of factories in the community. In proposing increased credit facilities it needs to be pointed out that (1) an issue of credit is primarily an issue of *purchasing power*, and its injection into industry would immediately tend to relieve present congestion, since it would enable many to purchase who are not able to do so to-day, and the goods from the fresh producers would thus find a ready market; (2) consumption would be further increased by the circumstances, first, that the goods from the new factories would usually be sold at reduced prices, and secondly, that the increased industrial activity of the community would increase the wages, and hence the purchasing power of the whole employee class. In other words, as I pointed out in Chapter III., every injection of cheaper credit into our industrial system must increase consumption faster than production.

This is also the reply to the Douglas school. Major Douglas is an energetic money reformer who asserts that it is useless to issue more money because prices will rise and consumption be reduced again. He therefore proposes a most elaborate system of artificial price reduction, the balance between the cost of production and selling price to be made up by an issue of Treasury notes to the seller. In the first place, it is not certain that an issue of fresh credit will increase prices. There have been instances to the contrary. It seems only natural that when, after a long period of trade depression, manufacturers should find orders coming in again, they should be only too glad to sell, without risking a rise of prices. Secondly, if prices show a tendency to

rise, it is better to permit the rise than to stop it artificially. A rise of prices indicates that consumption is outstripping production. If we now reduce prices artificially, the available stock of goods will be rapidly exhausted and queues will appear outside our shops. On the other hand, a rise of prices discourages consumption and stimulates production, which is precisely what the situation demands. Major Douglas diagnoses the present scarcity of money as due to the fact that insufficient money is distributed in the course of production to enable the purchase of the product. He thinks that the reason is that manufacturers reckon their overhead costs into prices. But manufacturers must recover the overhead costs. Competition between manufacturers prevents an undue portion of overheads being recovered within a given period. It is true that insufficient money is sometimes distributed in the course of production to enable the purchase of the product; it depends on the amount of the money distributed, compared with the value of the product. It is not necessary for every manufacturer to distribute enough money to enable his product to be purchased; the banks should see to this. If consumable goods remain unsold, the main cause to-day lies in those laws that prevent banks from monetizing the credit of those who would purchase. If banking is freed from these restrictions, the goods will find consumers and no harmful rise of prices need ensue.

A case can certainly be made for an issue of Treasury notes to meet current government expenditure. At present the State borrows from the banks amounts which it will recover in taxation. This practice arose in consequence of fear of the inflationary consequences of permitting the State to issue notes. The practice, however, simply fines the community the amount paid to the banks in interest. If the quantity of notes issued by the Treasury were confined strictly to the amounts

voted annually by Parliament, and were issued in instalments, no harm need result. Moreover, the issue of such notes would relieve the constriction of money which results from the payment of taxes by the community.

It is further urged that the payment of interest by the community to its banks tends to put the community deeper and deeper in debt to the banks. There is some ground for this view, since a banker demands payment, not only of the money he has issued in a loan, but also of interest, and he has issued no money to enable the payment of this interest. Yet, the case is not so bad as it appears at first sight. In the first place, the banker himself lives on interest, and the money he spends is an issue over and above his loans. Secondly, there is a constant addition to the monetary stock of the world from its gold mines. If gold should ever be demonetized, the payment of bank interest might present a real problem; but at present the restriction of actual loans caused by our banking laws is a problem of far greater magnitude and importance.

In reply to the contention that it is impossible to abolish the monopoly of the Trusts by any means short of nationalization, in Chapter II. reasons have been given for a belief that the waste arising from the system of huge industrial combines would favour the rise of smaller and more agile firms, were not the monopolists protected from competition by our legally restricted credit system. It has been shown that the freeing of our credit system would enable the monetization of quantities of now latent purchasing power in the community, and cause a great demand for goods. If, under such conditions, it should be found that a system of Trusts most economically supplied the wants of society, the combines would persist. Their existence, however, would depend upon their paying to their employees as high wages as their profits would admit, and upon their providing goods at the lowest possible prices. If they

should, as is at present often the case, be reaping excessive profit, or be paying an unfair wage to their employees, it would be profitable for other combines of capital, content with smaller profits, to enter the competitive arena by reducing prices and attracting labour by a higher wage. Such fresh competition will be rendered possible by the removal of the danger of gold stringency, by the reduction in the price of credit, and by the monetization of hitherto untouched stores of productive ability. Under our present restricted system any such extension of competition is practically impossible. For, in order to introduce any degree of sanity into our industrial system, there must be established a considerable number of aggregations of capital with the aim of fresh production. Such trade revivals recurred at intervals of approximately ten years during the last century; yet each revival caused a financial panic by withdrawing credit from other industry. We need a system wherein fresh aggregations of capital may be formed without drawing from the existing gold supply. This may be accomplished by granting freedom to banks to set up the system necessary to economize the use, and protect their stores, of gold.

Under an elastic credit system there would be little danger of the "freezing out" of such fresh competition as would doubtless arise. The Trusts find it to their advantage, even in our present congested state, to combine with firms of equal credit powers rather than attempt the formidable task of "freezing" them out. Under free competition, individuals or corporations will rarely be left in enjoyment of big profits long enough to enable them to accumulate such vast fortunes as are necessary to permit of a reduction of prices for a sufficiently long period to "freeze out" competitors. With a flexible and cheap credit system, any considerable reduction of prices by one firm will immediately cause a great increase of purchase on the part of the rest of the com-

munity, and will seriously tax the firm which proposes thus to sell at a loss. Competitors will not therefore feel the strain so seriously as at present, when, under the restricted credit market, a reduction of prices in one quarter simply withdraws their customers, without creating a sufficiency of fresh purchasers. In this connection a story is told of two American railway magnates who were conducting a freight war. The one finally made such a reduction of freight rates that goods might be conveyed over his line for next to nothing. His rival, however, with plenty of capital at his command, was equal to the occasion. He promptly telegraphed to his agents in the west to buy up so many head of horned cattle, sufficient to supply the eastern districts for some considerable time, and sent them by his rival's line. The profits netted by this transaction enabled him to stand the "cut". A more flexible credit system would enable a similar increase of trade activity to result from every endeavour to "freeze out" competition. Furthermore, even if a chance firm were successful, under a free system, in "freezing out" certain competitors, a flexible credit system would enable the speedy resuscitation of competition whenever the successful firm resumed its normal prices.

Certain critics then relinquish the contention that free competition must always result in harmful undercutting, and declare that modern employers "will not compete" but will combine to keep prices up and wages down. In the first place, however, I would ask why, if all combination of employers is an advantage, we still find competition among great firms in almost every branch of industry. The negotiations among taxicab proprietors some time ago are interesting in this connection. Proposals were made that the large companies should combine to raise taxicab fares. One of the largest companies, however, the Gamage-Bell, declined to enter the combine, stating that the low fare yielded a reason-

able profit, which profit would only be reduced by the proposed alteration. A system which permitted the creation of several Gamage-Bell companies would cause employers to consider more carefully the dangers of attempting to raise prices before proposing combination.

The facts of present industry rather show that, in most cases, employers compete as long as possible, and combine at last only in order to avoid producing more than the purchasing power of the market can take off their hands. I am convinced that if a free credit system be introduced, even while comparatively few employers remain on the market, competition will arise, and the way will be open to a healthier state of industry. I have personally known several cases in which, even under our present congested system, small manufacturers worked their way steadily up until they were employing several men, but they were suddenly made bankrupt owing to many liabilities falling due at a time when they were unable to obtain cheap capital, although their business was in a perfectly sound condition. Of course, as in the case of A, B, and C, given in Chapter IV., the statement can always be made that such failures are due to over-trading, and the allegation can rarely be definitely refuted because the circumstances can seldom be completely ascertained. Under present legal restrictions upon the free development of credit, the small trader can obtain financial accommodation only by paying exorbitant interest to a money-lender, and he consequently tends to work his own capital up to the closest possible margin. Any stoppage of his sales, or successive failure of a few of his debtors, immediately push him into bankruptcy. It cannot be denied that many such cases of failure could be easily avoided if small manufacturers had access to credit at such times; and, with a free credit system, every case of the successful entry of a fresh employer into the industrial arena

tends to increase wages, reduce the price of goods, and render fresh accumulations of capital for the establishment of business more easy. Thus the movement, once started, tends to proceed automatically.

The critics that raise the above objection reason from our present state of continual stagnation to different conditions. At present there is feverish competition among employers for a market of limited purchasing power; but, with the demand for goods created by a fuller monetization of the productive ability of the community, employers will find an outlet for all their energy in supplying this demand. Furthermore, as the demand for labour begins to overtake the supply, it will be less advantageous to create "corners" in necessaries, since such "corners" will cause a rise of prices all round, and thus lessen the gain of their promoters. When the wheat supply is artificially restricted to-day, all middlemen raise their prices, down to the baker, who charges more for his bread. They are able to do so because there is a steady demand for their services. At the foot of the list, however, stands the worker who cannot at present demand higher wages on account of the weak demand for his services. He consequently pays the bill. Increased competition among employers will render the worker more independent. When the price of necessaries rises, he will demand higher wages, and will obtain them, since the employer will also obtain higher prices for his goods and will be exposed to competition from other employers who will seek to attract away his employees if he declines to raise wages proportionately. The result to the monopolists, therefore, granted that their "corner" is successful, will be a proportionate rise in the prices of all commodities, including labour—a rise which will persist until the consequent reduction of foreign trade causes a fall of prices in the manner described in the previous chapter. But the abolition of the legal restrictions at present laid

upon the development of credit will undoubtedly prevent the accumulation of such huge fortunes as occurs to-day—the possession of riches will depend upon other service than the mere manipulation of a severely restricted quantity of money. The danger of monopoly of necessaries will thus become a remote one.

I am, moreover, of the opinion that, did we know the full facts, there are but few combines formed to-day with the aim of maintaining excessive profits, except perhaps in articles which are natural monopolies, such as, for instance, oil; and even in these cases, as previously demonstrated, the progress of invention tends to destroy the possibility of effective monopoly. The majority of ordinary industrial combines are to-day formed because the Trust is the only type of firm which can withstand the ever-recurring periods of trade stagnation. The combination is formed rather to avoid a throat-cutting competition than to maintain high profits. It is said that 95 per cent. of present firms have at some time in their career been on the verge of bankruptcy. In the staple industries—those in which the demand is steady and easily to be calculated—profits are already cut to the lowest margin capable of giving the normal monopoly returns to our legally restricted supply of capital; yet the manufacturer must periodically suspend production in order that demand may again come up to the supply of commodities. The only type of industrial organization which can do this without the risk of bankruptcy is the wealthy Trust. Stagnation of trade is a far more real cause of industrial monopoly than the doubtful economies secured by rigid centralization.

In his recent work *Efficiency as a Basis for Operation and Wages*, Harrington Emerson, an expert American engineer, states:—

"It is notorious that great aggregations of wealth

> and power usually do not operate as efficiently as smaller concerns. . . . The great industrial and transportation corporations are often very inefficient in manipulation, but content with low efficiency of operations."

He ascribes the persistence of these huge firms to their command of capital. As examples of the highest efficiency he points out the smaller manufacturers of automobile and cycle parts. The capable organizer of industry will scarcely combine with others, binding himself with many rules, and engaging not to sell below a certain price, when there exists everywhere an insatiable demand for goods, stimulating him to the invention of fresh means of supplying it, and every such invention causing an increase in his profits. Let me illustrate this contention by an example. A certain article is produced, we will suppose, at a cost of fifteen shillings, and the producing firms propose a combination under agreement not to sell the article at less than a pound. Among the inducements to the individual employer to enter such a combination in these days is the recurrence of trade stagnation previously mentioned. If this danger were removed, the energetic producer would pay more attention to the fact that if he entered the combination and subsequently discovered a process by which the article could be produced at ten shillings instead of fifteen, his profits would be but little increased since he would be obliged to sell the article at a pound; whereas if he were free to sell the article at fifteen shillings, his sales would increase enormously: he would sweep the market, and profit much more than he could as a member of the combination.

Even in the United States, trade monopoly has not become so close as is supposed by some Socialists. In the 1902 Report of the British Steel Association, p. 5, it is stated:—

> "In every part of the United States new companies are entering the lists to compete against the Steel Corporation, and the capacity of the private companies opposed to it to-day is possibly considerably greater than it was at the time it was founded, although that was only February, 1901."

When the American Steel Trust was standing its trial in 1911, its directors were able to prove that the Trust was not responsible for more than 50 per cent. of the total quantity of steel produced in the United States. Its capital was spread over other industries, thus demonstrating that the absolute control of the manufacture of one article by one organization is difficult, even under the present restricted credit system. In *The Raid on Prosperity* (p. 183), Mr. J. R. Day quotes from the American *Financial Chronicle* on Commissioner H. Smith's Report on the petrol industry:—

> "The popular supposition, no doubt, has been that the Standard Oil Company holds a monopoly of oil lands in the United States. Not so. The report tells us that out of a total production of crude oil in the United States, in 1905, of approximately 135,000,000 barrels, not over 1/6th came from wells owned by the Standard Company or affiliated concerns; furthermore, that in no one of the great fields did it produce over 50% of the total."

Moreover, with an elastic credit system—one which is continually tending to emancipate itself from the control of gold—it will be impossible for any body of employers to prevent outside competition by their power over the banks as they are so often able to do to-day. The fact is well known, and was amply proved in the American official investigation into the operations of the Money Trust by a Committee of the House of

Representatives in January 1912,[1] that in America, apart from the effect of Protection in preventing competition, the financiers are enabled to crush competitors chiefly by means of their control over the banks. The injunction is sent to the banks that no overdrafts are to be granted to a certain company, and no loans to be made on its stock, under threat of withdrawal of the gold deposits from the banks. The result is a speedy collapse of the company thus attacked. Commenting upon Governor Wilson's assertion that "the greatest "monopoly is the money monopoly", the *New York World* stated (June 17th, 1911):—

> "The same day that the *New York Times* ingenuously asked Governor Wilson what he meant by the 'money monopoly', the newspapers announced that Mr. Morgan's Bankers' Trust Company had bought from Mr. Morgan's Equitable Life Assurance Society its holdings in the Mercantile Trust Company, and that by this transfer the aggregate assets of the banks dominated by J. P. Morgan & Co. exceeded $1,000,000,000. This $1,000,000,000 is not Mr. Morgan's money, but it is in the hands of the Morgan interests, which say who *can* borrow it and who *cannot* borrow it, how it shall be used and how it shall not be used.
>
> "When Mr. Morgan took over the Equitable from Thos. F. Ryan, he paid more than $2,500,000 for stock that can legitimately earn only $3,514 a year, but what he really bought was control over the Equitable's $400,000,000 of assets and $80,000,000 of surplus. After this control was acquired, the statement was made in one of the financial newspapers that no man could borrow $1,000,000 in New York, *whatever the security*, if Mr. Morgan objected to his having it. No doubt this is true, for there are few

[1] See Report published by the Government Printing Office, Washington.

