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MONEY

ITS PRESENT AND FUTURE

By

G. D. H. COLE



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THIS BOOK IS PRODUCED IN COMPLETE CONFORMITY WITH THE AUTHORIZED ECONOMY STANDARDS

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PREFACE

SINCE the main text of this book was finished towards the end of 1943, further discussions have been proceeding in the United States and in this country concerning post-war monetary arrangements, but there had been no further public statement until the very moment when I was passing the final proofs. It had been widely suggested in the newspapers on both sides of the Atlantic that what was likely to emerge would be a currency plan much more closely resembling the White Plan issued last year from the American Treasury than the Keynes Plan, similarly issued in Great Britain; and the text of this book reflects the fears, which these suggestions aroused, of the effects of a restoration of the Gold Standard on a basis of fixed exchange parities between the leading countries. It seemed to me clear that Great Britain, in view of the unavoidable difficulties of its post-war international economic situation, could not possibly afford to tie itself down to a fixed exchange rate between British and American money, at any rate as long as there was no assurance that the American economy would not return after the war to the conditions of extreme instability which characterized it between the wars.

It is an indisputable fact that Great Britain after the war will find great difficulty in the balancing of its international payments at a level sufficient to ensure the progressive improvement of the British standard of living, and it was clear that under Gold Standard arrangements such as were contemplated in the White Plan Great Britain would forfeit the right to pursue policies of internal economic expansion in face of any considerable price and income recession in the United States. I know that it is worth much both to secure Anglo-American co-operation after the war and to set going forces that will prevent a return to conditions of economic nationalism and extensive bilateral trading arrangements of an inherently restrictive nature; but it would have been foolish to undertake to pay a price which could not in fact be paid. If Great Britain, without any assurance of stable economic conditions in the United States and of an ordered basis for world economic advance, had surrendered the power to control its own monetary and trading arrangements by falling in with proposals framed exclusively from an American point of view, good service would have been done

neither to the British nor to the American people, for when these arrangements broke down—as break down they would—the ensuing recriminations and mutual mistrust would far more than counteract any advantage which could have been reaped from the initial compliance.

I felt it necessary to set these warnings in the very forefront of my argument; but I am glad to be able to record that the new Currency Plan which has been issued under the joint ægis of the British and American Treasuries, goes a long way towards dispelling the fears aroused by the White Plan of 1943. The reader who turns to the brief Appendix (C, on page 318) in which I comment upon the new Plan, will understand that the emphasis would have been different in some of the later chapters if I had been writing with the new agreed draft, instead of the earlier British and American drafts, before me. It was unavoidable that I should try to deal as best I could, in such a book as this, with immediate practical issues, of which the shape is bound to change almost before the ink has had time to dry. Its main purpose, however, is not only to point the practical morals in relation to post-war monetary policy but even more to equip the reader with the ingredients for forming his own judgment. My conclusions may possibly be wrong: my account of the actual institutions of the modern monetary system and of their working is, I am convinced, essentially right, and I have tried to set forth the fundamental facts in language so clear that no intelligent person shall be left with an excuse for not understanding them. In one sense, this book is a textbook on money designed not for the specialist but for the intelligent general reader. It is, however, in these days, impossible to write a textbook without making it in some degree a tract.

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INTRODUCTION

All the world over, there are bound to be acute monetary difficulties at the end of the war. Some of these difficulties will be international; for it will have to be settled at what rates and under what conditions the money of each country is to be exchangeable for the money of each other country, as well as whether there is to be some new kind of international money replacing or supplementing gold as a means of adjusting the financial accounts between the nations. These international difficulties are most under discussion at present; and in both Great Britain and the United States tentative plans for dealing with them were put forward in 1943. But there will be also serious internal problems to be settled in each country, and the methods adopted in dealing with monetary questions internally and internationally will react on each other. If we in Great Britain were to tie ourselves down by international agreement to return to the gold standard after the war, the effect might be greatly to limit our internal freedom to adopt the monetary and economic policies which we are likely to deem best to fit our needs; and, on the other hand, if we were to reach decisions about our internal policy in advance of any international agreement, we might find our attitude to international monetary arrangements largely conditioned by what we had already decided to do at home.

These decisions about monetary policy, both internal and international, are bound to be of vital importance both to our own future prosperity and to that of the whole world. The experience of the period between the wars shows clearly that the world had not, even in 1939, made any real recovery from the monetary upsets which arose out of the last war. To say this is not to contend that the world's economic troubles between 1918 and 1939 were mainly due to monetary disturbances or even to bad monetary policies. I do not think they were; but it is indisputable that monetary instability and mismanagement of the monetary factors made the inter-war economic crises more devastating than they would have been if the world's money affairs had been in better order. Money itself creates nothing: it is a lubricant of real economic processes of production and distribution of goods and services, a standard of value, and a means of storing claims to purchasing power. It is not creative; but when anything goes wrong with it the result can be to prevent useful things from being created, and to cause any amount

of economic loss and human distress. In getting our monetary arrangements right and sound, we shall not solve the numerous and difficult problems which confront us in the organization of our productive effort and in the distribution of what it yields. But, unless we get our monetary arrangements right, it is highly probable that everything else will go wrong.

The purpose of this book is to discuss what we ought to do in matters of monetary policy, internal and international, both in preparing for the after-war situation and in dealing with it when it comes. My purpose is to do this, to the fullest possible extent, in language so simple that no ordinarily intelligent man or woman reader shall be prevented from understanding the problems involved by any obscurity in the language used. I cannot, of course, make easy those parts of the subject which are difficult in themselves; but I can at any rate hope to remove the obscurity from many matters which are not really difficult, but are made to appear so when they are clothed either in the complex terminology of professional economic theory or in the no less obscure jargon of money markets, stock exchanges, and other institutions of what is called 'The City'. I am writing primarily neither for professional economists nor for professional financiers, but for laymen—including politicians, whose knowledge of monetary matters is apt to be very sketchy indeed. The settlement after the last war showed all too clearly the imperative need for a better understanding of such questions among political leaders as well as among ordinary intelligent men and women.

I am writing in this way, because the happiness and wellbeing of these ordinary people are at stake. Decisions about post-war monetary policy, both internal and international, will have to be taken by Governments, just as much as decisions about tariffs, or house-building, or any other part of reconstruction policy. They will have to be taken by Governments; and, whatever their substance, they will purport to be decisions taken democratically in the public interest, with the assent of those who represent the people. There is, however, in this instance, a peculiarly high risk that this democratic character of the decisions arrived at may be merely a sham. For how can a democratic decision be taken about any matter which is not understood, at least by those representatives who are called on to make or to endorse it and by a considerable fraction of the intelligent public? I am not suggesting that every voter can equip himself to form an intelligent judgment about the mechanisms

of monetary policy, or about the policies to be furthered by these mechanisms. That would be altogether too much to expect, not only about money, but also about a great many other things that ought to be settled as democratically as possible. What I am combating is the view, widely held even among the most intelligent sections of the public, that there is about money some peculiarly esoteric quality which prevents it from being understood by ordinary men and women. I maintain, in opposition to this view, that money is not, for the most part, a particularly difficult subject, and that it is well within the reach of ordinary intelligent people—not indeed to master the intricacies of all its technical arrangements, which there is no need at all for them to attempt—but to arrive, on clearly presented evidence, freed from jargon, at sound views about the general lines of desirable monetary policy and, having done this, to exert pressure through public opinion to ensure that the right lines are followed, and the wrong avoided.

Ordinary intelligent people are apt to be frightened about monetary problems, because at the first approach everything seems to be topsy-turvy. Money is a means of buying other things; and the more money one has to give for them the dearer they are. It follows that, when goods are dear in terms of money, money is cheap in terms of goods. The fewer units of goods a sum of money will buy, the more units of money go to a unit of goods. Money and goods cannot both be cheap, in terms of each other, at the same time. But in a quite different sense money and goods can both be cheap together; for whereas, when we speak of the 'price of goods', we mean the amount of money needed to *buy* them, when we speak of the 'price of money' we ordinarily mean the rate of interest that must be paid for *borrowing* it over a period of time. Now, the rate of interest may be low at the same time as goods are cheap; and in this special sense money and goods may be cheap together, though they cannot be cheap simultaneously in terms of each other.

This confusing dualism depends on our habit of using the word 'money' in different senses. The money we keep in our pockets or in our current accounts in a bank, and use for buying things that we need or want, is not the same thing as the 'money' which is available in the 'money market' for those who wish to borrow it. As soon as it has been borrowed, this 'money market money' is simply purchasing power, just like that other money which we use for our current purchases. But until it has been borrowed it is something different—a potential source of purchasing power for

which the owner can make a charge, in interest, to anyone who desires to borrow it from him. The cash we keep in our pockets, or locked up at home, or in our current accounts in the banks, does not ordinarily earn us any interest. It is simply a store of purchasing power, which we keep handy until we need to use it by transferring it to someone else in payment for goods or services. But the money which is available in the 'money market' is money to be lent out at interest to various classes of borrowers who want a command over purchasing power in excess of what they have on hand in readily transferable form. The loan of such money has a price, which is the rate of interest which it can command; and this price can be high or low according to current conditions in the money market. It is not of necessity cheap when goods are dear, or dear when goods are cheap.

There is, however, nothing very terrifying about the fact that the word 'money' is used in different senses; for so are a number of words of which most people feel not in the least afraid. Most of the words we use have a variety of meanings according to the contexts in which we use them; and over a great many words difficulties arise because it is not easy to keep their several meanings distinct. This happens, not only because we are short of words and have to make many of our words do double, or triple, or quadruple service, but also because words, as Milton said of books, "are not absolutely dead things, but do contain a potency of life in them to be as active as that soul was whose progeny they are; nay, they do preserve as in a vial the purest efficacy and extraction of that living intellect that bred them". In effect, words, as we use them in everyday speech, trail along with them a multiplicity of associations, relevant and irrelevant to this or that particular purpose, in which a large part of their meaning to us, based on our past experience, is to be found; and we cannot rid them of this associative content and, as it were, pin them down to mean just this or that which we wish to signify without doing violence to their fuller meaning. The scientist, or anyone who aims at accuracy in discussion, must pin certain words down and make them mean, in the particular context of his discourse, as precisely as possible what for his immediate purpose he requires them to mean. This is the justification for the special terminologies adopted in the various sciences, which often use outlandish words precisely because they require words as free as possible from associative content. Those writers whose business is with the affairs of everyday life are often

placed, in this respect, in a peculiar difficulty. They cannot without extravagance avoid the use of everyday terms which are full of associative significance and are in many cases used in different senses in different connections. They have, however, to give to these words meanings more fixed and more precise than are given to them in ordinary speech; and, in doing so, they often appear to the layman to be talking nonsense and to be doing violence to the common meaning of ordinary words. Economists are especially liable to this source of misunderstanding, because they are trying to write precisely about things which are continually talked of in unprecise and highly coloured terms. In writing of money the difficulty is particularly acute, because in addition to the layman's talk there are the special jargons of the market-place, the stock exchange, the 'City', and the financial newspapers: so that many words, including 'money' itself, have a host of meanings, and obstinately resist being pinned down to serve only a single use.[1] I think myself that many of the consequent misunderstandings are largely of the economists' own making; for they fail themselves, despite their resolutions, to stick consistently to the single sense in which they lay down that a particular word is to be exclusively employed. How, indeed, can they help failing, unless they are to give up using their native tongues, or to invent new words to take the places of those they have appropriated to a single specialized scientific use? It would be better if they would invent new words for their own specialized senses, instead of appropriating and impaling the words used currently by the ordinary man. But, even if they were to do this, they would need translators, who would, even at a sacrifice of accuracy, put their writings back into language intelligible by ordinary, non-expert readers. Accurately delimited words, meaning unambiguously one thing and one thing only, are of great convenience and even necessity to the expert, both in his thinking and in his communion with his own kind. For the rapier-work of economic and financial discussion they are invaluable; but the ideas which are thus expressed should, if they are relevant to men's everyday affairs, be capable of translation into non-technical language without losing their main value. This book, in which I eschew, wherever I can, all technical language, either of the academic study or of the market-place, is an essay in such translation, or re-translation, written in the belief that monetary policy is too important

[1] To say nothing of the additional difficulty that there are wide differences between British and American monetary terminology.

for the welfare of the whole people to be left for settlement by the experts, without appeal to the commonsense judgment of the ordinary man.