> independent bankers anywhere who would care to incur the hostility of the money trust that has been built up by the Morgan-Standard Oil interests and their allies."

Freedom of note issue tends, as has been demonstrated previously, to promote competition in banking, and therefore to prevent effective monopoly in this direction.

Finally there remains the objection that to extend credit facilities in this way is merely to put more wealth into the hands of those who already possess abundance. But I must have made it clear that I believe that free competition will not permit so unlimited an extension of individual firms as obtains to-day. The enterprising individual will much sooner reach the point where his business becomes too large to enable him to compete successfully with his smaller rivals. Thus the major portion of the benefit arising from the extension of credit will tend to assist brains rather than mere wealth.

I have now shown the undoubted influence of credit restrictions in producing monopoly and congestion of the labour market, and have sketched the probable results of the relaxation of those restrictions in abolishing monopoly. To recapitulate, the causes of monopoly may be comprised under two headings: (1) credit restrictions, (2) natural advantages, i.e., the possession of forces which are in themselves natural monopolies such as railways, coal mines, oil wells, etc. There can be no doubt whatever that the former cause is responsible for the greater part of such monopoly as exists to-day, and that the harmful effects of these unwieldy aggregations of capital would be removed in a harmless manner by the growth of competition among organizers of industry which would result from the grant of freedom to our credit system. With regard to natural monopolies, the general growth of industry outside those mono-

polies and consequent increased demand for labour would compel their owners to pay high wages to the employees engaged therein, and the progress of invention tends to prevent the same owners from taxing the community too heavily in the form of high prices. A comparison of the rates, facilities, speed, and comfort of the British privately owned railway lines with those of the continental State lines, or of the telephone systems (privately owned) of the U.S.A. with the British State system, demonstrates solid advantages on the side of private ownership. Coal, gas, oil, and water have never been seriously harmful monopolies in this country. Moreover, if we were to tunnel our streets after the manner of certain thoroughfares in Paris and elsewhere, there would even be opportunity for competition in the supply of gas and water.

The great Trusts and Cartels in forms of natural wealth which have sprung up in the United States and Germany have undoubtedly been for the most part due to the effects of a protective system upon the already severe congestion and monopoly of capital set up by State credit restriction. The effects of credit restrictions in causing monopoly of wealth in few hands have been insisted upon throughout this work; what more natural than that the possessors of such wealth should invest it in those natural monopolies which are already to a certain extent shielded from outside competition? A free development of credit, in placing capital in the hands of ability, instead of merely heaping it in the hands of the few who possess the valuable security required by present banks—in tending to equalize opportunity for all forms of productive ability—will undoubtedly prevent the accumulation of dangerously large fortunes, and render effectual control of natural monopolies a rare occurrence. Shall we then say that the small remaining danger of harmful monopoly warrants us in burdening all enterprise with the incubus of

State monopoly? I can only hope that there remains a sufficiently large body of opinion in the community to demand that the precious principle of freedom be given a full trial before society commit itself to State socialism.

There remain, however, among the socialist critics those who are dismayed at the prospect of "increasing competition". They declare that they desire to see a reduction of this competitive strife. They would like to see men live more tranquilly and take an interest in higher things than the mere struggle for material property. I suspect that if the truth were known, there are many who are attracted to socialism from this motive alone, who care and know little of the economics of their proposals. The cry is usually from those who already possess a fair share of this world's goods, or who are physically weary of the struggle which delights their fellows. The difficulty is that these types are both in small minorities to-day. Most men are still comparatively poor and possessed of an insatiable desire for material possessions: culture means but little to them. These men struggle, and will continue to do so for many generations under any system—they struggle to get wealthy by every means in their power. The utmost we can do is to maintain such a system of judicial administration that they shall not be able to take an unfair advantage of one another, and shall not oppress those who do not care for the struggle.

Credit restrictions, however, render the struggle far more fierce in the lower walks of industry than it need be. The prize is to the man who devotes his entire energies to business, to the exclusion of practically every other interest. Increased power to this type of man to assist him to raise himself out of the lower ranks of industry to the position of employer would enable him to spend his energies in a beneficial direction. Every increase of competition among employers would then mean cheaper goods, higher wages, and improved

conditions of labour for those who dislike, or are unable to take up the struggle and responsibility of the employer position. Under a sound credit system and undisturbed political conditions, men would be paid in accordance with their skill or the quantity of their exertion, and labour would receive as high a reward as organizing returns could afford. This is as much as the pacific few can in reason demand. They cannot ask that the majority of their fellows shall be content with less comfort or luxury because they (the cultured or the weary) do not care to labour for these things. A rational credit system would ensure that the latter were adequately paid for as much labour as they chose to perform, and would also ensure a plentiful market for their labour. It would, moreover, ensure that great wealth followed only great service, and would thus provide an outlet for the energies of the strenuous in a social direction. But to put the born struggler, with all his present passions, into a system of State ownership and production, where the path to promotion depended upon departmental favour, would be to turn a stream of energy in the direction of influencing departmental decisions, and we may rest assured that the tirelessness which proved so effective in commerce would not be without effect in State service.

Let us put away from us the hope that State socialism can prevent competition. The competitive tendency is bound up with the very flesh, blood, and spirit of the present average type of individual. Mankind is in the stage of desiring material wealth and luxury. Its chief energies are at present directed towards this end. The number of those who have developed sufficient philosophy of life to be content with moderate means is remarkably small; and even the members of this small company are prone to stretch their definition of the word "moderate" when the goal of their previous aspirations is realized. If particular departments under the

socialist State were so excellently managed that the employees therein judged that it would pay to be watchful and industrious, precisely the same "speeding-up" which we now perceive in monopolized private industry would appear. The man who is prepared to subordinate all private interests to his one desire to "get on" would, under such circumstances, be the man who would be found at his desk long after his fellows had gone home; he would take work home with him in the evenings; his holidays would be spent in scheming; and any men in his department who wished to secure promotion in their turn—who did not wish to be passed over in promotion by the energetic individual—would be compelled to imitate his activity.

There would be, however, I think, little danger of this form of competition under State socialism. It is probable that the chiefs of the future State departments, being less exposed to public criticism than to-day, would be less inclined to study and reward the efforts of their subordinates, than just to rub along, or spend their time in planning for their own promotion. The fundamental moving spirit of competition, however—the desire for wealth with as little output of energy as possible—this spirit would remain, and would disappear only when men's philosophy of life changed. But in free commerce the energy of competition would be directed into the beneficial channels of organizing production, since wealth would depend upon the favour of a public free to deal with a competitor. Every fresh output of energy in organization of production by exceptionally capable individuals would at once increase the demand for labour, and cheapen commodities, thus doubly benefitting the less energetic individual. Under State socialism, however, the worst feature of the present congested system of industry would be reproduced, since fresh industry could be established only by the slow method of moving majority opinion, and the whole

competitive spirit of the community would be confined and directed towards securing a limited number of positions. Hence, not only is State socialism likely to perpetuate the fierceness of competition, but since promotion under the State would not depend solely upon merit, but also, to a far greater extent than is possible to-day, upon the individual's power to ingratiate himself personally with the chiefs of his department, the competitive spirit would partly be spent in the socially less beneficial ways of the manipulation of backstairs influence. For proof of this statement we need only turn to the United States. Americans, on the whole, are more pushful business men than Englishmen; hence we perceive that bribery and political jobbery are more widespread in the United States than in this country. But political corruption, like most other human tendencies, increases proportionately with the temptation and encouragement offered. The more State industry is multiplied, the more difficult it will be to keep watch over the working of the different departments, and the more corruption must spread.

If the mere transfer of industry from private hands to the State could so change men's hearts that they would thenceforward labour for the sole pleasure of expending energy in the interests of the community at large, State socialism would probably work well. We know, however, that it would simply take a number of men who are idlers and shirkers at heart, and remove them from a station where their shirking can be comparatively easily discovered and dealt with, to one where it would be to the interest of their personal chief to defend them against criticism. For, obviously, if socialism is to work at all, experts must be placed at the head of each department. These heads appoint or "recommend" others to work under them. If the department work badly, the suffering public, which is unable to use the remedy of free men to purchase elsewhere, must criticize the

expert. Apart from the difficulty of criticizing a man who is an acknowledged expert in his branch, there is the further difficulty that he will undoubtedly defend his choice of subordinates. The only men who are capable of criticizing the working of the various departments are those who are themselves experts, and any criticism from them is always discounted by the accusation of jealousy and self-interest. Accordingly a Commission must be appointed to enquire into the working of the said department. Until its decision is made known the public must suffer. Moreover, as I have remarked in a previous chapter, criticism from one who is himself employed by the body he criticizes, the State, is a dangerous procedure, and would probably, therefore, assume the objectionable form of anonymity if all industry were put under the wing of the State. Hence the political body would be perpetually pested with anonymous criticism of its innumerable departments, and a never-ending stream of Commissions of enquiry.

Throughout State service, Mr. Hugo R. Meyer writes in *The State Telegraphs*, there is a conflict between promotion by merit and promotion by seniority. Promotion by seniority, he says, inevitably results in the occasional raising of an incapable man. Promotion by merit inevitably evokes a complaint of "favoritism" from the man who has been passed over. The head of a department has not the incentive of a private employer to elevate the most capable man; hence there is always room for the latter accusation against his choice. The rejected employee, backed by a powerful trade union or organization, can frequently get a member of Parliament to take up his case, and Mr. Meyer alleges (I have been unable to verify the statement) that Mr. J. Austen Chamberlain, when Postmaster-General, complained that at least a third of the time of the higher officials of the Post Office was occupied in dealing with the complaints of members of Parliament against de-

partmental methods of promotion. Imagine this state of affairs extended by the further nationalization of industry, and let us then ask ourselves how far social peace would be stimulated by the establishment of State socialism.

Let me not be accused of injustice towards State officials. They are neither better nor worse than their fellows in privately owned industry. I opened my examination of the social problem by affirming my belief in the existence of the "economic man". I believe that the *average* man to-day seeks to obtain as much wealth and leisure as the law allows him, although I fully admit that he may frequently spend this wealth and leisure admirably upon his wife and children, or as a Carnegie upon his fellows. In privately owned industry the law has so far perfected its machinery that the ordinary manufacturer is unable to maintain his position if he provide inferior goods or poor service. Hence he deserves little praise if he provides that which the community desires. Under socialism, however, the law will be less capable of preventing State officials from providing inferior goods and poor service; accordingly these will appear. Honest dealing and personal virtue have been enjoined upon men by Christianity during two thousand years, and yet every impartial economist to-day must admit that, on the whole, employees of the present day are not securing a fair reward for their labour. I have demonstrated, however, that the law, by preventing the due monetization of productive ability, actually prevents the majority of men from obtaining a due reward for their efforts. Hence I may be pardoned for looking for improvement in the direction of the abolition of these unjust laws rather than in the increase of a State industry which assumes for its effective working the existence of a personal virtue among its members which it is unable to enforce.

Faced with these objections, certain Socialists declare

that it was only the older Marxian "barrack" socialism which proposed to take all industry under the wing of the State: modern socialism proposes merely that sufficient State industry shall be set up to compel ordinary employers through competition to pay a better wage to their employees. I reply first, that if the aim of the Socialist be to create a proper demand for labour, he can accomplish this without invoking the coercive power of directive State interference, by simply relaxing his hold over men's power to lend capital to each other. Secondly, I deny that the maintenance of this "half-way" socialism is possible. State factories can be set up only on the proceeds of taxation or by capital obtained from the ordinary money market (proposals to confiscate private industry are here ignored as impracticable). In either case the result of the withdrawal of a quantity of purchasing power from the market sufficient to effect any appreciable difference in present conditions would inevitably be to harden the credit market and restrict the means of carrying on ordinary industry. There would ensue more unemployment and reduction of wages in privately owned industry, followed by the demand for more State workshops, and so on until the Marxian "barrack" conditions were actually realized. The evil would be mitigated if the State were to finance its first industry on State paper; but as soon as the Socialist has perceived that the evil needs an injection of cheaper credit, he must put the question to himself whether this credit should not rather be issued at their own risk by the men who have specialized on the profession of financing industry, the professional bankers, than by that organ of the comparatively ignorant majority vote, the State. This consideration will probably lead him to the opinion that such credit as were issued had better be advanced to the men who have shown aptitude for organizing industry and who are willing to take upon themselves the risk of failure of

their operations, than to men who are selected merely by majority vote and who will tax the community to repair their failures. If the Socialist continue his reasoning so far, he will be ready to consider sympathetically the demonstration in this book of the contention that the evil does not need the issue of State paper, but requires simply that the State shall relax its hold over the private issue of credit.

The fundamental evil of the existing system is not so much the competitive struggle, as the fact that the majority of men obtain so little result from their struggles, and are consequently compelled to continue the fight longer than they perhaps otherwise might, being obliged to subordinate all sympathy for their fellows and practice of the gentler arts to the one consideration of winning bare necessities. Let us remove those restrictions upon free exchange which now prevent the masses from obtaining a due reward for their exertions, and we may be sure that with increasing means and leisure a little philosophy of life, a little *savoir vivre*, will introduce itself and temper their efforts.

A typically socialist objection is directed against the "waste" of competition. The prominent tendency exhibited by modern industry, it is asserted, is the endeavour of two or more men to do what could easily be done by one. It cannot of course be denied that a certain amount of waste is inseparable from any system of free competition. If men are to be permitted freely to introduce improvements, we must be prepared to see continually a certain quantity of comparatively useful machinery being scrapped for no other reason than that it has been superseded by a better type. But this machinery is scrapped only when those who are best qualified to judge, the manufacturers who use it and depend upon the efficiency of the particular industry concerned for their livelihood, are of opinion that the advantages of the new invention cover the loss of

scrapping the old. The protest against State socialism arises partly from the fear that the stimulus to the introduction of fresh, and the scrapping of old methods would be lessened under a system of State ownership. It is always possible to criticize a competitive system on the ground that it entails duplication; a certain amount of duplication is inseparable from such a system. But under freedom this duplication is always resolving itself into variety, and the hand which "eliminates" waste by centralization, at the same stroke diminishes the possibility of future progress.

The present system, however, exhibits a more serious waste than the mere supersession of outworn methods. In Chapter II., during the examination of the case for centralization presented in the example of the competing milkmen, it was admitted that lack of better outlet for their energies frequently compels men to-day to force themselves into industrial areas which are already adequately stocked with labour. Again in Chapter XI. attention was drawn to the feverish search for markets which to-day compels manufacturers to waste their substance in excessive advertisement, use of travellers, and general harmful overlapping and undercutting. Obviously this waste of the employer's labour has a bearing upon the previously noticed waste of employee labour. When the manufacturer cannot sell his goods, the worker is put upon short time and low wages, and is thus compelled to search elsewhere for more adequate remuneration. But the chief aim of this book has been to show that State restrictions upon free competition in banking have hindered the conversion of wealth into capital and its distribution to productive ability. Hence glut of goods and unemployment, resulting in excessive competition for markets on the part of employers, and excessive competition for employment on the part of employees. The introduction of a rational credit system, in tending to raise consump-

tion to the level of production, would tend to remove the harmful and excessive waste which at present characterizes our system. It is, on the part of the Socialist, an assumption unwarranted by any facts of experience, that an elected body can, in the present state of social sympathy, supply the wants of the community in goods and services with even as little waste as the present congested system; and if we compare socialism with the possibilities of a system of less restricted competition, it appears in a yet more unfavourable light.

In a similar category stands the appeal for "Production for Use, not for Profit". We see people consuming adulterated goods produced by manufacturers whose aim seems rather to capture a market than to supply demand. Yet, a closer examination of the problem reveals the fact that the production of adulterated goods is often an actual endeavour to supply demand. The demand from the great majority of our underpaid workers is for cheap goods. Hence they are supplied with cheap goods—cheap by reason of adulteration. The price which must normally be paid for the means to establish industry to-day precludes the offer on the market of cheaper unadulterated goods, and the reward is to those firms that are lucky enough to attain the control of gilt-edged securities and the consequent command of cheap credit. Freedom of competition, in raising wages and cheapening commodities, will enable the worker to demand a better class of article for consumption.

It is again an unwarrantable assumption on the part of Socialists that the mere transfer of industry from individuals to the control of a political body will mean that "Production for Use" will be substituted for "Production for Profit". Men, for the most part, labour to-day only because the law has, to a certain extent at all events, prevented them from eating unless they work. Nationalization of industry will leave this distaste for

productive labour as firmly rooted as before. Men will still strive to do as little work as possible for as great a reward as possible. The only difference will be that State socialism will offer greater opportunity in some directions for shirking, and reduce certain present opportunities for excessive profits. "But goods will be produced for use"—it is protested. For whose use? At present, I am at all events able to obtain the goods I *personally* desire, if I can pay for them. If the State will but withhold its hand from directive interference with my efforts, I shall be able to extend greatly the range of my purchasing power. State socialism, on the other hand, offers me a choice of those goods only the production of which has been decided upon by majority voice, and calls this "Production for Use"!

So far the ordinary objections of Socialists. But furthermore, the fears of the wage-earning classes will undoubtedly be played upon by orthodox economists. The spectre of high prices will be raised against the banking reformer, precisely as it was raised against the Bimetallist. It has already been admitted that a necessary part of the cure of present social conditions is a certain preliminary increase of prices. It has, however, been sufficiently demonstrated that the rise of prices will be only temporary. Real wages will rise in proportion to the quantity of productive ability which is enabled by cheaper credit to be applied to the cheapening of commodities. But, let it be admitted, the first phenomenon will be a rise of prices, resulting from an injection of credit purchasing power. The injection of credit, however, is in itself a sign that trade activity is increasing, and it is only a question of time before workers are able to demand higher wages, and until the application of fresh productive ability to raw material causes a general cheapening of commodities.

Let the workers choose. Under present conditions prices are possibly lower than they will be during the

early periods of the introduction of freedom of credit; but the general congestion of industry causes widespread unemployment, and general wages are reduced by competition from those workers who are thus deprived of employment. The outlook in this direction is quite hopeless. Freedom of credit will most probably cause a temporary rise of prices, but must inevitably result eventually in high wages and cheap goods. To those who will cry: "Freedom of credit means higher prices!" it must be retorted: "What is the use of low prices when the worker is unemployed?" The worker who thoroughly understands his own interests will suffer the temporary and fractional rise of prices for the sake of the certain benefits to follow.

Turning now to the second class of objector, we are immediately met by the question: "Do you seriously intend to permit the banker to create money?" If, by the "creation" of money, the mere creation of tokens of credit is meant, it needs only to be replied that the banker is to-day allowed this freedom. The banker to-day "creates money", in that for every pound sterling deposited by him he issues without supervision many times that amount in cheque credit. We ask only that he be permitted to issue credit in a form which shall benefit the whole of the community—not merely a privileged section. Let us freely permit the whole of the community to come into contact with its banks by means of note issues on the part of the latter, and the people will rapidly demonstrate to their bankers that it is to the interest of the latter to refrain from issuing money except to the capable individual; and the bankers, on their side, will surely bring it home to those who borrow from them that it is to the interest of the borrowers to meet their engagements honourably.

It has been said that free issue banks tempted producers into overtrading; indeed, one of the chief contentions of Lord Overstone was that issue banks caused

overtrading, and that such overtrading caused financial panics. He said: "The banker, when the whole trading "world is acting under an impetus of expansion, cannot "contract his issues." In reply I would say first, that no such results occurred in Scotland where greater freedom existed than in this country; and secondly, that the community has methods at its disposal whereby unwise advances of the banker may be guarded against or detected. If we are not yet too strongly imbued with the protective spirit, these two arguments should suffice. Overtrading is a species of epidemic which seizes upon the community when certain exceptional industrial opportunities arise, whether the price of credit be low, or normal, as may be proved by examination of every speculative period in the past. No legislative action can prevent these crises without at the same time preventing all development of *legitimate* trade prosperity. Time and education alone must be the agents in preventing epidemics of speculation. The majority of past crises which have been ascribed to rash speculation, however, will, upon examination, prove rather to have resulted from unwarrantable credit restriction. The governor of the Bank of England was asked by the Committee of Enquiry which met in 1840, what he had considered to be a sufficient ground for extending credit during the late crisis. He replied that the willingness of old established firms to pay 5 per cent. for money, constituted, in his opinion, a sufficient ground for the advances which the Bank had made. This was during a period when the restrictionists considered that the Bank should have diminished its issues on account of a drain of gold. It is consequently a decided reply to the contention that the then impending crisis was produced by overtrading. We possess indeed no better test of sound trading conditions than the willingness of old established firms to undertake fresh operations. A truer explanation of 'overtrading" usually lies in the fluctuations of the

money market. Credit is at present almost continually restricted. When it occasionally becomes easier, producers undertake operations which, under those credit conditions, are perfectly sound and profitable. If, however, any considerable numbers of producers are so tempted, the extra strain on the limited credit market again raises the price of advances. This would not be so serious if it simply discouraged further production; but its operation is twofold, since it also closes the very markets to which the manufacturer had looked. Should the calls on him for money be further increased by reason of credit stringency (a very frequent occurrence at such times), he is bankrupted, and our financial experts talk wisely of "rash speculation".

It will undoubtedly be urged that since unwise trading harms both the sober and foolish trader, general restriction is justified. This is the old insidious and plausible argument for Protection. It needs to be pointed out, and constantly reiterated, that under freedom the community suffers only *when* unwise trading occurs—that under normal conditions freedom usually results in increased prosperity and in the invention of improved methods of detecting fraud; whereas any directive restriction *inevitably* harms the whole community and hinders the speedy elimination of those very persons for whom the restriction was judged necessary. In such cases prevention is not better than cure, since prevention introduces worse evils than those which it aims to eliminate.

Professor Jevons is frequently cited as one who has clinched the arguments against freedom of banking. In his work previously cited he states (p. 314):—

> "What the currency theorists want, then, is not more gold, but more promises to pay gold. The Free-Banking School especially argue that it is among the elementary rights of an individual to make promises,

and that each banker should be allowed to issue as many notes as he can get his customers to take, keeping such a reserve of metallic money, as he thinks, in his own private discretion, sufficient to enable him to redeem his promises. But this free issue of paper representative money does not at all meet the difficulty of the money market, which is a want of gold, not of paper; on the contrary, an unlimited issue of paper would tend to reduce the already narrow margin of gold upon which we erect an enormous system of trade. . . . When prices are at a certain level, and trade in a quiescent state, a single banker is, no doubt, unable to put into circulation more than a certain quantity of bank notes. He cannot produce a greater effect upon the whole currency than a single purchaser can by his sales or purchases produce upon the market for corn or cotton. But a number of bankers, all trying to issue additional notes, resemble a number of merchants offering to sell corn for future delivery, and the value of gold will be affected as the price of corn certainly is. . . . Everyone who draws a bill or issues a note, unconsciously acts as a 'bear' upon the gold market. Everything goes well, and apparent prosperity falls upon the whole community, so long as these promises to pay gold can be redeemed or replaced by new promises. But the rise of prices thus produced turns the foreign exchanges against the country, and creates a balance of indebtedness which must be paid in gold. The basis of the whole fabric of credit slips away, and produces that sudden collapse known as a commercial crisis. . . . Knowing as we do the very narrow margin of real metal upon which our many great banks conduct their business, it is impossible to entertain for a moment the notion of allowing the paper currency of the country to rest upon the discretionary reserves of such competing bankers."

The great importance attached in orthodox circles to the pronouncements of Professor Jevons upon this subject induces me thus to quote him at length. I am anxious to avoid the accusation of mis-quotation. With regard to his first statement respecting the need of the money market for gold, not paper, it will scarcely be believed that it is the same writer who stated earlier in the same work:—

> "No sooner have a people fully experienced the usefulness of a good system of money [gold] than they begin to discover that they can dispense with it as a medium of exchange."

I need not recapitulate the arguments which I have previously adduced to demonstrate that improvements in the mechanism of exchange consist mainly in substituting for valuable metals paper promises indicative of men's mutual trust. Professor Jevons apparently recognizes this, but omits to state precisely where the process of substitution should cease, and the passage first quoted is a striking evidence of the manner in which an eminent authority may be represented as stating principles which he would be the last to uphold. This professor of logic next compares the effect of the issue of promises to pay gold with the effect of promises to deliver corn: the latter naturally raises the price of corn, and the former the value of gold. The analogy is largely fallacious. A promise to deliver corn cannot be liquidated by a fresh promise to deliver corn, as can a promise to pay gold. Corn is required for consumption; whereas gold is in this case required merely as a basis for mutual trust. The multiplication of promises to deliver a given quantity of corn inevitably inflates the price of the grain when the time for redemption of the promises draws near; whereas promises to pay a given quantity of gold may be multiplied indefinitely so long as they are met at maturity by fresh promises. The one

necessary condition for the renewal of promises to pay gold is the continuance of men's mutual confidence in their respective power to produce wealth in *ordinary commodities or services*. It will be seen that Professor Jevons recognizes this later on; but he is not thereby induced to correct his previous analogy between corn and gold. He comes to the crux of the whole matter in the sentence wherein he states that the rise of prices

> "turns the foreign exchanges against the country, and creates a balance of indebtedness which must be paid in gold. The basis of the whole fabric of credit slips away, and produces that sudden collapse known as a commercial crisis."

The student who has followed the reasoning in the previous chapters of this work will have no difficulty in meeting this argument of Professor Jevons. If my examination of the existing system be correct, it is obvious that the fundamental cause of the withdrawal of gold in times of high prices in this country is the privilege afforded to the foreigner by our legally created free gold market of abstracting the metal. Prosperity causes only a temporary rise of prices—the rise will persist only until the goods produced through the agency of the credit begin to be offered for sale. If the banks are allowed to protect their gold during this period in the manner suggested in the earlier chapters of this book, there is no reason why the notion should not be entertained "of allowing the paper currency of "the country to rest upon the discretionary reserves of "competing bankers." The whole passage above-cited from Professor Jevons is, however, noteworthy as showing no attempt to raise the bogey of "over-speculation" to account for trade crises as is almost invariably done when other orthodox economists write of financial stringency. Professor Jevons observes that the crisis results merely from the bankers' endeavour to issue

additional notes: he does not contend that the notes are issued to incapable producers. He thus discloses the same grim law as was previously noticed in the utterances of Sir Edward Holden, namely, that under present conditions an extension of legitimate trade activity may bring about financial crisis. The one reply which it is necessary to make to Professor Jevons and to those who fear the bankers' issue of money is that the dangers attributed to Free Banking are mainly State-created. Freedom would enable the community to set up perfectly adequate protection for its credit system.

It has been asserted, and repeated by many economists, that the difference between the present amount of the total note circulation of banks of issue in this country, and their authorized issue, indicates a growing unwillingness on the part of people to use notes in exchange. The question only needs to be put to these theorists as to why the note issue uncovered by gold in Scotland is at present as close up to its authorized amount as is compatible with the law. For a period of four weeks in November 1911, the average circulation of the Scottish and Irish banks was as follows:—

	Authorized Issue*	Actual Issue
Irish banks (total) . .	£6,354,494	£8,077,037
Scottish banks (total) .	2,676,350	7,611,251

* That is, notes permitted to be issued in excess of the banks' gold reserves.

The difference between the authorized and actual issues is, of course, balanced in both cases by gold held at the banks of issue, in accordance with banking law. The explanation of the difference between English and Scottish banking in respect of the amount of the total note issue is rather that legislative interference in this country prevented people from acquiring that confidence

in banks of issue which prevailed under the less restricted conditions over the Border. English people were never thoroughly easy with regard to note-issuing banks. Hence the restrictions imposed by the 1844 Act upon the growth of issue banks were more easily successful in discrediting the reputation of those banks in England than in Scotland. In the 57th Report of the Commissioners of H.M. Inland Revenue for the year ended March 31st, 1914 (Cd. 7572), it is stated that the number of bankers in England has declined by amalgamations, etc., in the previous ten years from 219 to 69; whereas in Scotland during the same period the number of bankers has increased from 656 to 700. It is obvious that the greater the growth of the population in any district, in the absence of power on the part of the issue banker to increase his issues proportionately, the less familiar must people become with his notes, and the less chance he has of even maintaining his circulation. It was only the well-established tradition of the Scottish pound note which was able to withstand this tendency. Moreover, the distribution of population has changed a good deal more in England during the last century than in Scotland. Districts that were formerly of sufficient importance to maintain a considerable note issue, have been drained of their population to the newer centres, and the law prevented the establishment of issue banks in the latter towns. This opinion is supported by Sir R. H. Inglis Palgrave, who points out[1] that the note issues of English banks of issue in agricultural districts are, in proportion, more below their authorized amount than in industrial districts. He asserts that if the authorized issues of agricultural districts were transferred to the banks in industrial centres, the total actual issues would not fall far short of the authorized amount.