The first point at which monetary policy plainly affects the interests of the ordinary man is that of employment. Most economists are now prepared to agree that it is practicable for a country which sets out to maintain a condition of 'full employment' to achieve its aim only if its monetary policy is rightly adjusted to the maintenance of demand at the required level. In other words, there must be a sufficient amount of purchasing power in active circulation to keep the producers and distributors of goods and services busy and not to induce employers to curtail the volume of business activity for fear of incurring losses. We shall discuss later what this involves in practice, and also what happens if the supply of purchasing power is increased beyond what is necessary to maintain 'full employment'. For the moment, we need only observe that, although in theory *any* quantity of money can be sufficient to achieve the distribution of any quantity of goods, provided prices can be adjusted without hindrance, in practice prices never can be so adjusted. Changes in the supply of money do not react either equally or equitably on all prices: they distort price-relations and in doing so set up all sorts of secondary reactions, some of which may be for good, but many of which will certainly be, at any rate in the short run, inconvenient and unjust. It may be necessary, for sufficient reasons, to put up with these inconveniences and injustices when we think the good outweighs them; and we may reach the conclusion that those economists who, in order to avoid them, propose to stabilize the supply of money once and for all would, if they had their way, lead us into even greater injustices and inconveniences. But it is plainly true that we should, as far as we can without causing greater evils, try to immunize our economic systems from the effects of unnecessary changes in the supply of money and to offset the consequences of changes in supply which are not responses to any real change in the need for means of payment. Monetary stability is in itself a good, and worth pursuing, provided we do not make the mistake either of pursuing it as the only good or of confusing it with a rigidity of supply which may in fact induce not stability at a satisfactory level of economic activity, but endemic depression.

I can safely begin by asserting that there ought to be enough money, of various sorts, available at all times to make possible, in

the light of the existing economic structure and conditions, the maintenance of 'full employment'. In saying this, I am not by any means putting forward employment as an end in itself. Employment, including of course the work of employers and independent workers as well as that of 'employed persons' in the narrower sense, is not an end but a means. It is a means to getting goods produced and distributed and services rendered; and it is desirable up to, and only up to, the point at which the community elects for more leisure rather than for more goods and services produced by human effort. 'Full employment' means, not that everybody ought to be at work up to the very limits of his capacity, but employment as nearly as possible up to an *optimum* point beyond which leisure is preferable to more goods and services. This is the amount of employment which, having made the limits and the meaning clear, we can safely postulate as desirable; and it is this amount of employment that there ought always to be enough money available to maintain.

This truth is obviously of international as well as of merely national application. It applies to each country, and accordingly it applies to all, and should be recognized in any international monetary arrangements that may be made either on a world-wide scale, or between particular countries or groups of countries. All such arrangements should be of a nature to facilitate the maintenance of full employment both on the home territories of the countries concerned and over all the world. It is a further obvious truth that success in maintaining full employment in one country is a contribution towards maintaining it in others, unless this success is achieved by highly autarkic methods. Full employment in a country implies a high level of consumption as well as of production; and unless the country is very self-contained this in turn involves that it will be a good customer of other countries for materials needed in its industries and probably also for a wide range of consumers' goods. The successful pursuance in one country of a policy of full employment therefore, in most cases, makes it easier for other countries to pursue similar policies; and it should clearly be a prime object of international policy to bind countries together for a common pursuit of full employment on conditions which will enable them to help instead of hampering one another's efforts.

It is, of course, fully possible for certain countries to attempt to achieve full employment for themselves either by isolating themselves from others or by attracting employment to themselves at

other countries' expense. When a country isolates itself to a large extent (no advanced country could, of course, do so entirely), reducing both its imports and its exports to the lowest possible balancing point, the effect is to reduce the total level of international trade and to rob the world's consumers, at least potentially, of some of the advantages of international specialization. The adverse effects of such a policy on the rest of the world need not, however, be at all serious, unless the self-isolating country has exclusive possession of any important substances which other countries badly need. The rest of the world can adjust itself to a regime of mutual trading such as would arise if the self-isolating country were wiped right off the map. Difficulties of transition there would be, and they might be serious and prolonged if the country in question had previously played an important part in world trade; but when the adjustments had been made, no great harm need have been done to the rest of the world.

This, however, is not the form which in the past the attempt to build up policies of national *autarkie* has usually assumed. *Autarkie* has not meant doing as far as possible without both imports and exports. It has meant (*a*) trying to make the country which practises it as independent as possible of outside supplies essential to self-sufficiency in time of war, and (*b*) trying to push exports by all possible means, while restricting imports of all sorts that will not help towards the achievement of wartime self-sufficiency—i.e. machinery needed for essential industries and stocks of scarce materials are brought in, but imports of other goods are discouraged or prohibited. The 'guns instead of butter' policy is applied much more drastically to foreign trade than to home production: the autarkic country tries to export 'butter' in order to import 'guns' —taking 'guns' to mean anything that will strengthen its self-sufficiency under conditions of war blockade.

Such a policy exerts a much more unfavourable effect on the rest of the world than a policy of sheer isolation. Its consequences are especially bad where, in face of the impracticability of complete self-sufficiency, it is used as an agent of imperialistic expansion with the object of inducing weaker neighbouring countries to become economic satellites of the autarkic State. This was Germany's policy from 1933 to 1939—a determined endeavour to reduce countries which, in the event of war, the Nazis could hope to overrun and to bring within their war frontiers to the position of economic satellites, producing such goods as could not be produced

in Germany up to the point required to ensure self-sufficiency in time of war. This policy, to the extent to which it was successful, distorted the structure of European production. That it did to a great extent succeed was due to the fact that it was launched at a time when the world as a whole, so far from following a concerted policy of full employment, was haunted by depression and altogether lacking in any common policy of expansion by mutual help. The countries which the Nazis largely succeeded in dominating fell victims to German imperialism because they were riddled with unemployment and distress and could find nowhere except in Germany markets for the products which they needed to sell abroad in order to meet even the minimum import requirements of their home markets. It was preferable to sell to the Germans what the Germans wanted, even under highly disadvantageous conditions, to not being able to sell at all; and it was accordingly possible for the Nazis to impose on these needy sellers the most stringent conditions regulating both what they were to produce and what they were to receive in exchange. Even if they could neither produce what they were best fitted to produce nor get for it what they most wanted to buy, it was better to get something than nothing—and the rest of the world was offering practically nothing that the needy countries could find means of paying for.

It would take me much too far afield to attempt to describe the elaborate techniques which the Nazis built up for applying this carefully-thought-out policy of economic imperialist penetration. Its relevance to the questions discussed in this book is that monetary manipulation played in it a vitally influential part. The essence of the German method lay in the creation of a series of systems of bilateral trading and monetary exchange. The Nazis paid for what they bought, not in free currency which the sellers could spend as and where they pleased, but in one form or another of 'blocked' or earmarked German money which could be spent only in Germany, and sometimes only on certain specified German goods. The favourite instrument was that of the 'clearing' account. In the simplest form this meant that the German importer paid for what he imported not to the seller in the seller's currency, but in German marks, into an account kept at the German Central Bank. Similarly, the purchaser of goods from Germany paid, not to the German seller, but into an account in his own Central Bank. The German exporter was then paid, by the German Bank, out of the sums lying in its account, and the exporter of goods to Germany got his pay-

ment out of the account held by the Bank of his own country. If the accounts balanced, everybody got paid: if they did not, that is, if one country had bought more than it had sold and the other sold more than it had bought, some of the sellers in the country which had sold the more had to wait for their money, and a sum lay unused in the account in the other country after all its sellers had been paid.

The Nazis showed themselves adept at manipulating this system of bilateral clearing for their own advantage. They manipulated the rates of exchange between the *reichsmark* and the currencies of the countries with which they were dealing: they manipulated surpluses and deficits in particular clearing accounts as suited them from time to time: they exacted the products they wanted from other countries, and forced other countries to buy just what it suited them best to sell. This could not have been done if there had been alternative markets open to the countries affected, as there would have been if the world as a whole had been prosperous and well-employed. The Nazis were able to exploit the prevailing world conditions of mass-unemployment and under-consumption, and in doing so to make themselves strong, and the others weak, for the war for which they were getting ready from the first. The Nazi policy would have broken down, if indeed it could ever have been started at all, in a world actively pursuing both national and international policies of full employment.

Observe, pray, that the Nazi policy of *autarkie* did not imply either a diminution in the volume of German foreign trade or a determination on the part of the Germans to have in the long run what is called a 'favourable balance of trade'—that is, to export more than they imported. The aim of the Nazis was not to do less foreign trade, but to make their foreign trade serve their imperialist and warlike ends. They did not want, except temporarily, for the purpose of building up claims to future imports, to dump German goods abroad without getting paid for them in imports, as some other countries have sometimes seemed anxious to do. They wanted to be able to import as much as they could of the things that would help to make them strong for war, and to export as much as they could spare in order to be able to buy these things; and they wanted to shift the 'terms of trade' in their favour, by giving as few German goods as possible in exchange for what they wished to import. The gravamen of the charge against the Nazis is neither that they set out to diminish world trade nor that they

set out to 'dump' German goods on the rest of the world: it is that their policy of *autarkie* deliberately distorted the channels and the nature of the world commerce to the one-sided advantage of Germany.

Nor is it true that the Japanese, who were following in certain respects a similar policy, set out to sell more than they bought; for the Japanese wanted heavy imports in order to build up their war potential, and the active pushing of Japanese exports was a means to buying imports and not to building up a 'favourable balance of trade'. Japan was not strongly enough placed to push bilateral bargaining to the same extent as Germany, or to make use of the same devices of monetary manipulation. The Japanese had to concentrate mainly on pushing their exports by every means in their power; but they pushed their sales in order to buy. They were good customers to other countries, as well as competitors. In a purely commercial sense, leaving out their imperialist objectives, the world had no cause to complain of them, however much their competition adversely affected certain old-established industries in other countries, including Great Britain.

It is, indeed, probable that the imperialist economic policies of Germany and Japan in the 'thirties, so far from lowering the total of world trade, positively increased it. If they had not set out to buy all they could that would increase their aggressive power, who else would have been in the market as a buyer? Nobody denies that re-armament, like any other form of public investment, is good for employment in the country which practises it: so why should we attempt to deny that, in the 'thirties, the countries which were busily arming for world war helped to raise the level of world economic activity and of world trade at a time when more pacific countries were squealing impotently in face of mass-unemployment and its correlative, reduced purchasing power both at home and abroad?

It is true that Germany, unlike Japan, had over the five pre-war years as a whole an export surplus. Over those five years German exports averaged 4,871 million *reichsmarks* and German imports 4,745 million. But already in 1938 the position of the previous years had been reversed. Exports were 5,249 million and imports 5,443. The phase of intensive importation in readiness for war had set in.

After the war we want both 'full employment' in each country and a high level of trade between them. We can have these two things together only on certain conditions. 'Full employment'

within a country requires a system of national planning under which the State assumes the responsibility for ensuring a high level of economic development and an abolition of restrictive practices designed to uphold prices at the expense of diminished output. Such planning can clearly take, at any rate in some countries, a strongly nationalistic line, aiming at the largest practicable measure of self-sufficiency, not mainly as a means to war preparation, but rather in the hope of insulating the national economy from the effects of depression and dislocation in the rest of the world. It is, indeed, bound to follow this line to a certain extent if only one country is pursuing a 'full employment' policy, or at most a few, while most countries are continuing to operate under conditions which allow cyclical fluctuations and restrictive monopolies to exert their devastating effects. Clearly, what is wanted is not a series of quite independent national policies, carried out in the spirit of isolation, but a concerted international policy, covering as many countries as possible and designed to harmonize their national policies in such a way as to encourage a high level of mutual exchange and of collaboration in the economic development of the more backward areas.

Indeed, national planning in individual countries involves international planning, unless it is to be perverted into isolationism. *Laissez-faire* in international commerce and finance was the natural concomitant of internal policies of *laissez-faire*. As soon as countries give up letting their internal economic affairs manage themselves with a minimum of State intervention, and take instead to national planning for 'full employment', it becomes indispensable to extend planning to the international field, and to devise an international framework for the co-ordination of national plans. The old system, under which the international framework consisted mainly of a monetary arrangement whereby the relative values of national currencies were fixed by common adherence to the gold standard, will no longer serve; for the postulate of that system was that the effective units in international economic relations were not States, but private traders who happened to live in different countries and needed means of exchanging goods and money without bringing in their respective Governments. Planned economy on a national basis makes it impossible to allow private traders to act across national frontiers in ways which may upset the national plans of their several States. It implies regulation of international economic relations, on both the commercial and the monetary plane.

This book is largely an analysis of the necessary implications of national planning for 'full employment' in the field of money. It has to begin with an elementary exposition of the main monetary concepts and problems, because these are in general so little understood. But it is a 'textbook' only to the extent to which it must be a 'textbook' in order to equip its readers with the necessary knowledge of elementary monetary facts. Without this knowledge, they cannot possibly form an intelligent judgment about the questions which they, and their representatives in Parliament and in the international negotiations about the post-war settlement, will have to decide.

These questions are both national and international. They have to do both with the internal monetary policies which Great Britain is to pursue when the war is over, and with the relation of British money and monetary policies to the monies and to the monetary policies of other nations. Discussion of these aspects of 'reconstruction' is at present concentrated mainly on the international part of the problem; and on the internal part little is being said except that the policies to be followed ought to be such as to fit in with the requirements of 'full employment'. Internationally, negotiation has been proceeding for some time between emissaries of Great Britain and the United States; and both countries have put up, without committing themselves, plans which are examined in this book. These plans differ in many respects; but they have in common a proposal to bring into existence a new kind of money —an international 'money of account'—in terms of which countries could settle their mutual debts and hold balances in an international banking institution analogous in many of its functions to the Central Banks of the constituent States. The American Plan proposes to fix absolutely the value of this new international money in terms of gold; whereas the British Plan leaves open the possibility of changes in its gold value after its initial value has been determined. In both Plans, however, the new international money is intended to be linked to gold and to be exchangeable for gold at a definite rate of exchange.

The American Plan, in addition to fixing absolutely the gold value of the proposed new international money, proposes to fix, no less absolutely, the rates at which the various national currencies are to be exchangeable for it, and for gold. The British Plan, as against this, leaves room for variations, after the new system has been set to work, in the gold values and consequently in the exchange

ratios of the currencies of the nations which enter into the International Clearing Union. This difference brings out clearly the point that there are two quite different issues involved in the proposals now under discussion for the establishment of stable post-war monetary conditions. It is one thing to propose that there shall be a stable international money, either fixed absolutely in its gold value or alterable in its relation to gold only by international agreement. It is quite another thing to insist that this new international money must be exchangeable on fixed and unalterable terms, not merely for gold, but for each of the national currencies comprehended within the international system. May it not be that the right course is to stabilize the value of the new international currency in terms of gold, while leaving the exchange ratios between this new currency and the currencies of the various countries unfixed, or at any rate subject to alteration in the light of changing economic conditions? May it not be that the post-war settlement will offer an excellent opportunity for establishing an international currency unit of invariable value in terms of gold, at any rate for some time to come, while leaving open the power to vary the rates of exchange between the new international money and the currencies of the individual countries? It would be of manifest advantage to bring into being an international unit of account in which the transactions between nations could be freely measured; but it by no means follows that it is necessary to peg each national currency firmly to this new unit at an unalterable rate of exchange.

The case against doing this second thing is that countries which desire to follow internal policies of 'full employment' must reserve to themselves a freedom to manage their own monetary affairs on lines which may prove inconsistent with the maintenance of fixed ratios between their currencies and the currencies of other nations, or any international currency to which these other currencies are unalterably related. If some countries, but not all, are following 'full employment' policies, the appearance of depression in those which are not may make it impossible for those which are to maintain their exchanges at par without resorting to measures of deflation which will involve drastic internal dislocation. But will countries agree to have their democratic economic policies wrecked by the necessity of accepting deflationary expedients forced upon them by the failure of other countries to maintain production and employment? I have suggested in the later chapters of this book that no such crucifixion on a 'cross of gold', or of an international money

fixed in gold value, can reasonably be expected of them, and that, accordingly, room will have to be left for the adaptation of national currency values in any post-war scheme of international monetary regulation.

It may, however, be thoroughly desirable to set up a new international monetary unit in terms of which all money values can be expressed, even if the values of the national currencies in terms of this unit cannot be fixed once and for all, and even if, as the British Plan suggests, there should be no unalterably fixed ratio between the new unit and gold. The new international money, *Bancor* or *Unitas*, or whatever it is to be called, might serve a very useful purpose even if its value were to be finally fixed in relation neither to gold nor to any national currency. It might, indeed, come in time to supersede gold altogether as a standard of value; and it might be the bridge by which the monetary systems of the world could cross from their dependence on gold to a more rational procedure of international monetary management, better related to the needs of the real economic order and much less wasteful of productive resources than any form of the gold standard can possibly be. The establishment of an international monetary standard does not, as the draftsmen of the American Plan appear to suppose, involve a fixed ratio of exchange between the standard international money and gold, or between either and the national monies of the participant nations. A currency standard is none the less a standard, if the relations to it of the national currencies are allowed to vary. Gold has owed a part of its prestige hitherto to the absence of any alternative standard in terms of which currencies can be measured one against another. *Bancor* or *Unitas*, even if it begins its career as the equivalent of a definite weight of fine gold, may in time oust gold altogether from the function of serving as a yardstick for the measurement of relative monetary values.

The point which I wish mainly to stress in this book is that no country can pursue with success a policy designed to ensure 'full employment' of its labour and productive resources unless it is in a position to control the conditions of its internal monetary supply. This control is imperative, because the internal structure of costs and prices is not perfectly malleable, so that an enforced expansion or contraction of the means of payment is bound to distort the relations between costs and receipts in different branches of the economy and to upset the relative incomes of different classes and groups. Countries which are pursuing policies of 'full employ-

ment' cannot afford to accept such distortions at the call of forces which are exterior to their domestic economic conditions and requirements. They must reserve their freedom to adapt their monetary policies to their own needs, not without regard to the repercussions of what they do on other countries, but also so as not to allow their own actions to be determined for them by forces over which they have no control. The right compromise may well be to establish an international currency unit in terms of which the values of all national currencies can be measured, without any unalterable fixing of these values. Such a system may give each country a new sense of responsibility in the management of its monetary affairs, without tying it down to a fixed international ratio that may disastrously fail to correspond to the requirements of its internal economic policy.

I am conscious that these may seem dark sayings to many of my readers. But I cannot illuminate them further at the beginning of this book. Their meaning and their relevance will, I hope, emerge plainly before I have done. Money is an instrument for effecting exchanges, both within countries and between countries; and our problem is to find ways and means whereby it may serve both these purposes to the satisfaction of the peoples of the world. Important as international trade is, we must never forget that many more exchanges take place within than between countries, and that accordingly the first requirement for a satisfactory monetary system is that it shall serve fairly and adequately as a medium for internal transactions. It would be folly to adopt any system which simplified international exchanges only at the cost of making internal exchanges more difficult or more unjust. Our object, in settling the issues of post-war monetary policy, must be to strike a reasonable balance between the needs of the domestic market and those of international trade and investment, and as far as possible to meet the demands of both. A stable international medium of exchange, combined with a freedom, subject to consultation, to adjust national currency values, may prove to be the method open to the peoples of making the best of both worlds.

I

WHAT IS MONEY?

WHAT is 'money'? Before I attempt a definition, I had better begin with an enumeration of some of the kinds of 'money' of which any definition will have to take account. There is, first and most obviously, the 'money' we are accustomed to carry about in our pockets and to use in meeting the everyday expenses of living. This is also the 'money' in which wages—but not usually the higher incomes—are paid: so that wage-earners habitually receive their 'money' in the same form as they spend it, whereas the recipients of other incomes for the most part receive them in one form and spend at any rate part of them in another.

This first kind of 'money' is *cash*. It takes two forms—*coins* and *notes*. Coins are issued by the State, from the Royal Mint, which has a monopoly of coinage; and coinage has been for a very long time in most countries a government monopoly. Notes, on the other hand, are issued in Great Britain not by the State but by the banks—chiefly by the Bank of England, which is the Central Bank. The Scottish banks also issue a small number of notes of their own; and at one time a great many banks in England used to issue notes. But except in Scotland the issue of notes in Great Britain has now been concentrated in the hands of the Bank of England; and the separate Scottish issues are on too small a scale to be of much practical importance.

In the last war the Government itself issued notes, known as 'Treasury Notes'; and this issue remained in circulation for some time after the war was over. These Treasury Notes were entirely £1 and 10/- notes; and all notes of larger denominations continued to be issued by the Bank of England. The small notes had to be issued, partly to replace gold coin, which was withdrawn from circulation at the outbreak of war, and partly to meet the increasing demands for cash as incomes and prices rose during the war. It seemed the natural course for the Government, rather than the Bank of England, to issue them, because they were needed at first mainly to replace gold sovereigns and half-sovereigns previously issued from the Mint. It was an important decision of policy when, in 1928, it was decided to place the entire note issue in the hands of the Bank, leaving to the Government only the manufacture of

silver-alloy and copper coins—the small change of everyday business. The object was to have, in effect, one body responsible for the entire supply of cash; for the demand for silver and copper coins had no independent importance. In effect, such coins were also put into circulation through the Bank of England, which procured from the Mint such supplies of them as it needed to serve as small change for its ultimate customers, the public.

Coins are made of metal—nowadays of silver or copper alloyed with other metals. Before 1914 coins used also to be made of gold; and the gold sovereign actually contained a weight of gold worth 20/-. The Bank of England was always prepared to buy gold by giving sovereigns of equivalent weight and fineness in exchange. In most other countries in which gold coins circulated these conditions did not hold good. Most States made a charge, called *seigniorage*, to meet the cost of coining, and some charged enough to yield a profit: so that the gold coins they issued were not quite worth intrinsically the sums for which they passed current. It was because no such charge was made that the British sovereign was acceptable almost anywhere in the world.

Nowadays gold coins have gone out of circulation everywhere; and only silver and base metals remain. The coins that circulate to-day do not purport to be worth intrinsically the sums, or anything like the sums, for which they pass current. They are not solid money, worth its face value, but *token money*, owing their value as money to the fiat of the Government which issues them. There used to be in some countries silver coins which were worth, or nearly worth, as metal the sums inscribed upon them. But these coins too have ceased to circulate; and our own silver coins are much more heavily alloyed with base metal than they used to be. There has been a world tendency to reduce the intrinsic value put into coins for use as money. It is now pretty generally recognized that if a coin is not worth, as metal, the full amount for which it passes current as money, it does not matter in the least how little it is intrinsically worth. What does matter is that it shall be as difficult as possible to counterfeit; for obviously the temptation to counterfeit money increases as the difference between its intrinsic and its monetary value is widened.

Notes are made, not of metal, but of paper. There is no question of their having any substantial intrinsic value. They are, indeed, usually made of carefully watermarked paper of high quality, and much care is taken with the printing, which is a very highly special-

ized trade. These precautions are necessary both to produce paper money which will stand wear-and-tear, and to guard against forgery, which offers the prospect of very large gains where it can be successfully practised. The bankers have improved the art of detecting forged notes to a very high level of perfection; and in this country forgery is now uncommon, though it has not disappeared. In Great Britain all paper notes are in numbered series; and no note is issued for a value less than 10/-. In some other countries very much smaller notes are in circulation, and the supply of token metallic money is accordingly reduced. There is no vital difference, from the standpoint of monetary theory, between token coins made of metal and token notes made of paper. They serve the same purposes; and both owe their monetary value to the fiat of the State, which either issues them itself, or authorizes a bank or banks to issue them. The difference between State issues and bank issues is important in some connections; and we may have to come back to it. But for our present purpose we can group token coins and token notes together as the kinds of money which the ordinary man or woman receives in wages and uses for making small day-to-day payments.