These objections, together with the more fundamental fear of export of gold already dealt with, form

[1] *Notes on Banking* (London, Murray, 1873), p. 73.

the basis of the opposition of modern theorists to free banking. It will be observed that the objections are for the most part the direct legacy of the protective spirit. Our fathers prohibited experiment with paper money; hence we foster the superstition and continue to teach it to our children that the only "true" money (medium of exchange or credit instrument) and the only conceivable standard of value is gold. Therefore, when gold leaves this country we throttle our home exchange system—thus we break down industry here—thus we enable the growth of monopoly. Instead of adapting the money supply to the amount of productive ability desiring expression, or even to the volume of goods desiring exchange, we have regulated production by the amount of money (gold) in the market. Consider what would happen if the government were to limit the issue of postage stamps while correspondence increased. Postage stamps would increase in value, and extension of correspondence would be hindered. The effect of an arbitrary limitation of the issue of credit tokens is similar: it enhances the value of gold, and throttles industry.

Throughout these pages I have endeavoured to show that the perfect credit system might have been developed in freedom had people been permitted to experiment without governmental interference. The present Bankers' Clearing House system is a remarkable instance of the evolution of a complex piece of commercial mechanism by voluntary methods. Started in 1775 in a little parlour in Edinburgh, without coercion, without violence, it has slowly grown to its present gigantic proportions (in 1909 its operations for the year totalled £13,525,446,000). The evil of all protective interference lies beneath the surface. A single restriction on the free course of trade has effects which spread like blight into regions undreamt of by its advocates. Each "protective" act calls forth further protection from the results of the protection. To-day we

are fearful of free trade in credit because we are afraid that gold will leave the country. Yet how many persons trace the present need for protection against drains of gold back to the circumstance that, by a restriction imposed with a totally different aim, men have been prevented from freeing themselves from the necessity of using gold? Notice how the evil grows: We prevent men (in 1694) from lending their credit to one another in the manner which they find most suitable, in order that a certain corporation may enjoy a valuable monopoly. The time comes when the need for credit becomes pressing, and the many who are unable to obtain it, fall under the domination of the few who are lucky enough to obtain that credit. We see the workers groaning under bad conditions, and we again "protect" them by instituting factory inspection and refusing to allow the employer to offer certain conditions of employment. Numbers of workers then remain unemployed, and we "protect" them further by putting them into workhouses. But the burden of factory inspection and workhouses becomes gradually greater, and we tax ordinary industry in an ever increasing measure to deal with the mass of officialism, crime, and vagrancy. The heavy taxation renders quantities of industry impossible, and, the outcry against unemployment growing, in despair we levy further taxes in order to State-endow motherhood, State-feed the children, and take the unemployed into State workshops. The goods from these workshops either undercut ordinary manufacturers or are sold at a loss, thus necessitating further taxation and in either case causing more stagnation of industry. Finally, we throw all principles of political economy to the wind and take the whole of industry under State "protection".

The most serious feature of the whole process is that the disease caused by restriction is beginning to blight our philosophy. When once our *theories* are destroyed,

the way will be open for any absurdities of practice. It is surprising how frequently one meets to-day the contention that a community, having the opportunity to choose sound industry and reliable service, will yet make an inferior selection. The existence of this idea is simply an evidence of the deep disease in our present social relations. We notice in every direction the acceptance of such inferior goods and miserable conditions by those who seem to be capable and willing workers that we begin to doubt whether men are really able to choose the best at all. Yet, did we but know the limited range of choice which is offered to these people, we should better understand the wisdom of their decisions. Our poor would not choose adulterated goods if their wages were high enough to enable them to buy purer *and dearer* commodities. A few degenerates will always select alcoholic intemperance as a means of hastening their elimination; but whole communities will scarcely fall to such pleasures unless the saner pleasures are so dear as to be out of their reach, even taking into account the fact that continued poverty—a repeated destruction of hopes—eventually tends to destroy the vital nervous energy required for healthy exercise of choice. Our industrious classes would rarely invest their hard-earned savings in risky enterprises, were it not that it is so exceedingly difficult to-day to provide for one's old age on the results of patient industry. Freedom of choice has for generations been prohibited in the most vital of commercial operations: the selection of medium of exchange. The whole community has accordingly fallen under the domination of gold-holders, and is therefore obliged to accept conditions which it would not otherwise consider. Our monetary laws deny to patient production its reward, while increasing the reward to lucky speculations hundredfold. Financial speculations do not, for the most part, increase production: success of one individual is frequently attained by another's failure.

The outsider wonders that a poor man can thus risk his savings. The outsider does not see the years of patient daily toil, morning, noon, and night, for a scanty pittance, while before the worker's eyes wealth is flaunted and wasted by idlers and speculators. Let us not doubt that in the majority of cases choice of conditions is made deliberately, and, on the whole, wisely, considering the opportunities offered.

CHAPTER XV

INTEREST

PERHAPS the most fascinating subject of controversy among economists of all periods has been that of the cause of Interest. The ancients, the early Christian fathers, the mediaeval economists, now upheld the levy of Interest, now proscribed it. In modern times prohibition of Interest seems generally to have been given up; but the schools are still divided on the subject of the cause of Interest. Our economists pen their scorn across continents at each other, and still the mass of literature on the subject grows unceasingly.

Reading curiously (and patiently) through the marvellously subtle and complex arguments set up by modern economists, chiefly German, in support of their theories, I have often remarked the analogy between Interest theories and philosophy. The history of philosophy is a record of unverifiable assumptions, upon which have been raised vast edifices of minutely detailed argument. The task of modern science is to unravel the tangle, reveal the fundamental unverifiable assumptions in the various philosophical structures of the past, and enjoin a little modest agnosticism where such is necessary. Similarly in economics most theorists have set out with the assumption that Interest is inherent in the very nature of Capital, and have constructed their theories accordingly.

Perhaps the greatest modern authority on the subject is Professor E. von Böhm-Bawerk, some time Austrian Minister of Finance. In his work *Capital and Interest* he minutely reviews the various existing theories of Interest, disposes of them all, and, in his later volume, *The Posi-*

tive Theory of Capital, sets up his own explanation with an elaboration of argument and subtlety of insight quite admirable.

I propose to consider the more important theories in the same order as they are reviewed in *Capital and Interest*.

Böhm-Bawerk introduces his subject thus (Introduction to *Capital and Interest*, Smart's translation):—

> "It is generally possible for anyone who owns capital to obtain from it a permanent net income, called Interest. This income is distinguished by certain notable characteristics. It owes its existence to no personal activity of the capitalist, and flows in to him even when he has not moved a finger in its making. Consequently it seems in a peculiar sense to spring from capital, or, to use a very old metaphor, to be begotten of it. It may be obtained from any capital, no matter what be the kind of goods of which the capital consists: from goods that are barren as well as from those that are naturally fruitful; from perishable as well as from durable goods . . . from money as well as from commodities. And, finally, it flows in to the capitalist without ever exhausting the capital from whence it comes, and therefore without any necessary limit to its continuance. It is, if one may use such an expression about mundane things, capable of an everlasting life."

Again (on page 8):—

> "It may with reason appear questionable if the entire profit realized by an undertaker [employer or organizer] from a process of production should be put to the account of his capital. . . . On this point opinions are divided. Most economists draw a distinction. From the total profit obtained by the productive undertaking they regard one part as profit of capital,

another as undertaker's profit. Of course, it cannot be determined with mathematical exactitude, in each individual case, how much has been contributed to the making of the total profit by the objective factor, the capital, and how much by the personal factor, the undertaker's activity. Nevertheless we borrow a scale from outside, and divide off the two shares arithmetically. We find what in other circumstances a capital of definite amount generally yields. That is shown mostly simply by the usual rate of Interest Obtainable for a perfectly safe loan of capital . . . For instance, if an undertaking in which a capital of £100,000 is invested yields an annual profit of £9000, and if the customary rate of Interest is 5 per cent., then £5000 will be considered as profit on capital, and the remaining £4000 as undertaker's profits."

It is thus evident that Böhm-Bawerk holds that Interest inheres in capital, quite independently of the expenditure of labour power.

Let us proceed to consider the various explanatory theories of Interest.

The Productivity Theory, upheld by Say, Lauderdale, Molinari, Leroy-Beaulieu, and others, lays it down that capital, in virtue of its productive power, creates value or surplus value. Böhm-Bawerk's criticism of this theory runs thus:—

"Although it is correct to say that the productive power of capital is *a* cause of value, one cannot say that it is *the sole* cause of value and surplus value. There is not a single feature in the whole circumstance to indicate that the greater amount of goods produced by the help of capital must be worth more than the capital consumed in its production—and it is this phenomenon of surplus value we have to explain."

Of course Böhm-Bawerk holds that Interest is inherent in the nature of capital; but if we grant that the average man *can* produce wealth with the help of a plane, the lender of the plane will demand as great a portion of the resulting product as the market will permit. The fact that certain borrowers of capital are not able to use it to advantage will not seriously lessen the demand for Interest on the part of lenders. The theory does not demand unfailing productivity from *every* piece of capital, any more than the assertion that capital produces profit, demands that all capital produce profit to its owner: some capital loses itself in the search for profit. Böhm-Bawerk himself states no more than that it is *generally* possible for the owner of capital to obtain Interest from it (see above, p. 386).

Next comes the Use Theory, according to which, not only does the real capital itself possess value, but there is a use (*Nutzung*) of capital which exists as an independent economic good. Here, indeed, we begin to be reminded of the subtleties of early theological discussions. Is there a sufficient difference between these two theories to warrant the existence of two rival schools? It seems obvious that even if the use of capital can exist as an independent economic good, it can do so only by reason of the productive power of the capital itself—that is, regarding productive power as the quality of satisfying human desire. Men would not pay for the use of a use*less* article. Yet the Use Theory numbers among its adherents such men as Hermann, Bernhardi, Schäffle, Knies, and Menger, all of whom have felt it their duty to announce to the world their discovery that Interest arises, not from the loan of productive capital, but from the loan of *the use of* productive capital! But although Böhm-Bawerk notes the similarity between the Use and the Productivity Theories, he is not content with a reference to his refutation of the latter theory; but must again point out

that in most cases of capital transferred, the use of the capital is identical with the *using up* of the capital. Why, then, he asks, should more Interest be paid after one year than after six months on a barrel of potatoes required for immediate consumption? Surely the Use Theorist might reply that although the potatoes are eaten immediately, yet, since their worth is returned only after six months, the borrower has the use of productive capital during that period, and should therefore pay the market rate of Interest for six months.

Perhaps the most popular of all Interest explanations was the Abstinence Theory, of which Senior was the chief exponent, followed by John Stuart Mill, Jevons, Rossi, Bastiat, Roscher, and Cairnes (to mention only the more prominent names). Senior showed that capital is capable of affording gratification to its owner, and that any postponement of such gratification must be proportionately compensated. It should be noticed that in this theory the capitalist replaces capital as the active cause in the production of Interest, or, in other words, Senior begs us to notice that Interest does not arise from a loan of productive capital (with equal insistence on both the loan and the productivity of the capital), but from a *loan* of productive capital. The Productive Theory undoubtedly erred in omitting the influence of the loan in the production of Interest. Profit arises from the use of capital *sometimes*; but Interest invariably arises from the loan of capital on account of the unvarying *possibility* of the production of profit by the use of capital. The Abstinence Theorists, however, (and I experience almost a malicious pleasure in finding Mill among them) err by going to the other extreme and omitting the influence of the productivity of capital. As I have remarked above, no man would pay for the use of use*less* capital. But let us pass to Böhm-Bawerk's criticism of the Senior school. He cites Lassalle's famous criticism of the Abstinence Theory—a criticism

which, however inadequate from an economic standpoint, we must in the main agree with:—

> "The profit of capital is the 'wage of abstinence.' Happy, even priceless expression! The ascetic millionaires of Europe! Like Indian penitents or pillar saints they stand: on one leg, each on his column, with straining arm and pendulous body and pallid looks, holding a plate towards the people to collect the wages of their abstinence. In their midst, towering up above all his fellows, as head penitent and ascetic, the Baron Rothschild! This is the condition of society! How could I ever so much misunderstand it!"

But Böhm-Bawerk is not satisfied with Lassalle—the Abstinence Theory must be destroyed in a purely scientific manner and without rhetoric. He adjudges it a logical blunder to represent the postponement of gratification as a second independent sacrifice in addition to the labour sacrificed.

> "Consider", he says, "the planting of fruit trees in the expectation that they will bear fruit in ten year's time. In the night following they are destroyed by a storm. How great is the sacrifice? Surely a lost day's work. Now, is the sacrifice any greater when the storm does not come and the trees, without any further exertion, bear fruit in ten years? If I do a day's work, and have to wait ten years to get a return from it, do I sacrifice more than if I must wait to all eternity for its return by reason of a destructive storm?"

And so on through eight pages. One can only marvel at this statement. Senior held that the capitalist must be compensated for the *postponement* of gratification—not for the *sacrifice* of labour; in *loaning* capital there is no question of absolute sacrifice of labour, since the return

of the loan is expected. If one must postpone gratification for three days, greater compensation is demanded than for postponement during one day only, three days' pain demanding more sacrifice of comfort than one. Böhm-Bawerk is less open to criticism when he notes that there may be less actual abstinence on the part of a millionaire who puts out £10,000 at Interest than for the labourer who invests his hard-earned £50; yet the former reaps a greater wage of abstinence. But this removes the argument from the economic to the moral realm, and is merely a repetition of Lassalle's criticism. Senior might justly reply that, economically speaking, to abstain from a £10,000 gratification demands more compensation than abstinence from a £50 gratification, since the former sum represents potentially greater satisfaction of desire than the latter.

We now come to the Exploitation Theory, the enunciation of which, as Böhm-Bawerk points out, if not the most agreeable among the scientific events of our century, certainly promises to be one of the most serious in its consequences. It stood at the cradle of modern socialism and has grown up along with it; and to-day it forms the theoretical centre around which move the forces of attack and defence in the struggle of organizing human society.

Böhm-Bawerk condenses the theory thus:—

> "All goods that have value are the product of human labour, and indeed, economically considered, are *exclusively* the product of human labour. The labourers, however, do not retain the whole product which they alone have produced; for the capitalists take advantage of their command over the indispensable means of production, as secured to them by the institution of private property, to secure to themselves a part of the labourer's product. The means of doing so are supplied by the wage contract, in which the labourers

second volume, *The Positive Theory of Capital*, 426 pages of closely printed matter, is devoted to the proof of this theory.

Yet, the imposing array of "Positive Theory" arguments notwithstanding, I agree with Mr. Hobson that Böhm-Bawerk's position is untenable. We have seen that the Productivity Theorists erred in omitting the influence of abstinence in the production of Interest—we do not pay Interest for the use of air, for instance, although air is without doubt among the most productive of the elements. The Abstinence Theorists omitted to take into account the productivity of capital: we do not pay the lender for mere abstinence on his part; abstinence from physical exercise, for instance, would yield little profit; we pay Interest for abstinence from the consumption of *productive* capital. But Böhm-Bawerk has found another feature of the phenomenon. He has discovered that time is the all-important factor. It might be thought that this circumstance was already implied in the Abstinence Theory: abstinence is inconceivable except in terms of time. Yet for the same reason, apparently, as the Use Theorists were impelled to publish their discovery that the *use* of productive capital is to be strictly distinguished from the use of *productive* capital, Böhm-Bawerk must inform us that *one year's* abstinence is something quite different from one year's *abstinence*! But even granted that the intellect of a member of that race of philosophers, the Teutons, can perceive a subtle difference in these two circumstances, it yet remains to be asked on what grounds Böhm-Bawerk omits the productivity, the utility, of capital from his theory. Could Interest be obtained from *one year's* abstinence from the consumption of use*less* capital? There is in my opinion no doubt that Böhm-Bawerk has fallen into the error of the other theorists in ascribing Interest entirely to one out of several necessary factors of the phenomenon.