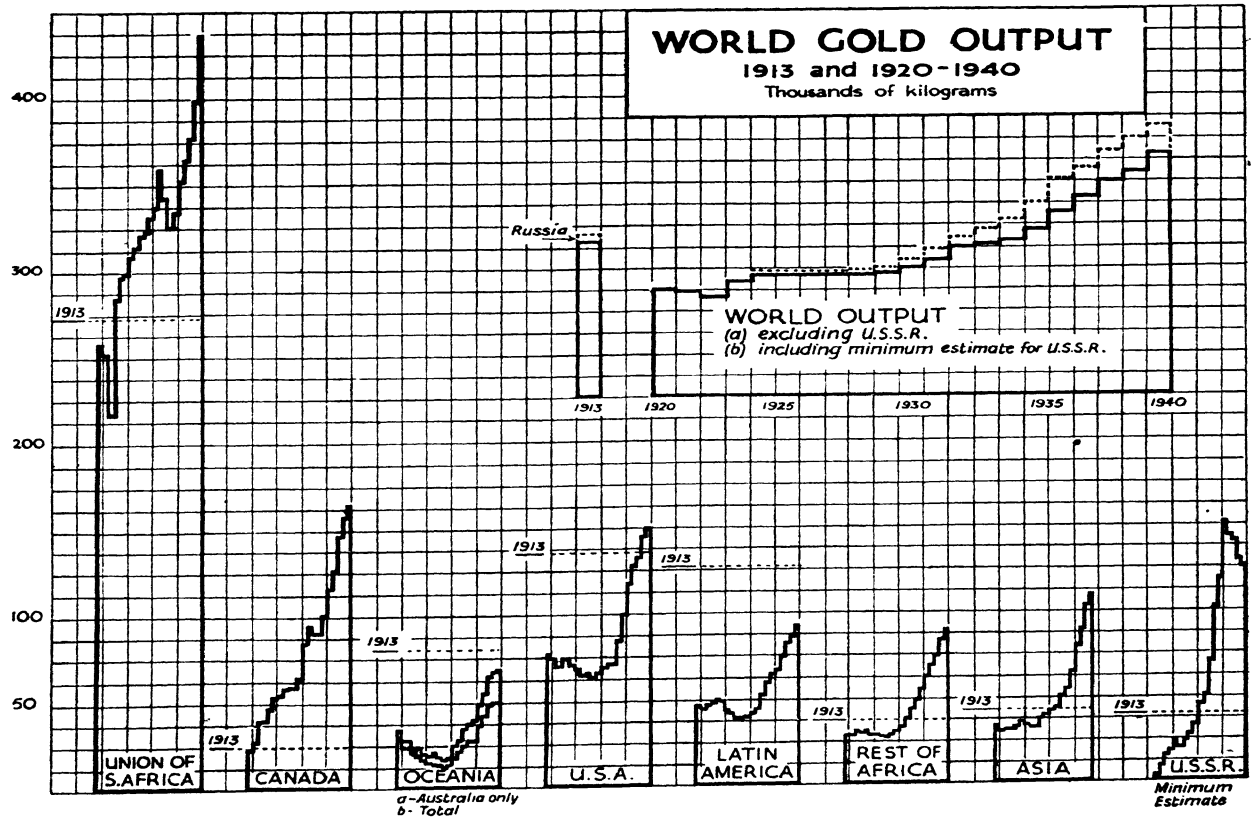
Wealthier persons, and some who are no more wealthy than wage-earners, receive their incomes, not in cash, but by *cheque*. If they have bank accounts of their own, they usually pay these cheques as they receive them into their banks, and meet their expenses partly with cash which they draw out of the banks by presenting cheques payable to 'self', and partly by writing cheques payable to their creditors. If they have no bank accounts, they get someone—often a tradesman—to change their cheques into cash, and thereafter meet their expenses by paying in cash. Most large payments are made nowadays by cheque: at least this is so in Great Britain, whereas notes and bills—to which we shall come presently—are made more use of in many continental countries where the use of cheques is less well established, or less widely spread. In this country, most middle-class households settle their larger tradesmen's accounts by cheque, pay their rents, insurance premiums, taxes and other large outgoings by cheque, and in effect cause their bank to keep for them a considerable part of their personal accounts. Similarly, most considerable business transactions are settled by cheque. Retail traders, who receive money in cash across their counters, pay most of it into the banks, retaining only till-money, and settle their own accounts with wholesalers mainly by cheque. Thus, there is a

regular flow of cash out of the banks late in the week, when most wages are paid, and back into the banks throughout the week, as traders pay it in. In working-class areas, this regularly circulating cash covers a much higher proportion of total expenditure than in richer areas, where more current expenditure is met by the use of cheques.

Coins and notes are 'money'; but cheques are not 'money'. The essence of money is that it can be passed from hand to hand in one act of circulation after another. A cheque, as against this, normally circulates only once. It is usually made out to a particular person, who has to write his name on the back of it as a receipt for the money. The person to whom it is made out endorses and presents it, and is paid; and the cheque is thereupon cancelled and is returned in due course by the bank to the person who wrote it out. A cheque can, no doubt, circulate more than once. I can persuade somebody to give me money for a cheque made out to me, when I have signed it on the back; and this person can even pass it on to someone else before it is paid in to a bank. But such circulation is unusual: most cheques are paid straight in to a bank by the person to whom they are made out. For an intermediate person to accept a cheque is an act of grace, and not of right. The value of a cheque depends on the person who wrote it out having sufficient credit with his bank for the bank to honour it: a cheque does not, like a bank-note, carry with it the bank's promise to pay. If the person who wrote, or 'drew', it has not sufficient credit with his bank, the bank will refuse to honour the cheque, and will mark it 'R.D.'—'refer to drawer'—or, sometimes, 'No account'. A cheque is simply some person's private promise to pay: its value depends on the drawer's ability to meet his obligation.

There are actually two sorts of cheque—'order' cheques and 'bearer' cheques. An 'order' cheque is an order made out by one person to his bank to pay a named sum to a specified person: a 'bearer' cheque is a similar order to pay a sum to a specified person or to 'bearer'—that is, to anybody who presents it at the bank. In everyday affairs, 'order' cheques are by far the more usual, because they are safer. If a 'bearer' cheque gets lost, anyone can present it to the bank and get cash for it, unless the drawer, conscious of his loss, has already ordered his bank to refuse payment; whereas an 'order' cheque, being an order to pay cash to a named person, cannot be honoured without that person's signature on the back.

Most cheques are both made payable to the 'order' of a particular


WORLD GOLD OUTPUT
1913 and 1920-1940
Thousands of kilograms
400
300
200
100
50
Russia
1913
1920
1925
1930
1935
1940
WORLD OUTPUT
(a) excluding U.S.S.R.
(b) including minimum estimate for U.S.S.R.
UNION OF S.AFRICA
CANADA
OCEANIA
U.S.A.
LATIN AMERICA
REST OF AFRICA
ASIA
U.S.S.R.
a-Australia only
b- Total
Minimum Estimate

person, and also 'crossed'. A 'crossed' cheque has two lines drawn diagonally across its face, and these lines mean that it cannot be cashed across the counter of the bank on which it is drawn, but must be paid into the account of someone who has an account at the same or at another bank. The 'crossing' may be either general or particular. The person who draws the cheque may write between the diagonal lines the name of the bank or of the specific account into which the cheque is to be paid. Thus, cheques drawn in payment of income tax are habitually crossed with the words "Commissioners of Inland Revenue Account". 'Crossing' is an additional safeguard that a cheque will not be used to get cash paid into the wrong hands; and specific crossing is a further safeguard.

Cheques, then, are not 'money', but merely orders on a bank to transfer money, or command over money, from one person to another. They do not circulate indefinitely, but in most cases perform their function in a single act of circulation; and, as most cheques are not cashed directly, but are paid into a bank account, the common use of cheques is to transfer command of bank deposits from one person to another.

If, however, cheques are not 'money', what of the bank deposits they are used to transfer? A person who has a bank account keeps a certain amount of purchasing power about him, or locked up at home, in the form of cash. But the amount so kept is usually small. Most of the purchasing power that accrues to him he probably keeps in the form of a deposit at his bank, until he decides to spend it. He can write a cheque against any sum standing to his credit in the books of his bank whenever he wishes to do so. Such a credit is, for most purposes, fully as good as cash, provided only that he can reasonably rely on the bank's ability to pay; and it is much more convenient to keep large sums in the form of bank deposits than to hold them in coin or notes. Where fears arise about the solvency of banks, as they did in the United States in the crisis of 1932-33, many men will withdraw money from the banks in cash, and keep it about them. But normally, in the modern world, banks are regarded as safe deposits for supplies of purchasing power; and the convenience of holding money in the form of bank deposits causes most of the bank-using classes to hold most of their supply of ready money in this form.

Bank deposits are of two kinds—*current* accounts and *deposit* accounts. Current accounts consist of sums which can be drawn upon at any time without notice. The banks hold such sums on

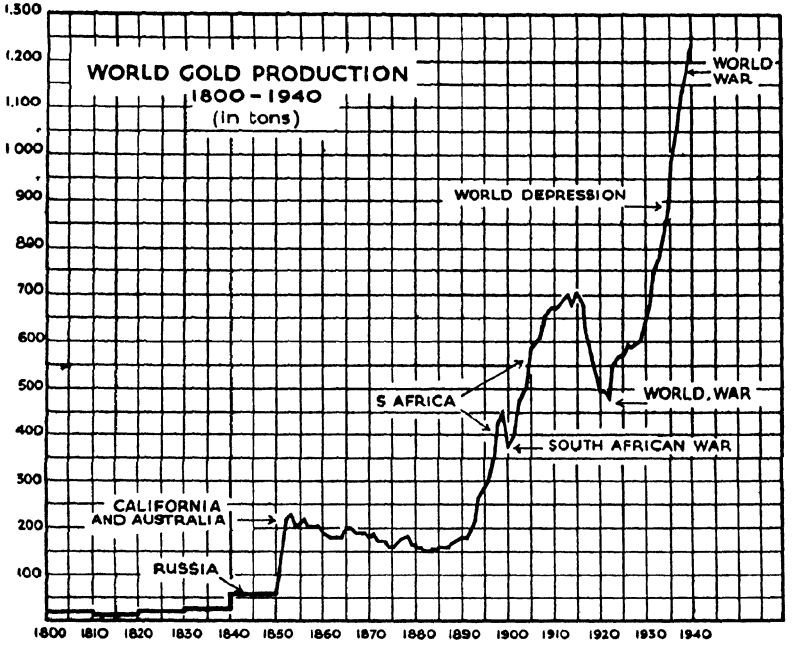
behalf of the owners, but pay no interest upon them. Deposit accounts, in the narrower sense—sometimes called 'time-deposits' —consist of sums deposited on the condition that they will not be withdrawn without a certain number of days' notice. On such accounts the banks pay interest, usually at a low rate. In practice, deposit accounts can be drawn upon without notice, because a banker will nearly always be ready to advance a sum at once to anyone who has it on time-deposit. In general, sums standing in current accounts are those which the owners think they may want to use almost at once, or at any moment; whereas time-deposits are sums which the owners expect to leave in the bank for an appreciable period. The difference, however, is by no means hard-and-fast; and some large concerns, which have big fluctuating deposits at the bank, are in a position to arrange with it to receive interest on their current accounts without the formality of converting them into time-deposits.

Bank deposits *are* money, though cheques are not. Bank deposits have exactly the same qualities as coin or notes, in that they can be transferred indefinitely from hand to hand, in payment for goods or services or in settlement of debts or obligations of any sort. A bank-note is a bank's promise to pay, embodied in a transferable bit of paper: a bank deposit is a similar promise to pay, inscribed in the bank's books, and drawn upon by cheque as required.

Bank deposits are, in the world of to-day, much the largest and most important element in the supply of money. They would become even more important if, as has sometimes been proposed, wages were paid by cheque instead of in coin and notes. The reason why this is not done is that it would involve too much trouble. Either the wage-earners would present their cheques at the bank, and change them for cash—in which event there would be no advantage over payment in cash at the works—or they would settle their own bills largely by cheque. As their transactions are mostly small, the handling of these cheques by the banks would involve much book-keeping, for which the banks would have to make a charge in order to cover their costs. The wage-earners would thus suffer a deduction from their earnings which they can avoid by receiving and paying out their incomes in cash, and thus acting as their own book-keepers. This is not to say that no wage-earners keep bank accounts; but it explains why most working-class spending is done by cash payments, and not by cheque.

The banks of which I have been speaking so far are the ordinary

deposit banks, sometimes called 'commercial banks', such as the Midland, Westminster, Provincial, Lloyds and Barclays—to name those which are called the 'Big Five'. There are also smaller commercial banks of the same kind, such as Martins and Williams Deacon's, and certain more specialized financial houses which do some ordinary deposit banking. In addition to these there are Savings Banks, including both the Trustee Savings Banks specially recognized by law and the Post Office Savings Bank maintained by the State itself. There is also at Birmingham a Municipal



Bank; but other municipalities which have tried to set up their own banks have failed to get the requisite powers from Parliament.

Savings banks differ from the commercial banks in that they deal mainly with small deposits and with money which is meant to be saved up rather than withdrawn speedily in order to meet ordinary current expenditure. Savings bank deposits are, of course, often drawn upon to meet charges for which persons with small incomes save up over a period of weeks or months; but they are not ordinarily used for meeting regular weekly payments. Usually, such accounts are drawn upon, not by cheque, but by the presentation of a bank-book, the payment being thereupon marked up in the

book and paid out in cash. Thus, savings bank deposits do not circulate as a rule from owner to owner in the same way as commercial bank deposits, and can hardly be regarded as 'money' in the same sense. They are convertible into money on demand; but they are not themselves 'money' in the sense in which I am at present using the word.

So far, I have been speaking as if bank deposits consisted entirely of sums deposited in the banks by their owners. This is the case with deposits in savings banks, but not with deposits in the commercial banks. A considerable part of the total which figures as 'deposits' in the accounts of the commercial banks consists, not of sums deposited by the owners, but of *advances* made by the banks to their customers. These advances take two forms—*loans* and *overdrafts*. When a bank makes a loan, the sum lent is credited directly to the borrower's account and becomes a deposit in his name, with a debt to the bank standing against it. When a bank grants facilities for an overdraft, the sum allowed is not credited at once to the borrower, but is added to, and at once subtracted from, his deposit as he writes cheques against it. The bank, of course, charges interest on both loans and overdrafts, at whatever are the prevailing rates. The normal period for which advances are made is six months; but they can often be renewed for a further period.

Bank advances can be made to individuals for their private spending; but the great bulk of them is made to businesses for financing the costs of production or trade over the period between the incurring of expenditure and the receipt of payment for goods or services supplied. Some businesses can usually finance their operations out of their own capital, without calling for loans or overdrafts from the banks. But many businesses, especially trading businesses, habitually carry overdrafts, which vary in size according as trade is busy or slack. Banks also advance money on special terms to financial specialists for the discounting of bills or for stock market transactions; but I wish to leave these particular types of loan out of consideration for the present, and to come back to them later.

When a bank grants a loan or overdraft, the borrower draws upon it by writing cheques, and the sums advanced thus pass into the hands of others, who for the most part pay them in to their own bank accounts. Thus, a loan granted by a bank reappears, in the same or in a different bank, as a sum deposited by the recipient. When a

bank receives a deposit, there is no means of telling whether it arises out of money belonging to the person who drew the cheque, or out of an advance made to him by his bank.

This point is important, because it provides the answer to a question about which there has been much foolish and unprofitable disputation. Bankers sometimes indignantly deny that they create money, and maintain that they do nothing more than lend out to some people money which others have left idle in their hands. This is not true. Every time a bank makes a loan or overdraft, it creates purchasing power, that is, money, which would not otherwise exist; and the banker, when he does this, has no means of telling whether what he is lending out is based on a deposit which someone has made out of his own money or on a loan or overdraft made by some other bank or even by the same bank to some other borrower.

It is, however, quite true that the power of the commercial banks to create money is by no means without limit. As we shall see later, in countries which possess a developed system of central banking, it is narrowly restricted by the policy of the Central Bank. In such countries, this limit in the main replaces the limit which is set, in the absence of an effective Central Bank, by considerations of prudence. Where there is no Central Bank, the limitations on the power of commercial banks to create deposits by making advances are twofold. First, if one bank outruns others in granting advances, it will find the other banks making claims upon it which it will have to meet in cash or bullion; for the recipients of its advances will draw cheques in favour of persons who will pay most of them into other banks, and these other banks will accordingly make claims upon it. This means that the various commercial banks are to a large extent bound to follow a common policy in making advances, so that their claims on one another tend to cancel out. Secondly, some part though not the whole of what the banks advance will be called for in the form of cash, and not of a mere transfer of bank deposits; and the banks must therefore avoid creating claims for cash against themselves beyond what they are in a position to meet. This second limitation is important in countries in which the banking system is relatively undeveloped. It does not count for much in countries with advanced banking techniques; for in such countries the amount of cash available is usually regulated so as to meet all demands arising out of the amount of 'bank money' that is allowed to exist, and the factor subject to

control is the amount of bank deposits rather than that of cash. The first limitation, however, applies to advanced equally with more primitive banking systems; for even where there is a strong Central Bank it is necessary for the various commercial banks to keep in step one with another in order to avoid having to meet claims for the transfer of cash. In advanced countries there is almost always a Clearing House, to which most of the important banks belong; and cheques drawn upon one bank and payable to someone's account in another are cancelled out against similar cheques drawn the other way round, so as to leave only quite small balances to be settled between banks, as long as they are following a broadly common policy.

The bank deposits which are to be regarded as money thus include the loans and overdrafts made by the banks themselves, as well as the sums actually belonging to their depositors; and the two are indistinguishable, because the sums advanced are paid over to others, who pay them into their banks as their own property.

So far, then, the 'money' we are discussing consists of coins, notes, and bank deposits. Some, however, of the coins and notes in existence are not circulating in the hands of the public, but are held by the banks as till-money, or as a reserve against claims for cash that may be made upon them by their depositors. The banks do not keep more money in this form than they think they need to meet probable claims[1]; for money so kept earns no interest. But the total amount of cash lying at any moment in the banks, and therefore not in active circulation, is bound to be quite considerable. It would, indeed, be much larger than it is were it not for the fact that under the banking system which has grown up in this country —and has been to a great extent imitated elsewhere—the Central Bank, that is, the Bank of England, acts as a reserve repository of cash. The commercial banks can at any time draw from the Bank

[1] Or, rather, they do not keep more than they need in the two forms of reserves of till-money and deposits in the Central Bank, taken together. In fact, commercial banks did tend, at any rate up to the early 'thirties, to keep an unnecessarily large reserve in notes, when they could just as well have kept fewer notes and a larger balance on the books of the Bank of England. The Macmillan Committee drew attention to this tendency, and pointed out that, as neither kind of holding earns interest, it must be indifferent to the commercial banks which they hold, provided their holdings of cash are sufficient to meet real needs. It therefore advocated a reduction in commercial bank holdings of notes, as a means of narrowing the gap between the real and the apparent note circulation.

of England such supplies of 'till-money' as they require; they can do this, because they keep at the Bank of England accounts which are always in credit, and can be drawn upon at will. This involves that the Bank of England itself keeps in its banking department a reserve of coin and notes which is available for meeting these demands; but the total supply of cash thus held in reserve, and not in circulation, is very much smaller than it would need to be if each bank had to keep a reserve of its own adequate to deal with any contingency. That this was necessary was an outstanding weakness of the American banking system before the reforms of 1913, which set up the Federal Reserve Banks; and a similar diffusion of reserves among a large number of separate banks existed in Great Britain in the early days of commercial banking. There must always be, under any banking arrangements, some reserve of notes and coin kept out of active circulation in order that it may be available in case of need. But the size of the reserve required can be greatly reduced by linking the banks together in a co-ordinated system and using the Central Bank as a bank of reserve.

If cash consists of token money, of little or no intrinsic value, the real cost of holding a reserve supply of it is negligible. It costs the Bank of England nearly nothing to print the paper notes which form the main part of its reserve. Cost considerations arise only if a reserve of something more valuable has to be kept against the notes themselves. Before 1914, when the reserve consisted partly of gold sovereigns, it cost an appreciable sum to maintain it; for the Bank of England had to pay the Mint for the gold of which these sovereigns were made and no interest could be earned on them as long as they remained locked up in the vaults. To the extent to which the notes held in reserve are backed by gold bullion lying in the Bank's vaults, a similar cost is incurred. Under the arrangements made for governing the issue of bank-notes at the time when the Treasury Notes were transferred to the Bank of England, there was to be a fixed 'fiduciary' issue—that is to say, an issue of notes not backed by gold—and all notes issued in excess of this fixed issue were to be covered up to their full face value by gold held by the Bank. The fiduciary issue was not, however, fixed absolutely. Normally, it was to amount to £260 millions—a sum settled on because it seemed to approximate to what would be needed to replace the Treasury Notes that were to be withdrawn; but power was given to the Bank of England to apply to Parliament to vary the amount of the permitted fiduciary issue, and it has been from

time to time both raised and lowered since the Act of 1928 came into force.[1]

Under these conditions, the holding of a reserve in notes by the Central Bank does involve cost; for the need to hold a reserve in notes means that the total supply of notes must be higher than it would otherwise need to be, and, as the total note issue exceeds the fiduciary limit, it follows that the additional notes needed to constitute the reserve must be backed by gold, and must therefore cost whatever it costs to hold so much gold idle. The position is somewhat different in most other countries; for most Central Banks are not tied down to a fixed fiduciary issue, but only to the keeping of a supply of gold representing a certain proportion of the notes issued. This means that the cost of maintaining a reserve of notes is lower—only half as great if the proportion required is 50 per cent., and so on. The cost, however, exists, wherever there is any requirement that an increase in the manufacture of paper money shall be accompanied by an increased holding of gold.

In war, of course, such requirements go by the board, and notes are issued in the quantities needed to finance cash expenditure irrespective of gold holdings. Under such conditions, the very notion of a reserve in precious metals loses its significance; for the printing press can always be resorted to, and the quantity of notes kept as till-money by the Central Bank becomes a mere matter of administrative convenience.

The supply of cash consists, then, of the notes and coins in the hands of the public—which, less any hoarding, constitute the active cash circulation—*plus* the till-money held in notes and coin by the commercial banks, *plus* the reserve of secondary till-money held in notes and coin by the Central Bank. Only the first of these makes up the active circulation. Of course, cash is continually flowing into and out of the commercial banks; but we must understand their 'till-money' as meaning the amount held by them in excess of their normal outgoings. This is not, in practice, a fixed amount; for the active circulation varies at different times in the week, as wages are paid and thereafter returned *via* tradesmen and others to the banks, and also at different times of the year, especially round about Christmas and at times of holiday, when the public spends

[1] The fiduciary issue has been greatly increased during the war to over £1000 millions in 1943. This increase is needed to meet the larger demand for cash arising from a higher level of employment (including employment in the armed forces) as well as from a higher level of prices.

more in cash and therefore makes larger demands for it upon the banks. At the rush seasons, the commercial banks will make calls for additional cash on the Central Bank, which will have to keep a reserve adequate to supply them, or to be empowered to issue additional paper money to meet the emergency need.