Theory, however, lies in its assumption that the institution of private property by itself secures to one set of men an exclusive command over the indispensable means of production. The institution of private property provides merely that the individual who has legitimately acquired wealth shall be permitted the exclusive enjoyment thereof. Production is continually proceeding, fresh capital is constantly being created, men are continually receiving reward for labour, and there is nothing in the Exploitation Theory to show why the means of production should fall into few hands, or why labour should receive less than its fair reward. Yet we are faced with the existence of Interest, defined as a reward without equivalent labour. Where then does Interest arise?

In his criticism of the Exploitation Theory, Böhm-Bawerk simultaneously states his own opinion of the cause of Interest. He says (*Capital and Interest*, p. 342):—

> "The perfectly just proposition that the labourer should receive the entire value of his product may be understood to mean, either that the labourer should *now* receive the entire *present* value of his product, or should receive the entire future value of his product *in the future*. But Rodbertus and the Socialists expound it as if it meant that the labourer should *now* receive the entire *future* value of his product, and they speak as if this were quite self-evident, and indeed the only possible explanation of the proposition."

And then we get Böhm-Bawerk's long-delayed description of the *true* cause of Interest. It is the superior value of present over future goods: the capitalist lends potential present gratification, which is held to be worth more to the recipient than future gratification: hence the borrower is willing to pay Interest. Böhm-Bawerk's

second volume, *The Positive Theory of Capital*, 426 pages of closely printed matter, is devoted to the proof of this theory.

Yet, the imposing array of "Positive Theory" arguments notwithstanding, I agree with Mr. Hobson that Böhm-Bawerk's position is untenable. We have seen that the Productivity Theorists erred in omitting the influence of abstinence in the production of Interest—we do not pay Interest for the use of air, for instance, although air is without doubt among the most productive of the elements. The Abstinence Theorists omitted to take into account the productivity of capital: we do not pay the lender for mere abstinence on his part; abstinence from physical exercise, for instance, would yield little profit; we pay Interest for abstinence from the consumption of *productive* capital. But Böhm-Bawerk has found another feature of the phenomenon. He has discovered that time is the all-important factor. It might be thought that this circumstance was already implied in the Abstinence Theory: abstinence is inconceivable except in terms of time. Yet for the same reason, apparently, as the Use Theorists were impelled to publish their discovery that the *use* of productive capital is to be strictly distinguished from the use of *productive* capital, Böhm-Bawerk must inform us that *one year's* abstinence is something quite different from one year's *abstinence*! But even granted that the intellect of a member of that race of philosophers, the Teutons, can perceive a subtle difference in these two circumstances, it yet remains to be asked on what grounds Böhm-Bawerk omits the productivity, the utility, of capital from his theory. Could Interest be obtained from *one year's* abstinence from the consumption of use*less* capital? There is in my opinion no doubt that Böhm-Bawerk has fallen into the error of the other theorists in ascribing Interest entirely to one out of several necessary factors of the phenomenon.

Let me here give praise to Mr. Hobson, the only economist, so far as I am aware, who has given equal weight to Productivity *and* Abstinence in the production of Interest. One more bone remains to be picked with Böhm-Bawerk. He has defined Interest as an entirely unearned increment, affirming that "It owes "its existence to no personal activity of the capitalist, "and flows in to him even when he has not moved a "finger in its making." Yet he traces it to the superior value of present over future gratification. Is there then no effort required to abstain from present gratification? Does the estimation of the probity of the borrower involve no activity on the part of the capitalist? I have seen no effective reply from Professor Böhm-Bawerk to these questions.

It might seem that in uniting the two theories, the Productivity and the Abstinence Theories, Mr. Hobson has uttered the last word on the subject. I propose, however, to add a word, without daring to affirm that it is the last which can be said upon this most subtle of problems, or even that others may not have said it before me, although their writings have not come under my notice.

In the primitive military stages of society, insecurity of property and imperfect administration of justice render lending the most hazardous of professions. The borrower must compensate the lender for the risk undertaken by the latter. As soon as society progresses beyond the stage of barter, and begins to use a medium of exchange, legal tender laws and royal monopoly of the issue of such legal tender place the unfortunate borrower in a yet more disadvantageous position in that the tokens which form the medium of the loan are legally rendered scarce. From this time onwards, risk forms, I believe, the main element of the Interest charge. For, with the gradual appearance of the industrial stage of society, men no longer produce for

individual consumption, but for exchange. Thenceforward men exhibit no desire to retain their products; on the contrary, retention of products usually involves either expense of storage, or risk of deterioration. Moreover, as the productive powers of society develop, it becomes increasingly possible for fresh producers to be supported for considerable periods upon the aggregate production of the community without entailing an undue demand upon individual producers. Hence the necessity for abstinence in the process of affording to the individual the means of establishing industry gradually diminishes, leaving only productivity and the element of risk of loss of the loan to be paid for. The predominance of the risk factor in the production of Interest is, moreover, increased by legal compulsion upon producers to use the artificially restricted exchange medium. This latter element in the risk charge tends gradually to assume predominance over the danger of loss of the loan through fraud on the part of the debtor; for the increase in the volume of goods produced throws added strain upon the legally restricted exchange medium, thus increasing the risk of financial crisis and failure of debtors; while the gradual perfection of the administration of justice, together with the concurrent growth of social sympathy, renders the fulfilment of contract the more imperative upon producers, and accordingly reduces the risk of fraud. In the preceding chapters of this book I have shown the manner in which the State has prevented the professional judges of commercial ability and integrity from establishing a cheap and safe method of distributing wealth to consumers. In binding the exchange system unnecessarily closely to a scarce and valuable metal, the quantity of which has further been legally exposed to unforeseen fluctuation, the State has enormously increased the risk of exchange and lending.

We may now sum up this chapter. We have seen that

Interest, considered as a charge levied without personal activity on the part of the lender, as in Böhm-Bawerk's premises, has simply no existence in reality: it is a figment of the imagination of certain economists and reformers. For this imaginary phenomenon we have substituted the conception of Interest as composed of the charges for the productivity of capital, abstinence and labour on the part of the lender, and risk of the loss of the principal. The gradual increase of industrial productivity, and the increased interdependence of producers set up by the growth of specialized production, tend to reduce the two former charges to vanishing point. The risk charge, however, has been artificially enhanced by State interference, which interference, by excluding the majority of producers from the benefits of credit, has hindered that growth of production and specialization which would conceivably have also lowered the two former charges. Under primitive conditions the banker is compelled to assume the whole risk of a loan, since he is compelled to accompany his guarantee of the borrower's integrity with material assurance in the shape of gold. The banker accordingly charges the producer an extra sum for his trouble and risk in providing the gold. With increasing civilization grows the possibility of mutual confidence, and the value of a good reputation rises relatively to purely material possessions. Hence under civilization, and in the absence of restrictions, the banker no longer risks his gold, but his good name, in guaranteeing the individual's credit. The producer likewise does not risk the loss of gold entrusted to him, but the loss of his reputation, should he not redeem his obligation to the banker. As confidence becomes more secure, so, in the absence of interfering restriction, Interest, the cost of the provision of mutual guarantee, can decrease. The Interest charge will then be proportionate to the risk involved. The banker will finance the safer industry at

a low rate; whilst private lenders will take the greater risks at a higher rate. Economists have looked forward to a time when Interest will fall so low that the motive for accumulating wealth for purposes of lending will disappear. The apostles of thrift need not take alarm at this prediction. The Interest charge on risky advances will seriously diminish only when sufficient numbers of men are so virtuous that no guarantee of their good faith is needed, and when material wealth is so abundant that postponement of gratification is not needed for any schemes of fresh production that are set on foot. Interest will, of course, finally disappear only when wealth is so abundant, and mutual trust so perfect, that no man will pay for loans. Under such circumstances those who have no facilities for storing wealth will transfer it to others on condition of the return at a future date, not of an equivalent sum (for this would throw upon the receiver the risk of storing such wealth without compensation and would constitute an Interest levy), but of the original sum minus a certain charge for storage. This will mean the disappearance of the loan as at present understood, and the simultaneous abolition of Interest.

To return, however, to practical matters of to-day. Interest is at present apparently paid on ordinary capital; but in reality it is for the most part paid on gold. This latter payment is unnecessarily great because the law has given to gold a monopoly value over all other commodities. The lender charges Interest because the borrower cannot, in the ordinary course, obtain capital without paying Interest. All ordinary commodities either perish or require storage; but since we are virtually compelled to use gold, we not only store it free of charge to its owners, but pay them excessive Interest for its use. Justice requires that gold be reduced to its true commodity worth by the extension to producers of legal permission to choose their own exchange medium.

The evil of Usury is thus seen to lie at the root of the social problem. The result of excessive Usury in all ages has been the same: gradual accumulation of all sorts of property into a few hands, a sudden outburst of revolution, a demand for the abolition of debts—and an attack on property in general. Such outbursts were witnessed in ancient Greece, in Rome, frequently during the Middle Ages, and again in the case of our own Chartist riots. The agitation is now being renewed by Socialists, and has already caused considerable bloodshed in strikes and popular outbreaks. The solution of the problem upon lines of sound political economy is, however, I believe, possible, and the subject of banking reform must take a prominent place in public discussion.

I trust that I have said enough to outline the far-reaching effects of credit restrictions. I can only reiterate in conclusion the words I have written elsewhere at the close of a series of articles on this question, namely, that it is always a difficult matter for a writer to estimate how far he can rely upon his readers being able to apply for themselves to present conditions the principles he has laid down. One type of mind assimilates easily the reasoning in a certain direction, whilst every detail of suggestions in another direction must be minutely explained. Yet, another type will require careful details of the former principles, while impatiently stigmatizing as laboured one's minute explanations of the latter. I cannot therefore hope to anticipate all difficulties. In reality, the numbers of difficulties raised are, for the most part, not proper to the subject at all; but have been set up by the confusion of banking with bullion questions, owing to constant governmental interference with the natural evolution of exchange expedients. The subject of banking has been neglected by all but a small circle of experts. It has been avoided by ordinary students as a minor commercial operation

of a complicated nature. I repeat that the fundamental principles of banking, divested of unnecessary wrappings, are of the clearest and simplest nature, and that a thorough comprehension of them is essential to students of modern social conditions.

APPENDIX I

THE LAND QUESTION

By certain classes of reformers it has been asserted that to provide a better opportunity of securing cheap land would solve the social problem. They have pointed to the present hunger for small holdings in proof of their theory. In the first place, however, it is evident that the desire for small holdings is, in many cases, merely a result of the exceedingly bad terms at present offered to wage earners: men fly to any means which free them from the bad conditions offered by present employers. Secondly, the complaint already arises from occupants of small holdings that some system of cheap credit must be set up if the land is to be worked at a profit. Cheap land is generally useless without cheap capital. Throughout England we may find cases in which small *freehold* farms of 30 and 40 acres are going out of cultivation, thus proving that neither land monopoly nor the landlord is the chief cause of the evil. The decay of agriculture in England is only partly due to land monopoly; it is partly due also to the restriction of credit, and partly to the increased facilities for the import of agricultural produce from countries which are either blessed with a better climate than our own, or which have made greater progress in scientific methods of production. The break-up of land monopoly is in itself an insufficient solution of the land problem, as is proved by the fact that in Germany and Russia, where peasant proprietorship is well in force, the money-lender is the parasite that fattens upon the industry of the peasant. The farmer needs credit in the spring for seeds and tools, and in the autumn for labour; but his returns

come in only after harvest time. The present banks are, for the most part, quite unable to grant such long-date credit as this, and the only resource of the farmer has been the money-lender with his extortionate interest. Germany and Italy have lately made some progress by setting up Land, Schultz-Delitsch, and Raiffeisen banks; yet all these institutions labour under the disadvantage of not being able to issue notes; they are continually compelled to charge higher interest than would otherwise be necessary, and to limit the variety of security on which they grant credit, on account of their inability to economize the use of gold.

I admit that ground rent is a form of usury, the payment of which is a charge upon industry without equivalent labour; and I admit that if it could be abolished, the price of all goods would fall in proportion to the amount of the tax thus removed, and the whole community would gain in prosperity. It is just that a man should receive compensation for labour expended by him upon land; if we can abolish the system whereby a man may purchase land and simply hold it out of use until the growing needs of his neighbours press them to offer him an exorbitant rent for the same—if we can abolish this system without thereby imposing greater evils upon society, our course of action is clear. I will go further and admit that land and credit reform must go hand in hand if we are to attain social equity. So long as land monopoly prevails, any pecuniary benefit that may accrue to the producing classes from credit reform will go largely into the pockets of landlords in the form of increased rents; and so long as the present legalized money monopoly persists, any additional wealth that may result from land reform will be largely appropriated by the financial classes in the form of increased usury charges. The ideal land system appears to me to be that sketched by Tucker in his *Instead of a Book*, namely, use-ownership. This system strikes at the levy

of ground rent by providing that no man be protected in the possession of land required equally by another person, unless the former can prove, to the satisfaction of a jury drawn from the neighbourhood, that he is personally using the land in a reasonable manner. Roughly speaking, the use-ownership system extends to individuals the right, conveyed to bodies of men by the recent Small Holdings Act, to compel sale of land. The Small Holdings Act, of course, is a product of present social misery. The State recognizes that applicants for small holdings are for the most part too poor to purchase land, and that there is no credit available for them; hence it empowers local authorities to purchase and sub-let suitable sites. There seems, however, no reason, except lack of political influence, why a single landless man, desiring a farm, should have to wait until others share his aspirations, before a local non-using owner of land be compelled to sell. A freeholder is a more solid citizen than a tenant, even though the landlord be the State. I note with pleasure that Mr. Frederic Harrison favours use-ownership as the ideal land system. His one fear is that the small owners would fall into the power of the money-lender. A free credit system would render this fear groundless.

Private ownership of land assures security of tenure. Experience shows that land is worked best when the individual receives the full reward of his labour, and is certain of being left in the enjoyment of improvements. Science in land culture is gradually diminishing the advantages of superior sites, and experience shows that the individual acquiesces more readily in whatever advantages his neighbour may gain from a superior site than in interference with his own method of cultivating his land. Yet, if harmful monopoly is not to arise, some method of determining if a man is "using" land must be set up, and the local jury system appears to me likely to produce less friction than a State-appointed Board of

Arbitration. This proposal does not necessitate small holdings; the most economic type of farm will prevail.