It used at one time to be supposed that the key to a right monetary and banking policy lay in taking the right measures to regulate the supply of cash. This view lay behind the Bank Charter Act of 1844, which furnished the foundations for the modern system of central banking. That Act laid down careful regulations under which a limit was set to the fiduciary issue of paper money, and the permitted issue was gradually concentrated in the hands of the Bank of England under the provision which caused the note-issuing rights of other banks to be progressively withdrawn. The draftsmen of that Act, very mindful of the unregulated issues of paper money which had occurred during and after the Napoleonic Wars and of the instability of the banking system which had been manifested in numerous bank failures, believed that if they could but put the issue of notes on a sound and conservative foundation the rest of the financial system could safely be left to look after itself without interference from the State. In this belief, they set up a regime under which increased supplies of cash could be made available only as a result of increased supplies of the precious metals acquired by the Bank; and they did this at a time when the world supply of gold was increasing but slowly. If their legitimate expectations had been fulfilled, it would have been impossible for the supply of cash to be increased at all rapidly, and any large increase in the quantity of goods and services needing to be exchanged would have had to be dealt with without a parallel increase in the cash available for effecting the exchanges.

In fact, all the expectations of 1844 speedily proved to be wrong. Within a few years the great gold discoveries in California and Australia brought with them a vast increase in the annual addition to the supply of monetary gold; and this enabled the Bank of England to issue an increasing supply of paper money, and the Mint of sovereigns, far beyond what had seemed possible in 1844. But this was not all. During the years which followed the Bank Charter Act banking methods were revolutionized by the rapid spread of the cheque system, with the result that many transactions which would previously have been settled in cash were dealt with by cheque so as to make no call on the supply of cash. There was

more gold to serve as a basis for the issue of cash; and each unit issued went further, because it became possible, through the extended use of cheques, to raise upon it a larger superstructure of credit. Consequently, in the eighteen-fifties, prices, instead of being driven downwards by shortage of gold-based money, rose in consequence of its plenty and of the economies made by the cheque system in the use of cash.

Under the new conditions, men continued to think of cash, and accordingly of the gold on which the amount of cash depended, as the ultimate regulator of the supply of means of payment, and to regard the credit supplied by the commercial banks as a superstructure raised upon the foundation of the available gold. So, in a sense, it was; for the supply of cash, which depended mainly on the Bank of England's holding of gold *plus* the number of gold sovereigns in circulation or in the possession of the commercial banks, set limits to the amount of purchasing power which could be created. There had to be enough cash to meet the demands made for it by the banks' customers; and the demands so made would be affected by the amounts of loaned purchasing power which the banks advanced in credits. The banks therefore could not create credits on such a scale as to lead to demands for cash which they would be unable to satisfy; but the more their customers, instead of paying one another in cash, took to doing so by transferring their bank deposits by cheque without demanding cash, the larger became the credit superstructure which the banks could afford to raise upon any given cash basis. The credit structure became more and more elastic, and would probably have become even more elastic than it did had not the increase in the supply of gold been enlarging the cash basis at the same time.

This is not the place to pursue the history of the later developments either of gold supply or of the elasticity of the credit structure. I am not writing a history of monetary development, but only a commentary illustrated from history as need arises. Gold supplies languished again in the 'eighties and 'nineties until the further gold discoveries in South Africa brought a vast accession to ease the strain. Meanwhile, the extension of advanced banking methods based on the gold standard to further countries increased the demand for gold; and as against this the continued spread of the cheque system added to the elasticity of the credit structure. Gradually, bankers settled down to a series of conventions about the volume of credit which they could venture to base on any given amount

of cash; and gold seemed still to be the master, because the amount of cash appeared to be regulated by the available amount of gold.

There grew up, however, one convention which was in time to undermine the supremacy of gold as the regulator of credit. The commercial banks, as we have seen, keep deposit accounts at the Central Bank, and can always draw on the Central Bank for cash by cheques on these accounts. Consequently, the commercial banker comes to regard any amount standing to his credit in his account at the Central Bank as being as good as cash, because he can always get cash for it. Accordingly, the commercial banks count *as cash* the whole of the sums standing to their credit at the Bank of England, even if the Bank has not in fact nearly enough cash in hand to pay out in cash if all these sums were asked for at once. The effects of this convention are, first, to enlarge the 'cash' basis on which the superstructure of credit is raised, and, secondly, to transfer to the Bank of England the obligation of deciding how much credit there shall be—or, at all events, a maximum beyond which the creation of credit shall not go. For the Bank of England, if it is to be in a position to honour all demands for cash that are actually made upon it, must take steps to ensure that these demands do not go beyond what it can meet. It must therefore prevent the commercial banks from granting credits on such a scale as would lead to an excessive demand for cash.

But how is the Bank of England to do this? It has no control by law over the amounts which the commercial banks may choose to lend to their customers. It has, however, the power to affect the amount of the balances standing to the credit of the commercial banks in its own books, and thus of reducing or increasing the cash basis on which these banks regard themselves as entitled to erect a superstructure of credit. The method by which the Bank of England can affect these balances is known as the engaging in 'open market operations', by which is meant the purchase or sale of securities in the open market. Whenever the Bank of England sells a security, the purchaser has to make payment to it, and will do this in most cases by means of a cheque drawn on his account in one of the commercial banks. The balance of the bank concerned will thereupon be diminished by the amount of the cheque, and this will involve a corresponding reduction in the 'cash basis' on which that bank rests its creation of credit. Any considerable sale of securities by the Central Bank will result in a reduction of the balances of all the leading commercial banks, and will be effective

in reducing the credit superstructure provided that these banks adhere to the conventional ratio between their holdings of 'cash', including their balances at the Central Bank, and the amount of credit they supply.

Purchases of securities by the Central Bank naturally engender opposite effects. The Central Bank pays by cheque the sellers of the securities; and the sellers pay the cheques into their accounts in the commercial banks. The commercial banks then present the cheques to the Bank of England, which credits their accounts with the sums involved, and thus increases the 'cash basis' on which they feel entitled to erect credits. There is only this difference in the working of the two processes: the commercial banks, unless they are prepared to alter their conventional ratios, must restrict credit when the Central Bank deprives them of 'cash'; but they need not expand their advances when their 'cash basis' is enlarged. They have, doubtless, a strong inducement to do so; for they earn interest on their advances, and have therefore good reason for advancing as much as they dare. They will not, however, make advances except to borrowers whom they deem credit-worthy—that is, likely to be able to meet the interest charges and to repay the principal at the due time—nor can they make advances unless they can find persons who are ready to borrow. It may be the case that an enlargement of the 'cash basis' by the Central Bank will fail to bring about an enlargement of the credit superstructure, either because there is a dearth of borrowers or because the borrowers who do present themselves are not deemed to be credit-worthy by the commercial banks. In other words, 'open market operations' on the part of the Central Bank are much more assured of success when their object is to contract credit than when their object is to expand it.

Even within these limits, the success of the Central Bank's policy depends, not on any power placed in its hands by law, but on a pure convention. If the commercial banks choose to disregard the cash-credit ratio which is traditionally observed, there is no legal obstacle in their way. They do in fact to some extent disregard it, by allowing themselves a little elasticity when they feel so disposed. But, in the main, they observe the conventional limit; and no one bank can break away far from it unless the other banks are prepared to behave in the same way. This is because any bank which outran its fellows in expanding credit would at once find itself paying over to the other banks more than it was receiving from them; and, as

the commercial banks settle their mutual indebtedness by transferring sums to one another's accounts out of their balances at the Bank of England, the bank which granted credit more freely than the rest would find its 'cash basis' reduced by these transfers, and would thus have to face a still wider gap between its available 'cash' and the credit raised upon it, with the prospect of finding its balance at the Central Bank exhausted if it persisted in its course.

No such condition would apply if all the commercial banks were to act together. They could, by doing so, expand their credits to any extent, by altering their notion of the appropriate ratio between 'cash' and credit. But, if this happened, the Bank of England could, by continued open market operations, go on depleting their 'cash' until their balances were exhausted, so that they would no longer be able to call on it for further supplies to replenish their 'till-money'. In practice, such a situation would never arise. The Bank of England and the commercial banks work in together as parts of a single system. They may bicker, and have their differences, from time to time; but the commercial banks are much too well aware of the importance of keeping in with the Bank of England ever to engage with it in a trial of strength that might bring the entire system crashing down.

The general conclusion is that, under the prevailing conditions, the available supply of credit, though it is actually issued for the most part by the commercial banks, depends on the Bank of England, which can make credit scarce or plentiful practically at pleasure by means of open market operations. The commercial banks create credit, by making advances to their customers; but how much credit they can create depends on the policy followed by the Central Bank.

Thus the Central Bank, though legally it is the guardian only of the currency—that is, of the supply of bank-notes—is in practice no less the guardian of the supply of credit available to the business world. Moreover, whereas in earlier days the Central Bank did in fact regulate the supply of currency and leave the other banks to follow their own devices in the matter of credits, nowadays it tends more and more to think first of regulating the supply of credit, and to regard the supply of cash in the form of notes as quite a secondary matter. The amount of notes required is derived from the amount of credit created. If so much purchasing power is made available to borrowers in the form of bank advances, they will tend to draw out so much in the form of notes and coin in

order to pay wages and meet such other expenses as require cash money. The Central Bank must therefore make available whatever amount of cash is called for as a result of the amount of credit which it allows to be created. Instead of the supply of cash in the form of notes and coin governing the supply of credit, the amount of credit that is made available comes to determine the need for cash.

This truth is concealed because of the double sense in which the term 'cash' is currently employed. • In the narrower sense, cash consists of coins and notes: in the wider, it includes besides these the balances standing in the Central Bank to the credit of the commercial banks, because these are treated as equivalent to cash in the narrower sense. These so-called 'cash balances' have, however, in truth a key function of their own. They are not cash in the ordinary sense, but the instrument whereby the Central Bank regulates the supply of credit.

This difference was very clearly illustrated when, in the inter-war period, a difference of view arose between the Central Bank and one of the 'Big Five' about the amount of credit that ought to be created. The recalcitrant bank, the Midland, held that the Bank of England was pursuing an unduly restrictive policy. It therefore proceeded to build up, by buying gold, a special cash reserve of its own, on which it proposed to erect a superstructure of credit, thus enlarging the total credit supply beyond what the Bank of England regarded as appropriate. The Bank of England promptly met this move by open market operations which reduced the balances of all the commercial banks in its books to such an extent as to offset the Midland Bank's gold. The other banks, finding their 'cash basis' narrowed, thereupon turned on the Midland, which was forced to abandon its expansive policy. This incident clearly illuminated the truth that the volume of credit no longer depended on the amount of gold available as a foundation for currency, but on the view of the Bank of England as to the appropriate level of total purchasing power.

This control by the Central Bank over the supply of credit, in the form which it assumed between the wars, amounted to a repudiation of the gold standard in its traditional form, even before Great Britain had formally "gone off gold" in the crisis of 1931. Under the old gold standard, the theory was that, in general, the Central Bank should remain passive as a recipient of such gold as was offered to it at the standard price, and should proceed to create whatever amount of notes it was entitled to create on the basis of its gold

stock. Even before 1914, the Bank of England did not behave quite so passively as this theory implies; but broadly it did act on the principle of using such gold as came its way as a basis for the issue of currency (which in those days included gold coins obtained from the Mint) and leaving the other banks to erect the appropriate amount of credit on this substructure of cash. But after 1918 the Bank of England was never merely passive; and even when the gold standard was nominally restored in 1925, it did not come back in its traditional form. During the war, the supply of currency, including Treasury Notes, had come to be merely derivative from the supply of purchasing power issued in other ways; and in effect this situation continued after the war, with the difference that the Bank of England was continually operating on the supply of credit with the object of confining it within limits compatible with the available stock of gold. Or rather, up to 1925, the Bank of England was trying to compress the credit supply in order to be able to restore the gold standard at the pre-1914 parity; and after 1925 it was continuing to compress the credit supply in order to be able to remain on the restored standard. This lasted up to 1931, when Great Britain was driven off gold in the course of the world crisis; but even thereafter the Bank of England was continuing to manipulate the supply of credit so as to limit the amount of depreciation of the gold value of sterling. The Bank was behaving nearly as if Great Britain were still on the gold standard, at a changed parity; and it continued so to behave until the crisis had passed its worst.