The coercive principle set up in the Small Holdings Act was, however, a little premature, at least in this country. Two or three measures of reform in the direction of increased individual liberty should have been given precedence if our politicians had the sociological and economic knowledge that their position demands. First, they should have abolished that absurd relic of feudal tenure, the entail system, which prohibits particular persons from selling their land when they so desire. Most of the large estates of this country have, at some period of their tenure, come into the possession of a person who would have been only too glad to sell had he been permitted. Secondly, the legal costs for transferring land should have been reduced. Lastly, it should have been seen that State restrictions on banking compel the payment of an extortionate price for the capital required for the purchase and cultivation of land, and consequently either force the farmer to become a tenant, or throw him into the hands of the usurer. Hence credit restrictions should have been abolished. If, after these reforms, the land in certain districts still remained in few hands, whilst the applicants became numerous, local courts might be established where the use-ownership test could be applied to local land monopolists. The rigid application of the test everywhere would probably never be needed. I admit that this interference with the retention, and conditions of bequest, of land property abrogates an existing liberty; but I agree with the land reformers that the inevitably limited extent of available land on our globe places this property in a peculiar position, and renders some form of restriction necessary.

While this subject is under discussion, however, I would draw attention to the evils of landlordism in large towns. By the recent Small Holdings Act we have recog-

nized the right of the landless man, or at least of a body of them, to compel the non-using owner of agricultural land to sell. The question may well be asked why the farmer should be thus exceptionally favoured. In our large towns we see everywhere landlords who are able to charge a fabulous ground rent to tenants who would be only too pleased to buy the land if the price were more reasonable, especially if, in addition, cheap credit were available. If the land in large towns were owned more generally by those who are dwelling upon it, instead of by absentee landlords, the ordinary accidents of life would render it far more easy than at present to obtain town sites for dwelling or factory. The tenant who so desires should be empowered to purchase the freehold of the land whereon his dwelling stands, the price to be fixed, when necessary, by a local jury, or, what is perhaps more suitable for large towns with their shifting population, by a court of arbitration; notice to be taken, in deciding the price, of the part played by the owner in causing the current price of the land. In cases where it could be sufficiently proved that the owner had contributed little to the increased worth of the land, a part of the market price might either be remitted, or devoted to communal purposes. I offer this as a suggestion only, and leave the details, which are evidently of considerable importance and difficulty, to be worked out by those who are more specifically interested in land problems.

The system of setting up the State as sole landlord appears to me to suffer from the cumbrous machinery which would be necessary for its administration. It would be difficult to eliminate the influence of the politician from the decisions respecting tenancy of particular plots of land. With regard to the Single Tax scheme, I am unable to see why land should be singled out from other possessions for taxation. The argument that "no man made the land—therefore no individual

"should own it or appropriate any portion of the in-"crement due to increased demand for the same" appears to me to be perfectly applicable to all forms of natural wealth, e.g., timber, fruits, cattle, etc. Land is in most cases quite useless unless *some* labour is expended thereon. If individual ownership of land be expedient, these arguments from "natural right" are futile. The Single Tax system, considered as a means of raising revenue, appears to be open to all the objections of inequity which may be raised against any indirect taxation. If the abolition of land monopoly be the aim of the Single Taxer, I would simply point out that the withdrawal of legal protection from the possession of unused land is a much cheaper method of attaining this end, since the charge for legal procedure in cases of dispute would fall upon the unjust claimant. Nationalization of the land with the State as farmer, hiring labourers at a fixed wage, has all the defects of ordinary socialism in loss of stimulus to the individual worker.

With the passion for equality which characterizes the present wave of social sympathy, certain reformers have pointed out that true equity cannot exist so long as one man may find a coalfield upon his land, whilst another man may experience the greatest difficulty in raising potatoes upon his farm. The choice here lies between two evils. If the community take upon itself the right to tax a man for the exceptional productivity of his land, the stimulus to exertion is reduced. It is difficult to determine the part played by individual ability and exertion in causing the current price of a particular estate. Whilst it might be worth while to undertake these calculations in the relatively few cases where the *sale* of land is under consideration, I am of opinion that the friction set up by the constant supervision of an individual's activities, necessary for the annual assessment of taxation upon productivity of land, would outweigh the benefits likely to be derived from such a

course. A man of ability and resource might utilize the mineral wealth of a certain estate, where another man might be able only to grow potatoes on the same land, and it would be inadvisable to discourage the activities of the former by the imposition of any greater tax upon the results of his activity than the ordinary income tax. We find everywhere that certain men prosper by reason of natural genius, and others by acquired talent. We judge it inadvisable to tax general ability because it is exceedingly difficult to distinguish the two forms, and we are justly fearful of discouraging the *acquirement* of ability. We are satisfied when we have set up such conditions as permit each individual to reap the reward of his own ability. Under such conditions it is impossible for the possessor of exceptional ability to oppress his less fortunate brethren; he is simply able to acquire greater wealth than they. The evil of present conditions is that the possessor of great wealth monopolizes the medium of exchange, and consequently prevents others from reaping the reward of their own capacities and efforts. If we abolish this inequity by enabling banks to create the means of transferring wealth produced for sale to possessors of productive ability, there is no doubt that the community will decide to permit exceptional ability to reap its exceptional reward for the sake of the freedom from majority interference, and the stimulus to the acquirement of talent, to be thus gained. In the main this consideration applies also to the exceptional productivity of certain land sites. The one evil peculiar to private property in land is the retention of land by one who does not use it personally but simply taxes a tenant user, although the latter might be willing to purchase the farm. This evil does not necessitate the objectionable remedy of nationalization, but simply the application of the use-ownership test previously described.

It is urged that as long as certain natural products

such as coal, oil, etc., are inherently monopolies, the owners of the sources of their production will endeavour to combine in order artificially to raise the price of these products to the consumer. I am willing to admit that such harmful combinations may be possible; but I would point out that a cheap and flexible credit system would render harmful combination difficult, if not impracticable. There is scarcely any natural product to-day which is not exposed to the competition of some substitute. Freedom of credit would enable the substitute to be marketed far more readily than is the case to-day. If, for instance, coal-owners were to combine to raise the price of coal, a free credit system would enable the rapid introduction of oil fuel, and when once manufacturers had established the new system, the coal monopolists would find it difficult to regain their former customers. It will be contended that combinations will be formed to include all possible forms of fuel. I reply that experience shows that so enormous a combination is a most difficult organization to keep together. Effective monopolies of this nature, even under our present system of legal discouragement of competition, are rarely long-lived, and freedom of credit would render their life still more uncertain. This question, however, received more detailed treatment in Chapter XIV.

I am aware that I am passing over many objections from upholders of the various schemes of land reform which I have condemned. This is not the place further to discuss the land problem. I merely state my views on the subject because it seems to me that the inclusion of the general term "Individualism" in the sub-title of this work necessitates some pronouncement on the controversy respecting land tenure and "natural" monopolies.

APPENDIX II

THE WAR, FINANCE, AND ECONOMICS

IT has been asserted in many quarters that the financial expedients established during the war have revolutionized our currency theories. I think this is an exaggeration of the facts. The war measures have taught us little currency science that we did not know before. We have had a limited Treasury issue of £1 and 10s. notes, and the displaced gold has gone to swell the Bank of England reserves and to pay for imported necessities. This experiment does not prove that these notes served all the purposes of gold coins, since the notes were made legal tender and therefore could not be refused by those persons that might have preferred gold. Moreover, the wave of patriotic feeling throughout the country has doubtless caused the suppression of many a criticism that might otherwise have arisen from the conservatively minded. I, personally, am of opinion that the notes formed a better medium than the gold they displaced, if only because they were cheaper; but the mere acceptance of the notes by the public proves neither that the notes were liked, nor that the maintenance of the system after the cessation of the war is likely to be approved.

So much for practice. From the standpoint of economic theory the opinions of the classic schools remain unchanged. Professor Shields Nicholson has written to the Press asserting that the issue of State paper has inflated commodity prices, and that we will do well to retire the notes as soon as possible upon the cessation of hostilities. This is a curiously familiar echo of the discussion of a hundred years ago. The Bank of Eng-

land officials can still urge, as they did to the American Monetary Commission (see p. 278) that, an issue of small notes would tend to drive gold out of the country. The embargo laid upon gold exports at the outbreak of the war prevents any disproof of their theory.[1] I myself wrote to the Press pointing out that a fluctuating price of gold, regulated by the supply and demand conditions of the bullion market, was a method superior in flexibility to the bureaucratic embargo that was laid upon exports of gold; also that the fluctuating gold price was a measure for peace as well as for war-times. But my voice was drowned in the chorus of warnings from bankers that we would do well to re-establish the free gold market as soon as possible.

The socialist school has been at pains to show that the war has demonstrated the folly of leaving banking to private enterprise. The State was obliged to come to the support of the banks in war-time; therefore, it is asserted, the State should take over the banks permanently. On these grounds one might argue that because it was necessary to send several millions of men and engines of destruction to Flanders in war-time, it should be done in peace-time. Surely Individualists have always contended that directive State control of the individual's actions is the necessary accompaniment of the militarist State. Banking depends mainly upon general confidence that borrowers will pay their debts. When war breaks out, and firms previously regarded as stable are made bankrupt on every hand, the most stable organization, the government, must step in and save the banks; otherwise all industry collapses. The rigidity and inflexibility of the State which, by rendering it proof against even violent disturbance, qualify it

[1] There is some mystery surrounding this allegation. In financial circles it is pretty generally maintained that an embargo was laid upon the export of gold from this country at the outbreak of the war; but I notice that Mr. Hartley Withers denies that any such restriction was imposed upon gold exports.

to act thus in war-time, disqualify it to maintain such control in peace-time. On similar grounds we may support State control of industry in war-time, and condemn it in peace-time. Individualism depends for its healthy operation upon the tendency of men to compete in the reduction of unduly high profits. In war-time the stoppage of overseas commodity supplies, the bankruptcy of many firms and the general withdrawal of producers for military purposes convey an artificial monopoly to the remaining producers, and unless the government step in, unfairly high profits will be gained in industry. But the State's hand is heavy: and whilst the State alone has a hand heavy enough to prevent the gross evils that would otherwise arise in industry in war-time, it is precisely the weight of its hand which unfits the State to control industry at other times. Competition, left free from directive State interference, suffices to keep industry healthy in times of peace. The war leaves the arguments against State interference with the individual in peace-time in the industrial State precisely where they were.

Of more interest is the comparison that has been made in all quarters, since the outbreak of the war, between German and English banking methods, generally to the disadvantage of the latter. There is no doubt that commerce in Germany has been assisted by the banks to a greater extent than has been the case in this country. German bankers have diligently endeavoured to acquire or employ expert knowledge of the industries they were called upon to support. They have therefore been able actively to foster home industry; whereas British bankers have, for the most part, confined themselves to supporting mercantile operations. It should, however, be remarked that these German industrial loans were useful only because they were of long date, and that German bankers were able to make such loans with safety only because they were protected from the

fluctuations of the international bullion market by the absence of a free gold market in their country. Yet, the endeavours of German bankers to support industry is an interesting object-lesson for Socialists of the willing and useful co-operation undertaken by individuals in the absence of State interference.

With regard to the social problem: the chronic disease of unemployment will undoubtedly assume a more aggravated form at the close of the war. The labour market will be swelled by numbers of men who will be unable to find employment owing to the ruin of industry and dearth of capital occasioned by the long suspension of normal production. We are already being prepared by insistent propaganda on the part of Socialists for a growth in the demand for the establishment of fresh State industry to use up the future surplus labour. But what is evidently needed is that the capable organizers of industry shall be encouraged to commence operations, and I can only hope that the reader will see that it is preferable to attain this end by a reform of our credit system than by the establishment of further State industries.

APPENDIX III

FINANCE SINCE THE WAR

In preparing this book for its second edition I am reminded of one economist critic who wrote in 1920 that Mr. Meulen's book was useless to-day since it was written before the war and it omitted to take into account the immense change in our financial theories that had occurred during the war. To-day I can only smile—a wry smile. Those immense changes—where are they? We may safely say that the war taught us nothing useful—not even how to make a stable peace.

Early in the war the government appointed the Cunliffe Committee, under the chairmanship of Lord Cunliffe, a Governor of the Bank of England, to consider:—

> "the various problems which will arise in connexion with currency and the foreign exchanges during the period of reconstruction, and to report upon the steps required to bring about the restoration of normal conditions in due course," and subsequently "to consider the working of the Bank Act of 1844 and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable."

Here was scope enough; but on August 18th, 1918, the Committee produced its first report, practically recommending that the 1844 Act should be restored with very slight amendments. It decided that the rise of prices was due to inflation of the currency, which could not have occurred had we remained on the gold

standard. The most important part of financial reconstruction must be, it declared, that the country reduce its currency until prices fall to such a point that we could permit the free export of gold again and so return to the gold standard. So much for the immense changes that had occurred in our financial theories during the war.

At the close of the war millions of men returned to civilian life. Here was clear need for a liberal extension of credit to enable the replenishment of our depleted stocks of the goods required for peace. The "Big Five" banks rose to the occasion ponderously, and with the dignity befitting their monopoly; but they certainly rose. The wheels of industry began to hum again, and prices rose. Immediately a cry of "Inflation" arose. My friends and I wrote to the Press pointing out that for years we had not been renewing the stocks of raw materials required for peace, and that the sudden demand on these stocks would largely account for the rise of prices. We advised patience: let industry get on its feet again, and prices will come down by themselves as long as the Treasury issues no fresh money. The government, however, turned for advice to the Cunliffe Committee.

Mr. Hartley Withers is one who listened throughout the war, with his ear close to the ground, for any changes in economic theory. He wrote in 1924 (*Bankers and Credit*, p. 112):—

> "This [Cunliffe] Committee, by laying down these principles, thus took a firm stand against the many prophets who were proposing to lead us into a new economic Paradise, merely by the unlimited expansion of credit. It pointed out that for capital purposes what was required was not credit but capital, and that capital could best be provided, not by making entries in the books of bankers, but by somebody

saving money and handing it over to industry to be used for purposes of development."

The only comfort in this statement is the reference to "the many prophets". I did not know we were so many. But Mr. Withers must have stopped his ears carefully against our reasoning. Let me say again: Industry does not produce money: the bankers do this. Industry cannot save its products: it can save only the money which the banks permit to be issued against these products. We insist that our laws prevent banks from issuing money to sound borrowers. Why does not Mr. Withers reply to this argument? I suggest that the reason is that it is easier, and more likely to prejudice public opinion against us, to accuse us of proposing "the unlimited "expansion of credit".

In August 1919 Mr. Chamberlain made a speech in the House of Commons in which he used portentous language to describe what would happen if this extravagant expenditure were allowed to proceed. The banks took this to foretell deflation, and the rise in prices slowed down. In November the bank rate was raised to 6 per cent., and to 7 per cent. in April 1920, where it remained for a year. By the spring of 1920 prices were falling headlong. In 1925 we reverted to the gold standard, and the pound experienced again the dazzling pleasure of "looking the dollar in the face". The effect of the vision on industry, however, resembled rather the petrifaction which, in the old fable, seized those who gazed on the Gorgon's head.

It is unnecessary for me to detail the industrial misery that followed our return to the gold standard. The spectacular fall of prices and profits, and the increase in unemployment are familiar to every student of economics.

Amid the general ruin and misery one policy was held firmly with clear and steadfast vision: the govern-

ment held securely on to the gold standard. With every outflow of gold the Bank of England tightened the bank-rate screw until our wretched industry sweated blood. And to make matters worse, other countries also returned to the gold standard. Perhaps their action was partly due to British influence. When the mother of banking returned to the gold standard, what else could her children do? But the real determining influence was the U.S.A. Practically every one of the European nations was in financial difficulties at the close of the war. The one country that could afford to make loans was the U.S.A. And when the U.S.A. was invited to set a country on its feet, a return to the gold standard was made one of the conditions. Obviously when the U.S.A. held half the world's gold stock, it did not wish to be left with stocks of useless gold on its hands.

Doubtless economic historians of the future will look back at the period 1923–33 as the "Hungry Twenties". The parallel between that time and the "Hungry Forties" of 1840–50 is a close one. The main difference is that the formerly helpless victims of our currency ignorance, the unemployed, have been able to extract monetary relief from the State. Also our economic ignorance is not quite so dense as it was during the "Forties". In the years since the war a small but energetic band of reformers has persistently attacked the gold standard and the banking monopoly. Eminent men like Keynes, Hawtrey, and McKenna have been talking more boldly. Most of the daily papers have opened their columns to discussion of currency, once deemed the driest part of the "dismal science". This work bore fruit in August 1931 when the crisis arose over the persistent drain of gold. Here was a severe testing time for the gold standard. In spite of the "immense changes in our "financial theories that had occurred during the war" cabinet ministers and eminent economists fell over each other in their earnestness to tell us through the Press

and the wireless that our future depended on our holding fast to the gold standard. The drain of gold persisted, however, paying no attention to cabinet ministers; and with dramatic suddenness the government announced the abolition of the gold standard. The same voices then filled the air and the Press to tell us that it did not in fact matter if we were on the gold standard or not.

It really must be distressing for a serious man to be an "eminent person", and to be obliged to make diplomatic pronouncements on critical occasions. It is a melancholy reflection that after all our labours the government did not discard the gold standard deliberately, in calm and reasoned consideration of the great harm that the gold standard was inflicting on the country: it just stumbled into the path of progress, blindly, anxiously, fearfully, as a temporary refuge from a grave danger. Perhaps our propaganda gave the government a little confidence—who knows?

Since September 1931 we have been off the gold standard. True the Bank of England examined its books of precedent and discovered that the correct thing to do at a time of a drain of gold was to raise the bank rate. Our move off gold was accordingly made suitably miserable by a rise of the bank rate to 6 per cent. I wrote to the papers protesting that the abolition of the gold standard removed the danger of a further drain of gold, and it was unnecessary to burden us with a high bank rate; but my protest found no echo. The high bank rate was maintained right down to the summer of 1932, when, for no apparent reason, it was suddenly reduced by quick stages to 2 per cent. Mr. McKenna then wrote that the high bank rate imposed when we went off gold was entirely a mistake and had inflicted incalculable hardship on industry.

But the abolition of the gold standard has done us no harm whatever—only good. The foreign exchanges

moved against us; but this was merely the natural depreciation of a currency that was no longer convertible into gold at a fixed price. It was a depreciation in the estimation of bullion brokers only. Our foreign trade has been seriously hampered by the bristling barbed-wire defence of tariffs, but not by the abolition of the gold standard. Our exchanges of goods have proceeded the more easily since the removal of the hindrance of the gold standard—that standard which jerked the value of our bills about until our industry was sick.

Yet I have throughout this book insisted that, important as is the abolition of the gold standard, that measure is of little use without freedom of note issue. Banking history since 1931 has proved my contention. The gold standard is abolished. Gone is the danger that an unforeseen drain of gold may compel the banker to realize his customers' security. The banks are now able to make long-date loans on less valuable security; but do they do it? I have watched in vain for any sign of more flexibility in banking policy. The banks are continuing steadily the customs of their fathers. They can of course assert with truth that the abolition of the gold standard is only a temporary measure, and that high authorities are urging its re-imposition. But even if the gold standard were definitely abolished, why should the banks bother to take further risks? Throughout this last decade of depression, when some of the strongest of industrial concerns have passed into the Official Receiver's hands, and the profits of the remainder have been reduced to next to nothing, the banks have maintained their same dividends of 14 to 20 per cent. In addition they have been covering up profits by the expenditure of vast sums on bank premises, and expensive sites for new branches. The community is already restive at the spectacle, and it is conceivable that the banks feel it to be unwise to show greater profits. In any case they are doing too well under the present system

to have incentive enough to take additional risks. Only fresh competition will stimulate them to perform the business of searching out productive ability in the community; and freedom of note issue provides an avenue for the establishment of fresh banks. Let the banks but feel the gentle prod of competition with which all of us in industry are familiar, and they will grow blossoms of altruist service to the community in a vernal shower.

And now to current banking discussion. The spectacular abolition of the gold standard set even the popular papers discussing currency theories. The Macmillan Report, awaited with so much expectation, showed its appreciation of the "immense changes in our "financial theories that have occurred during the war" by giving strong support to the gold standard. Its remedial proposals are negligible. Yet the Macmillan Commission began hopefully. It invited communications from several monetary reformers, including myself. Our combined eloquence, however, evidently failed to shake the Commission's conviction that no important changes in our financial theories had occurred during the war. The Gold Delegation of the Financial Committee of the League of Nations also evidenced its vigorous originality by assuring us that adherence to the gold standard is essential. It gave us hope only if we could arrange internationally to economize gold. This statement reassured all the timid people: nothing could be done without international agreement. In view of the pathetic spectacle of the efforts to arrive at international agreement on disarmament, it is safe to predict that to await international agreement on currency questions will postpone any decision for at least another generation. The same people insisted that we could abolish the gold standard only by international agreement. The stark realities of events forced us to abandon the gold standard without consulting other nations, and "nobody seemed a penny the worse"!

It is equally certain that we can return to freedom of note issue without international agreement. All the industrial nations of the world have copied the banking institutions of Great Britain: let us set the example of a saner system than that imposed by the 1844 Act.

It is interesting to note one result of the stream of criticism that has recently been directed upon the banking system in most civilized countries. The banker, *méchant animal, se défend.* And his defence is again reminiscent of the ways of his fathers. He says that there is obviously no scarcity of money, since money has never been so cheap for such a long time, and the banks are finding the utmost difficulty in placing their funds. This was said after every financial crisis in the past. We deflate the currency by a high bank rate, causing widespread ruin to industry, and unemployment among wage-earners. Commercial confidence and enterprise are shaken, and the monetary consuming power of the community is cut down. Then, when prices are so low as to be hardly remunerative, surprise is expressed that even with a low bank rate the banks are unable to find borrowers. But if we examine the facts a little closer, we find that the banks are offering only either short-date loans or long-term loans against gilt-edged security. Let the banks offer to take a little more risk in long-term loans, and they will find no lack of borrowers. "No," replies the banker, "we dare not jeopardize our depositors' money." Well—well—my confidence in the industrial ability and integrity of our people makes me distrust the banks' protest that every long-term loan must be backed by gilt-edged security. If the present generation of bankers remains adamant (and I do not doubt that it will), let freedom of note issue open the way for the creation of competing banks, and then let us see what will be an average commercial risk in banking long-term loans. Be it remarked again that note-issuing banks will operate mainly on their own money,

increased by a note issue. They will be risking their own money and reputation rather than depositors' money.

Mention should here be made of the proposals for a managed currency. It is proposed to maintain the note-issuing monopoly of the Bank of England, but to empower the Bank to vary the note issue either according to its discretion, or by reference to the commodity index of prices with the aim of keeping the internal price level stable. This system has in fact been in operation since we left the gold standard in September 1931. Its superiority over the former system is shown by the fact that we have had a 2 per cent. bank rate since June 1932, in spite of the troubled state of international politics and foreign finances. For my part, however, I think there are grave objections to putting a Central Bank in sole control of the currency supply. The supporters of this plan use the fallacious arguments of Lord Overstone. They assume that bankers and their public cannot be trusted to adapt the supply of currency to public needs and they argue from the crises in the nineteenth century, omitting to notice the baleful part played by the gold standard in causing those crises. If a Central Bank is in control, the country will always suspect political influence. How can the Bank of England know as well as a local banker in Bradford when advances are required by the wool trade? The supply of credit to industry and commerce requires a flexibility which it is next to impossible to obtain from a Central Bank.

It is urged that this objection will be met if the Bank regulate the supply of currency by reference to the index number of general prices. I reply that this is a cumbersome method. In the first place, economists are not yet agreed on the particular commodities whose prices shall form the basis of the ideal index number. Secondly, the system assumes that the sole cause of fluctuations in prices is an alteration in the supply and

demand conditions of the money market. But, as I have frequently pointed out in this book, an outburst of trade activity usually causes at least a temporary rise of general prices. In face of such a rise the Bank will assume that credit is redundant, and will cut down the supply, throttling industry just as effectively as would a gold standard system. Similarly labour-saving invention may cause a fall of prices; but if the Bank then issue fresh money, the community will be deprived of the benefit of lower prices. In practice every move on the part of the Central Bank would meet much criticism, which would hardly aid the smooth working of trade. Be it noted that economists have not even yet settled the explanation of the rise of prices which occurred in 1919–20. I did my utmost at the time, by lectures and newspaper correspondence, to urge that the chief cause of the high prices was the scarcity of peace products during the war; and that if business were to be started again, a temporary rise of prices was inevitable. The government, however, took the view that there had been wild inflation, and imposed upon us the disastrous period of deflation, now generally admitted to have been a mistake.

As I write (March 1934) President Roosevelt is making currency history. Disregarding the warnings of the serried ranks of American and European economists, he has decided boldly for inflation. When he inaugurated his policy I risked the fate of prophets by predicting benefit to U.S.A. from his measures. Events so far have justified his courage. The *National City Bank of New York Journal* has consistently opposed inflation. Yet the February number, which has just reached me, reports that a list of some 350 industrial companies showed during 1933 combined profits of about $163,000,000 as compared with a deficit of $41,000,000 during 1932 for the same companies.

Compare now this encouraging improvement, ob-

tained with comparatively little State interference with industry, with the poor results in Germany and Italy, where grandiose schemes of State regulation have been in force. True that U.S.A. has had its N.R.A. policy of reducing the labour week; but this has rather hindered than helped recovery. What a policy of despair is this plan of compulsory leisure! The fundamental evil is lack of consuming power. From this springs unemployment of producers. And instead of increasing consumption by freeing the supply of money, we proceed miserably to ration the existing low-consuming power by forcing those in work to share their work with others. All our quota schemes have only the same aim: the rationing of a consuming power that we ourselves have artificially restricted. We sit like children round a table quarrelling bitterly over the division of the crumbs that have fallen from the cake in the centre—the full cake that stands there only waiting to be cut.

INDEX

Abstinence Theory of Interest, 389
Accepting Houses, 56
Acts of Parliament referred to:
  1694, 85
  1695, 127
  1709, 86
  1727, 127
  1765, 87, 132
  1775, 88
  1777, 90
  1797, 90, 101, 265 *et seq.*
  1819, 110
  1826, 90, 114
  1828, 115
  1844, 125, 126, 146 *et seq.*
  1845, 141 *et seq.*
  1854, 70
Adams, Brooks, 71
Addington, Lord, 102
American Steel Trust, 358
Anarchism, Individualist, 13, 16
Andréadès, A., 90, 104, 108, 117, 119, 165, 180, 182, 204
Angell, N., 202-3
Argentina, crisis in, 211
Assignats, 275-6
Association of Chambers of Commerce, 1908, Report of Banking Committee, 179-80, 312-13
Attwood, T., 114, 137 (footnote)
Australia, crisis in, 211
Avebury, Lord, 3, 149

Bagehot, W., 53, 58, 89, 174, 190-191, 226, 286, 301, 317
Bain, F. W., 149
Bank balance-sheets, 284-5, 301-2
Bank Charter Act, 125, 126, 146 *et seq.*
Bankers' Clearing-House, 381
Bankers' Magazine, 170
Banking principle, 118 *et seq.*, 299
Bank notes:
  compared with cheques, 150 *et seq.*
  origin of, 75 *et seq.*
Bank of England:
  Bank Charter Act, 125, 126, 146 *et seq.*
  establishment of, 85
  frequent changes in bank rate, 179 *et seq.*
  Restriction Act, 90, 101, 265 *et seq.*
Bank of Hamburg, 67, 72
Bank of Scotland:
  formation of, 127
  option-clause notes, 81-3, 87-8, 128
Bankruptcy laws, 233-5
Bank Restriction Act, 90, 101, 265 *et seq.*
Banks of issue:
  Bagehot on, 190
  prohibited around London, 114
Banque de France, 58, 178, 180, 185, 189
Banquier system, 281-2
Barter, 66
Beaconsfield, Lord, 209-10
Berkeley, Bishop, 193-4
Bidwell, W. H., 189
Bilgram, H., 227
Bill-brokers, 56
Bills of exchange, fabrication of, 60, 71
Bimetallism, 279-80
Birkbeck Bank, 174
Boase, C. W., 131
Böhm-Bawerk, E. von, 385 *et seq.*
Bonar, J., 237
British Linen Co. Bank, 129, 130
British Steel Association Report, 357
Brutus and usury, 70
Bullion Committee, 103-6, 265-6
Burke, E., 95
Buxton, Sydney, 267