In effect, instead of regulating the currency and leaving credit to look after itself, the Central Bank took to regulating credit directly, in the light of its knowledge of the conditions affecting the currency. From 1933 onwards, the ways in which it did this were greatly affected by the existence of the Exchange Equalization Fund, to which I shall come later; and one result of the Fund was that the Central Bank was enabled to apply a policy which cut the regulation of the supply of currency largely away from fluctuations in the national stock of monetary gold. These, however, are points too complicated to be followed up at this stage. What is pertinent here is that credit supply, which in the nineteenth century was in the main regarded as something that would look after itself as long as the currency was managed on sound lines, came to be a matter for direct and constant regulation by the Central Bank, which thus made itself responsible for controlling the total amount of purchasing power available for financing money transactions of every kind.

We can now come back to our original point of departure. We have seen that, in the world of to-day, not only coins and notes, but also bank deposits, have all the essential qualities of 'money', in the sense of generalized purchasing power transferable from person to person. We have seen further that bank deposits constitute by far the largest element in the total supply of 'money', in this sense, and that the volume of bank deposits is under effective regulation by the Central Bank. Now that gold sovereigns no longer circulate in the hands of the public, coined money has lost all independent significance: it is merely the small change that is used in retail transactions and is made available in such quantities as are needed as a consequence of the major decisions which regulate the supply of money in a wider sense. Bank-notes are vastly more important than coins; but they too fulfil a subordinate function and are supplied in such quantities as are needed in consequence of the policy followed in regulating the volume of bank deposits. Bank deposits are, in effect, the predominant element in the supply of money; and the determination of their volume by the Central Bank is the essential factor in settling the plenty or scarcity of the means of payment.

When a country is working under the gold standard and is allowing its internal monetary policy to be settled for it by the condition of the gold supply in the hands of its Central Bank, its power to increase the volume of bank deposits is limited finally by the demand for cash to which the regulations affecting the issue of currency allow it to respond. Loss of gold through the foreign exchanges involves a contraction of the supply of currency, and this in turn necessitates restriction in the supply of credit. In practice, under these conditions, Central Banks take action to restrict credit before the point is reached at which there is any felt shortage of currency; for they take steps to check the depletion of their currency reserves before these have reached the point of exhaustion: so that the element which is in fact made subject to regulation is credit—that is, the volume of bank deposits—and not the amount of issued currency. Even under the gold standard, under modern conditions, credit rather than currency is the factor on which the monetary authorities operate, although their operations are influenced by the legal requirements affecting currency issues.

When a country is not on the gold standard, and the rates of exchange between its money and the monies of other countries are

not therefore fixed automatically within narrow limits, credit is even more evidently the key factor. The object, generally speaking, of severing the automatic link between the national currency and gold is to obtain freedom to pursue a credit policy corresponding to national needs, instead of being compelled to follow an internal policy of deflation designed to preserve the external value of the currency intact. Accordingly, it is to be presumed that a country which goes off the gold standard will hold itself free, within limits, to pursue a credit policy which is deemed appropriate to its internal needs—the limits being that it will not wholly disregard the effect of its internal policy on its balance of trade or on the value of its currency in relation to foreign monies. Its monetary authorities can behave more as if they were still on the gold standard, or less. They can either allow the external value of the currency to fluctuate freely, without attempting to influence it, or they can set themselves any level they please as appropriate for the value of their money in terms of others, and thereafter adapt their internal credit policy to holding their money at the chosen external value, while retaining their freedom to alter at any time the external value to which they attempt to make it conform. They can, in other words, put such relative weights as they please on the two objects of adjusting the internal credit supply to domestic needs and of holding the external value of the currency stable at any chosen level. Whatever they do, the factor which they will set out to regulate will be primarily the supply of credit, rather than the amount of currency in circulation.

We can, then, safely conclude that credit policy is the key factor in modern monetary management, and credit the predominant form of money. Coins and notes alike have become subordinate elements in the total monetary circulation: the main kind of money now in use takes the shape, not of token currency, but of bank deposits—of book entries in bank ledgers, transferable from owner to owner by means of cheques, without any notes or coin necessarily changing hands.

There are, however, other claimants besides coin, notes, and bank deposits to the name of money. The 'bill of exchange' is a much older credit instrument than the bank deposit transferable by cheque; and it still retains a high importance. In this country, bills are used chiefly in foreign trade transactions, and comparatively little use is made of them in commercial transactions of a domestic character. This was not always the case. Before the development of the cheque system bills were extensively used in settling debts between manu-

facturers or traders and their suppliers; and they are still used on occasion. But for the most part the bank overdraft and the cheque, along with an elaborate system of trade credit, have supplanted the bill in the financing of internal exchanges of goods.

A 'trade bill' is a promise to pay at a fixed future date. It is drawn by the creditor—e.g. the supplier of goods to a trader—upon the recipient of the goods, and is payable by the debtor after so many months—often three—by which time he is expected to have put himself in funds by selling and getting paid for the goods supplied. The creditor 'draws', i.e. makes out, the bill upon the debtor: the debtor accepts it by endorsing it, and thus promises payment at the due date. This is the simplest form of bill. It is usually drawn because the creditor does not want to stand out of his money until the debtor is ready to pay. He wants to borrow from someone else the trade credit he has granted to the debtor. Accordingly, he gets the debtor's written promise to pay at a certain date, and also makes himself responsible for 'taking up', i.e. paying off, the bill in the event of the debtor's default. The bill thus bears two names—the creditor's and the debtor's; and it is therefore saleable for immediate cash on the combined guarantee of the two. This makes it more saleable than it would be if it bore only a single name; and there are persons with available money who are prepared to buy the bill at once if the names are good. Naturally, no one will pay for it the full value for which it is cashable at the due date; for interest will be demanded on the sum locked up in the bill until it falls due. This interest will take the inverted form of a 'discount'—that is, of a deduction from the face value of the bill corresponding to the period for which it has to run and to the prevailing rate of interest in the money market. 'Discount' is simply interest upside down.

Clearly, a bill which bears two unknown or little known names will be less readily discounted, i.e. bought for cash down, than a bill with well-known names upon it. Accordingly, the traders who draw and endorse bills can add to their acceptability if, instead of using their own names, they can use those of banks or other well-known financial institutions whose solvency is likely to be unquestioned. The practice has therefore grown up of traders arranging with their bankers to accept their bills on their behalf, thus substituting their names for the names of the parties to the transaction. The bank, or other financial institution, makes a small charge for this service; and the bill is converted from a 'trade bill' into a 'bank bill', which commands a wider market. It can then

be readily discounted; and the trader who has granted credit to his customer can thus get his money at once, subject to the discount, instead of waiting for it until the bill matures. The credit, of course, is not annihilated, but only transferred: whoever discounts, i.e. buys, the bill becomes the supplier of the credit.

Now, bills of this sort can be discounted, not once but, if their holders think fit, over and over again, before payment falls due. If the purchaser of the bill wants ready money, he can sell it, adding if need be his own name, so as to make himself responsible for payment if the original signatories default. Bills of exchange, therefore, though they are in form not essentially different from post-dated cheques, being simply promises to pay in the future, do not, like cheques, simply operate in a single act of transferring purchasing power. They resemble bank-notes, in that they often carry a bank's guarantee; and they are also, like bank-notes, capable of being passed on from hand to hand in settlement of debts.

Bills, however, are not 'money', in anything like the same sense as bank-notes. Their range of circulation is ordinarily very limited, and has become much more limited since the general development of the cheque system. In the eighteenth century, as readers of old novels will be aware, it was common for merchants to carry about bills and use them for settling day-to-day transactions which would nowadays be settled by cheque; and loss or theft of such bills was a common occurrence. In these days, bills usually circulate only within a much narrower field. The original discounter may sell them; but he will usually do so to a bank or to a regular dealer in bills. He will not use them for making ordinary commercial payments. There was a good case, in eighteenth-century England, for regarding bills, equally with bank-notes, as a form of money; and there still is, in parts of the world where they are still used as a substitute for notes or cheques. But in Great Britain to-day bills are no longer to be regarded as 'money'. They are negotiable credit instruments which circulate in a specialized financial market. They are not, as 'money' is, widely acceptable means of payment for ordinary goods and services. The cheque, by its superior convenience, has driven them out of this particular field.

Later on in this book, we shall have to consider some of the implications of this change of practice. For the present, we are concerned with it only as it affects our attempt to arrive at a working definition of 'money'. We can now at last attempt such a definition. 'Money', in the sense in which the term is used in this book, is

anything that is habitually and widely used as a means of payment, and is generally acceptable in the settlement of debts. It may be coined money, used nowadays mainly in retail transactions and in payment of wages; bank-notes, used chiefly for the same purposes, but also to a limited extent in settling larger debts; or bank deposits, transferred by cheque. Most large transactions, and many quite small ones, are done nowadays by this last means. Cheques are not money, because they do not circulate freely from hand to hand, being merely promises to pay signed by a single person and usually completing their circulation in a single exchange. The bank deposits on which cheques are written are 'money', and by far the most important kind of money. The volume of bank deposits is the key factor in determining the supply of 'money'; and the regulation of this volume is accordingly the critical element in general monetary policy.

II

HOW MUCH MONEY DO WE NEED?

How much money do we need? Clearly, enough to cover the purchase of everything that we need to buy and sell. Yes, but how much does that mean: will not any amount of money suffice to cover any volume of buying and selling, if only the prices are low enough? No doubt, theoretically, it will; but hardly in practice, when one is starting out, not from the beginning, but with an existing arrangement of costs and prices; for though some of these costs and prices may be fairly easy to alter, others are fixed by contract over long periods, and besides these many are in practice very difficult to adjust. If costs and prices were perfectly adaptable, and could all be quickly adjusted in equal measure, it would not matter whether we had much money or little, provided that we could divide what we had into any units we pleased.

The amount of money matters, then, because prices are 'sticky', and above all because they are 'sticky' in widely varying degrees. A reduction in the supply of money involves either that fewer things must be bought and sold, or that some or all of the things that are bought and sold must change hands at lower prices. If some prices are fixed, at any rate for a considerable time, it will be necessary for other prices to fall all the more, in order to enable the same amount of buying and selling to be done. Alternatively, the amount of buying and selling must be reduced.

In fact, a reduction in the supply of money is usually accompanied by both a fall in prices—in some prices, but not in all—and a reduction in the amount of buying and selling. When business men find that they cannot sell as much as before at the old prices, they can either lower their prices or cut down their production, or of course they can do both. The stickier their costs are, i.e. the smaller the reductions they can get in the prices they have to pay for what they use up in production, the more disposed will they be to curtail output and thus maintain the prices of what they have to sell. They may not take such decisions deliberately: they may simply find that, after they have cut their selling prices as fine as they dare, their orders fall off. Whether their curtailment of output be deliberate or not, its effect will be to throw some of their employees out of work and thus to diminish their power to buy. This will cause

other employers, from whom the dismissed workers used to buy things, to cut output in their turn. There will be a widening circle of unemployment and under-production as well as of price-cutting.

I have not asserted that these phenomena are *caused* by a reduction in the supply of money, but only that they *accompany* it. It is possible that the originating cause is not in money at all, but somewhere else. If, for example, Lancashire manufacturers have been accustomed to sell a large part of their output of cotton goods in India, and India is visited by crop-failure and famine which destroy for the time the ability of the Indian people to afford Lancashire goods, some of the manufacturers will have to close their works or reduce the number of their employees or take to working short time. They will then pay out less in wages, less to the merchants who supply them with materials, less for fuel, and probably less for their personal expenses of living. Their demand for money will fall off; and if the monetary authorities merely respond to the demand the supply of money will be reduced without any deliberate decision on their part. They will find the demand lower; and they will respond by supplying less. In such a case, the fall in the supply of money is not a *cause*, but a *consequence*, of the fall in productive activity.