Caledonian Mercury, 131
California State Country Life Committee Report, 340

Canning, 267
Capital defined, 38-9
Cartels, 31, 361
Cash credits, 134-6
Centralization of industry, 21, 27-33, 351 *et seq.*
Chamberlain, J., 215
Chambers, Mr., 103, 265
Charing Cross Bank, 173
Cheque:
  compared with note, 150 *et seq.*
  growth of system, 150 *et seq.*, 300
  origin of, 75
Clearing-House, Bankers', 381
Communism, 8-15, 331-2
Competition, 2 *et seq.*, 21 *et seq.*, 343-344, 351 *et seq.*
Comte, Auguste, 9
Conant, C., 90, 122
Co-operative production and distribution, 325-9
Coquelin, M., 20
"Corners", 352 *et seq.*
Credit:
  an ideal system of, 61-2
  definition of, 50-52
  issue of, 55 *et seq.*
Crises, causes of, 159 *et seq.*
Crisis:
  of 1797, 100-101
  of 1817, 108
  of 1825, 110-12
  of 1836, 115-16
  of 1839, 117-18
  of 1857, 164
  of 1907, 168
  of 1931, 416-17
Crusades, effect on currency of, 71
Cunliffe Committee, 413-14
Currency principle, 118 *et seq.*, 187, 299-300

Day, J. R., 358
Del Mar, 68
Dibblee, Professor, 20 (footnote)
Disraeli, 209-10
Douglas, Major, 349-50
Drains of gold, 159 *et seq.*

"Economic man, The", 8-10
Edinburgh Courant, 131
Emerson, Harrington, 356-7
Employers' responsibilities, 39
Encyclopaedia Britannica, 87, 141, 147 (footnote)
Enquiry:
  of 1819, 109
  of 1840, 118 *et seq.*
  of 1858, 188
  of 1875, 142
  of 1908 in Germany, 181
Entail system, 404
Exchange, an ideal system of, 61-2
Exploitation Theory of Interest, 391-3

Fallacy of Saving, The, 194
Farthing as a unit of value, 244-5
Feudalism, 11
Fisher, Irving, 232, 262 (footnote)
Forged bank-notes in Scotland, 68-9
Fox-skins as currency, 67-8
Foxwell, Professor H. S., 104-5
France:
  Assignats, 275-6
  Banque de, 58, 178, 180, 185, 189
  Banquier system, 281-2
  record of proceedings in French Chamber, 275
  war with revolutionary, 100 *et seq.*
Francis, J., 106-7
Franco-German war indemnity, 210-211
Free gold market, 177, 260-64, 293 *et seq.*
"Freezing out", 334-5, 351-3
Frewen, Moreton, 279, 289-90
Fullarton, J., 118

Germany:
  adoption of a gold unit in, 206 *et seq.*
  banking in, 178, 180, 202, 411
  Banking Enquiry of 1908, 181
Gide, C., 186-7, 246
Giffen, Sir R., 148, 157-9, 208-9
Gilbart, J. W., 134, 158, 322
Gilds, 10-12, 72-4
Gold Delegation Report, 419
Gold exchange medium, introduction of, 66-8
Goldsmith bankers, 74 *et seq.*
Gold Standard Defence League, 279

Goschen, Lord, 160, 165 (footnote), 211, 277-8
Graham, W., 100, 131, 133, 137 (footnote), 139
Gray, John, 196 *et seq.*, 215
Greene, W. B., 19, 325-30
Gresham's Law, 121-2
Guilds (*see under* "Gilds")
Gurney, Hudson, 189

Hadley, Professor, 31
Hake and Wesslau, 281-2, 288-90, 323
Hamburg, Bank of, 67, 72
Harrison, Frederic, 9-10, 403
Hawes, Mr., 125, 166
Hearn, W. E., 29-30
Hirst, F. W., 30-31
History of Banking in All Nations, 145
Hobson, J. A., 217-23, 394-5
Holden, Sir E., 161, 167-8, 171
"Honest" money, 64-5

Immigration of cheap labour, 342
Index number, issues regulated by, 262, 421-2
India, Interest liabilities, 212
Individualism in economics, definition of, 1
Industrial revolution, the, 13-14, 46-48, 91 *et seq.*
Interest, Chapter XV (385-400):
  definition of, 386-7
Interference, principles of State, 12-13
International adoption of a gold currency, Chapter X (205-213)
International Clearing-House, 331
Invariable Unit of Value, Chapter XII (236-280)
Ireland:
  authorized and acutal note issue, 379
  banking in, 143

Jackson, F. H., 178
Jevons, Stanley, 97, 110, 190 (footnote), 238-9, 263, 267-8, 375 *et seq.*, 389
Joint-stock companies criticized, 172-3, 231 *et seq.*
Justice, cheaper, 344 *et seq.*

Kerr, Mr., 131
King, Lord, 106
Kitson, A., xi, xiv, 176, 280

Land monopoly, 37 (footnote), Appendix I (401-9):
  nationalization of, 405-6
  single-tax system, 405-6
  Small Holdings Act, 296-7, 404-5
  State landlordship, 405
Lassalle, 389-90
Latin Union, banking in, 178
Laughlin, J. L., 307
Legal tender laws, 312, 331 (footnote)
Legs Rampal, 57
Leroy-Beaulieu, 194
Letters of Malachi Malagrowther, 115
Levi, Professor Leoni, 116, 125
Limited Liability law, 231-2
Liverpool, Lord, 113
Loubert, P., 180
Loyd, S. J., 118 *et seq.*, 373-4

Macgregor, D. H., 31
Macleod, H. D., 38-9, 50-51, 63, 104, 162, 322
Macmillan Report, 419
Major, M. B. F., 206 *et seq.*
Malachi Malagrowther, Letters of, 115
Mallock, H. W., 7, 341
Manchester School, the, xiii, 9-10, 16
Mark Banco, 67
Mercantile theory, 73, 266
Meyer, H. R., 24-5, 366-7
Militarism and State interference, 14, 410-11
Milkmen, the competing, 21-2
Mill, James, 216
Mill, J. S., 28-9, 38, 53-4, 105 (footnote), 117 (footnote), 158, 194, 195 *et seq.*, 223, 246, 273, 389
Minimum wage, legal, 36
Money:
  definition of, 62-4
  Trust, Report on the American, 358-9
Monopolies, natural, 360-2
Montesquieu, 273 (footnote)
Morgan, J. P., 359-60
Municipal gas, etc., 23 *et seq.*
Mutual banking, 325 *et seq.*

National and Provincial Bank's note issue, 114
Neave, Mr., 189
Nicholson, Shields, 409

Option-clause notes, 81-3, 87-8, 127-130, 291, 308-9
Overend & Gurney, 300
Overproduction, 35 *et seq.*, 214 *et seq.*
Overstone, Lord, 118 *et seq.*, 373-4

Paget, Sir John R., 87, 141, 147 (footnote)
Palgrave, Sir R. H. D., 143, 148, 166, 232, 285, 298, 380
Partnership Restriction Act, 86-7, 114
Peel, Sir R., 109, 113, 125, 253, 285, 298
Period of circulation of bank notes, 90
Phipson, Major C. B., 205 *et seq.*
Pierson, Dr. N. G., 187-8
Pitt, William, 101
Politics, the aim of modern, 8
Postage stamps are credit, 50-51
Pound sterling, the, 252 *et seq.*, 268-9
Price, Bonamy, 140, 201, 225, 318-322
Price, definition of, 249
Prices, increase of, 58-60, 111-12, 304-6, 372-3
Private banks:
  amalgamation of, 146-7
  in London, 146
Production for profit, 5, 371-2
Productivity Theory of Interest, 387-8
Prohibition of banks of issue around London, 114
Prohibition of small notes, 88-91, 114
Protection *v.* freedom, 56-8, 84, 87-88, 93-5, 130, 345, 361-2, 373-5, 381-4

Quantity Theory, 304-6

Raiffeisen banks, 283-4, 402
Railway speculation, 115
Railways, State, 25-6, 361
Rent, 402
Ricardo and wages, 45
Richardson, R., 135 (footnote)
Robertson, J. M., 72 (footnote), 194
Roman Empire, coinage in, 68
Roosevelt, President, 422-3
Rose, Mr., 105-6
Royal Bank of Scotland, 128
Rubber boom, 112
Ruding, R., 268-9
Ruskin, the economics of, 3

San Francisco, trade revival in, 338
Saving, The Fallacy of, 194
Schuster, Sir F., 171
Scotland:
  Act of 1845, 141 *et seq.*
  authorized and actual note issue in, 379
  Bagehot on Scottish banks, 190-91
  banking in, 68-9, 81-3, Chapter VIII (127 *et seq.*)
  cash credits in, 134-5
  foundation of Bank of, 127
  memorial on Scottish notes, 139
  option-clause notes (*see under* "Option")
  publicity of bank balance-sheets in, 285
  quarterly demand for gold in, 143-4
  Scottish notes prohibited in England, 138
  Sir R. Peel on Scottish banking system, 113
  small notes prohibited, 88-91, 114-15
  state of, in 1699, 133
  unlimited liability in, 232
Scots Magazine, 131
Scott, Sir W., 114-15
Seneca and usury, 70
Shaw, G. B., 315
Sidgwick, Professor, 30, 176-7, 239, 274
Small change in metal tokens, 64-5
Small Holdings Act, 296-7, 403, 404-5
Small notes:
  Huskisson on, 113
  Peel on, 113
  prohibited, 88-91, 114-15

Smith, Adam, 27, 73, 93, 132, 134, 158, 266, 290-91, 323
Smith, J. C., 259 (footnote)
Socialism and Anti-socialism, xiii-xiv, Chapter I (1), 17 *et seq.*, 287, 348 *et seq.*
Socialism and Christianity, 2
Somers, Robert, 131-2
Spencer, Herbert, xi, xiv, 14, 20, 344 *et seq.*
Standard of value, 107-8, 184 *et seq.*
Standard Oil Co., 358
Stanhope, Earl, 107-8, 269-72
Steel Trust, American, 358
Steuart, Sir James, 272-3
Straker, F., 154-5
Supernational power and credit, 330-331
Swaytheling, Lord, 278
Switzerland, banking in, 144

Tabular Standard, 238-9
Tandy, F. D., 340-42
Tariff Reform, 205, 212-13
Taxi-cab combine, 353-4
Taylor, James, 108, 274-5
Tooke, T., 100, 118 *et seq.*, 158, 322
Torrens, Colonel R., 119 *et seq.*
Town Charters, 11
Treasury notes, 409
Trusts, 21 *et seq.*, 27 *et seq.*, 174-6, 333-4, 348 *et seq.*
Tucker, Benj. R., xi, 13, 325, 402

Underconsumption, 34 *et seq.*
Unemployment, xiii, 34 *et seq.*, 91 *et seq.*, 162 *et seq.*, 175, 194-5, 206 *et seq.*, 348 *et seq.*, 412, 423
United States of America:
  banking in, 144, 158, 168, 178, 182-5, 416, 422-3
  crisis of 1893, 211
  crisis of 1907, 168
  Monetary Commission, 145, 171
"Unrestricted competition", 348 *et seq.*, 362 *et seq.*
Use ownership of land, 402 *et seq.*
Use Theory of Interest, 388-9
Usury, 69-71, 73, Chapter XV (385):
  laws, 69-71, 73, 92

Value, definition of, 246
Vansittart, Mr., 104, 267
Venetian banks, 71
von Böhm-Bawerk, 385 *et seq.*
von Kanitz, Count, 181

War and banking, 202-3, Appendix II (409), Appendix III (413)
"Waste of competition", 369 *et seq.*
Wealth defined, 38
Wells, H. G., 12
Withers, Mr. Hartley, 415-16
Whittick, W., 244
Wilson, A. J., 284-5
Wilson, James, 118
Wolff, H. W., 57, 284

THE END

Printed in Great Britain by R. & R. CLARK, LIMITED, *Edinburgh.*

NEW WORKS ON ECONOMICS

THE GREAT DEPRESSION. By LIONEL ROBBINS, Professor of Economics in the University of London. *Second Impression.* 8s. 6d.

SOME RELATIONS BETWEEN POLITICAL AND ECONOMIC THEORY. By G. D. H. COLE. 4s. 6d.

STUDIES IN WORLD ECONOMICS. By G. D. H. COLE. 12s. 6d.

CREDIT AND INTERNATIONAL TRADE: How they Work in Practice. By BARNARD ELLINGER, C.B.E. With an Introduction by Sir CHARLES ADDIS, K.C.M.G. 7s. 6d.

THE EMPLOYMENT EXCHANGE SERVICE OF GREAT BRITAIN: An Outline of the Administration of Placing and Unemployment Insurance. By T. S. CHEGWIDDEN and G. MYRDDIN-EVANS. With a Foreword by the Rt. Hon. WINSTON S. CHURCHILL, C.H., M.P. 14s.

THEORIES OF THE TRADE CYCLE. By ALEC L. MACFIE, M.A., LL.B., Lecturer in Political Economy, University of Glasgow. 7s. 6d.

THE NEW AMERICA. By the Rt. Hon. Sir ARTHUR STEEL-MAITLAND, Bart., P.C., M.P. 10s. 6d.

FRANCE'S CRISIS. By Dr. PAUL EINZIG. 7s. 6d.

THE FUTURE OF GOLD. By Dr. PAUL EINZIG. 7s. 6d.

FREE BANKING: An Outline of a Policy of Individualism. By HENRY MEULEN.

AN INTRODUCTION TO THE STUDY OF PRICES. By Sir WALTER LAYTON. *A New Edition with Revisions and Additions* by GEOFFREY CROWTHER.

(*All prices are net*)

MACMILLAN AND CO. LTD., LONDON

WORKS ON ECONOMICS

THE THEORY OF UNEMPLOYMENT. By Prof. A. C. PIGOU, M.A. 15s.

A TREATISE ON MONEY. By J. M. KEYNES, C.B. Vol. I. The Pure Theory of Money. Vol. II. The Applied Theory of Money. 15s. each.

A TRACT ON MONETARY REFORM. By J. M. KEYNES, C.B. 7s. 6d.

THE NATIONAL INCOME, 1924–1931. By COLIN CLARK, M.A. 8s. 6d.

CHRISTIANITY AND ECONOMICS. By A. D. LINDSAY, LL.D. 5s.

THE ECONOMICS OF IMPERFECT COMPETITION. By JOAN ROBINSON, M.A. 18s.

CENTRAL BANKS: A Study of the Constitutions of Banks of Issue, with an Analysis of Representative Charters. By Sir C. H. KISCH, K.C.I.E., and W. A. ELKIN. With a Foreword by the Rt. Hon. MONTAGU C. NORMAN, D.S.O. Fourth edition (1932). 18s.

GREAT BRITAIN AND THE GOLD STANDARD: A Study of the Present World Depression. By Prof. H. F. FRASER, M.A. 8s. 6d.

THE THEORY OF WAGES. By J. R. HICKS, M.A. 8s. 6d.

THE RATE OF INTEREST IN A PROGRESSIVE STATE. By J. E. MEADE. 7s. 6d.

THE ECONOMIC LIFE OF SOVIET RUSSIA. By Prof. C. B. HOOVER, Ph.D. 12s. 6d.

AN ECONOMIC HISTORY OF SOVIET RUSSIA. By LANCELOT LAWTON. 2 vols. 25s.

(All prices are net)

MACMILLAN AND CO. LTD., LONDON