Some bankers like to believe that the role of money is always purely passive, as in the example that has just been given, and that they merely respond to the public's demand for money, without influencing it at all. But this is nonsense. For one thing, banks do not lend money free, gratis and for nothing: they charge interest on their advances. To some extent, the readiness of business men to go on producing will depend on the price charged for borrowed money, that is, on the rate of interest, which is one of their costs. If, when depression threatens, the banks promptly reduce interest rates, it is reasonable to suppose that business men will be readier to go on borrowing, and will accordingly curtail production somewhat less than they otherwise would.

It must be agreed, however, that the importance of this factor can easily be exaggerated. Bank interest is not, in most industries, so large a fraction of the cost of production that any probable change in the rate will have a great deal of effect on decisions about the volume of output. It will have some, and much more in some types of enterprise than in others; but in most branches of manufacture it will not usually amount to a great deal.

But, secondly, bankers do not lend to all comers, but only to

those they deem 'credit-worthy', that is, likely to meet interest charges and to repay the sums advanced. If, on the development of unfavourable market conditions in India, or elsewhere, the bankers take fright, and become fearful about the solvency of a number of their customers, they will be less willing to lend, and will refuse advances which they would readily have granted when conditions seemed to them more hopeful. No doubt, bankers are quite within their rights in being as pessimistic as the situation warrants, and would be acting unfairly to those who have money deposited with them if they were to lend without due caution. But how if they become unduly pessimistic, and refuse loans to borrowers who have really every prospect of solvency? They will then be causing unnecessary unemployment and under-production: they will not be responding passively to the demand for money, but artificially reducing the supply. And bankers, in times of depression, are apt, out of over-caution, to behave precisely in this way.

Thirdly, there is the question of the attitude of the Central Bank. The commercial banks, as we have seen, can lend only up to maximum limits which the Central Bank is in a position to prescribe. They need not lend up to these limits; but they cannot exceed them. They have a financial inducement to lend up to the prescribed limits, in order to put the money which is at their disposal to profitable use; but this inducement no longer applies when they are afraid of making a loss instead of a gain. They may accordingly fail to lend as much as the Central Bank has made available to them; and if they are in this mood, it is not easy for the Central Bank to do anything to shake them out of it. If it further increases the supply of money, the bankers will not necessarily increase the amount of their loans. The additional money that is made available may not be used, or at all events may not be used in ways in which it will stimulate production and employment.

Most likely, what will happen is that the commercial banks, finding themselves with idle money on their hands, and fearful of embarking it in loans to productive industry, will start buying gilt-edged securities in order to earn some interest on it rather than nothing at all. The effect of such buying, reinforced by the fact that the Central Bank, if it is trying to enlarge the supply of money, will be buying gilt-edged securities too, will be to force up the prices of such securities. But a rise in the price of fixed-interest-bearing gilt-edged securities is equivalent to a fall in the current

rate of long-term interest. It means, since the prices of existing securities necessarily react on the prices of new ones, that clearly solvent business men will be able to borrow long-term capital more cheaply than before. This may induce them to borrow more, despite the unfavourable business conditions; but again we must observe that, except in a few industries, the effect will probably not be large, because business men will not be induced to borrow by a fall in the rate of interest they have to pay, if they think that the investment of the borrowed money is more likely to lead to loss than to profit. If, indeed, the business men are less pessimistic than the bankers, their response may not be negligible; but if they share the bankers' mood it is likely to be small. The power of the Central Bank to bring about an effective expansion of the money in circulation is weak at such times, unless it is prepared to act on a very large scale. If it goes on pouring money by open market operations into the commercial banks, the combined effect of falling interest rates and of its manifest determination to bring about an expansive, or 'reflationary', situation, can in the long run wear down the pessimism of the commercial bankers and of those business men who are best placed for taking advantage of the cheap supplies of money.

It may, however, need very drastic action by the Central Bank to achieve this result, including an expansion of the potential supply of money much beyond what would achieve it if the money were fully used. Central Banks are not usually controlled by persons who are likely to be willing to take action as forthright as may be needed. The Central Bank is much more likely to make, at most, a half-hearted attempt at reflation, and to abandon its efforts when small measures achieve no apparent success.

So far, I have been assuming that the Central Bank, instead of participating in the pessimism of the rest of the business and banking world, sets out to correct it. But this may very well not happen. We have now to ask what will occur if the directors of the Central Bank are themselves infected by the prevailing fright. They will then, instead of trying to make money more plentiful, set out to reduce the supply in order to force prices down to a level at which they believe an expansion of demand will be brought about. In our chosen example, they will seek, by making money scarce, to bring about a fall in the prices of Lancashire goods to a level at which the impoverished Indians will again be able to buy them.

To some extent, this policy may succeed in re-expanding sales to

India—unless the Indians are so poor as not to be able to buy at the lowest prices to which Lancashire's wares can be forced down. But, even if such success is achieved, the cost is likely to be heavy. The costs which go to making up the prices of Lancashire's products will not all be equally amenable to scaling down. Some will be fixed over long periods: some suppliers of materials will be better placed than others for refusing to reduce their prices: wage-earners will resist wage-cuts when they can, and directors and managers will be reluctant to have their fees and salaries cut down. Such cuts as are effected will be reflected in a reduction in the money-incomes which constitute the means of paying for goods and services in the home market. These reductions in spending power will face business men in other trades with the alternative of cutting their prices, or their output, or both; and they will, in total, reduce both prices—unequally for different goods—and output—also unequally. The net result may be that increased sales to India will be much more than offset by reduced sales in the home market. A 'deflationary' policy of reducing the supply of money in face of an impending or actual depression, instead of making the general state of employment and production better, will normally make it a great deal worse.

Yet the Central Bank's directors, in following such a policy, may be more than half convinced that they are not initiating anything, but are merely adjusting the supply of money to the changing state of demand. The more depression spreads, the less money seems to them to be needed: each step they take to cut down the supply curtails the demand, and seems to justify a further cut. The 'passive' theory of Central Bank action results in practice in the Bank becoming the most powerful of all the forces making for depression and unemployment. It is fully possible that the *initial cause* of the decline in the market may have nothing to do with banking, either central or commercial. But it is certain that both commercial bank pessimism and Central Bank deflationism may be, even in such a case, *secondary causes* so powerful as altogether to overshadow the initial cause in the havoc to which they give rise.

I have, however, admitted both that commercial bankers are bound to exercise due caution and that the Central Bank's power to influence the course of events is small unless it is prepared to act on a very extensive scale. I shall have to come back to this point in a later chapter, in which I shall deal fully with the policies which Central Banks ought to pursue in combating depression and with

the non-monetary measures needed to make their action effective. This question will come up when we get to the vital question of 'Full Employment' and the monetary measures necessary for its maintenance. In this chapter, I am dealing with a different, though closely related, issue—that of the criteria by which a community is to judge of the amount of money it needs.

It requires, we have said, enough to cover the purchase of everything that needs buying and selling for money. What does this include? First, the entire current output of goods and services, except such goods as are produced and consumed without being sold at all—the eggs my own hens lay, and so on—and such services as are rendered without money payment—my wife's as housekeeper, and mine as Chairman of the Fabian Society, for example. Many of these current products, moreover, will be bought and sold several times over. Finished goods will pass by way of wholesalers and retailers to the consumers; and in most forms of manufacture there are successive processes, which are often carried out by different firms. The turnover of money has to cover all these intermediate transactions, as well as the buying and selling of goods at the final stage. Indeed, a good deal more money changes hands between intermediaries than in the purchase of finished goods by the final buyers.

Of course, if we take any fixed accounting period, such as a year, the whole of the year's output will not be bought and sold in that year. There will be stocks of goods at various stages in existence when the year begins, and stocks to be carried over to the next year when it ends. The magnitude of these stocks changes from time to time; and accordingly in some years more will be sold than is produced, and in other years less. This piling up and depletion of stocks—they are much depleted now, in the fifth year of war—has very important economic consequences; but we must not pause to consider them at present. We shall come back to them later on.

Secondly, there are always going on transactions in goods which are not newly produced. Men buy and sell land, houses and other buildings, machinery, second-hand furniture, motor-cars, pictures, jewellery, and many other things, and second-hand stocks and shares which partly represent ownership rights in such forms of property, and partly are mere acknowledgments of debt—e.g. Consols or War Loan or any other elements in the National Debt, as well as that part of share values which represents business 'goodwill', and not any form of physical property. All money transactions in such

durable and second-hand goods, including stocks, shares and bonds of every sort, have to be provided for by the supply of the money needed for them. But whereas the great bulk of new output is made to be sold almost at once, in any accounting period only a proportion—a very varying proportion—of the total stock of durable and second-hand goods will be bought and sold.

The most variable elements in this stock, in respect of the frequency with which they are bought and sold, are stocks and shares and land—the two things round which centres nearly every kind of speculative activity. Stocks and shares have, indeed, a curious capacity for being speculated in without being actually bought or sold. It is common for professional operators, and even for outsiders, to contract to buy stock market securities without any intention of ever entering into possession of them, and to contract to sell securities which they neither own nor expect to own. Such dealing, upon 'margins', amounts to a sheer gamble on the expectation that the market value of a particular security will rise or fall. If it rises, the speculative 'buyer' pockets his profit without ever buying the security; if it falls, the speculative 'seller' similarly pockets his gain. It was one of the sources of President Roosevelt's unpopularity in American financial circles that he placed restrictions on this type of gambling, making it actually unlawful in its extremer forms. Where it exists, the quantity of securities that can be dealt in is obviously not limited to the number in existence, much less to the number actually up for sale. But money passes, whether the sale is real or fictitious, though of course the sum passing is smaller if the deal is 'on margin', so that only the difference between the actual and the contracted price has to be paid.

Stock market transactions and land speculation call for 'money', just as any other buying and selling does. But there is a difference between the effects of an increase in activity due to speculation and one that is due to a brisker market for ordinary goods and services. Speculative transactions, except some of the shadier sort, are usually settled by cheque, without the use of coins or notes: so that a boom on the stock or produce markets, or in land transactions, does not of itself call for an increase in the supply of cash. It increases the volume of credit outstanding, and therefore of bank deposits; but it does not call for a parallel expansion in the supply of cash money. As against this, a boom in production means that more will be paid out in wages, which create the principal demand for cash. It is accordingly easier for the banks to finance a speculative boom than

a real increase in production and employment without experiencing a demand for cash which will deplete their balances at the Central Bank and thus narrow the basis on which the credit superstructure is raised. This factor is of much greater importance in the United States than in Great Britain, because speculative activity rises to much greater heights in America and also because the banks are there much more directly involved in loans for stock market speculation.

The available supply of money has, then, subject to the reservations already made, to provide for the sale of the current output of goods and services (*plus* or *minus* changes in stocks held in reserve, and *minus* such goods and services as are consumed without being sold). It has to provide for intermediate as well as final transactions; and it has also to cover such sales of durable and second-hand goods already in existence as change hands for money during the accounting period. Now up to a point, the more developed the technique of production and distribution becomes, the more times on the average goods tend to change hands in exchange for money on their way from the producers of the raw materials to the final consumers. When the 'division of labour' results in the splitting up of a process of manufacture into several stages, each carried out by a separate firm, the amount of money changing hands increases, even if there is no increase—more probably there is a decrease—in the final price of the goods. As against this, when a certain stage of development has been reached, there may set in a counter-tendency towards the concentration of the successive processes in the hands of a single firm or combine, and this may lead to a reduction in the number of times the goods are exchanged for money during the processes of manufacture and distribution. It may not, however, have this effect, if the firms constituting the combine, or the factories constituting the complex firm, retain their independence to the extent of buying and selling among themselves for money, rather than by means of mere book-keeping entries in their own ledgers.

This selling of the same goods at different stages over and over again, as they move up the ladder of production and distribution, increases the demand for bank credit, but, like stock market speculation, it has no corresponding effect on the demand for cash. The workmen who work for the firms concerned at the various tasks of production and distribution will not, in general, receive either more or less in wages because they are employed by a chain of firms rather than by a single integrated firm. Of course, where the

'division of labour', instead of being an economy, results in waste —for example, by superfluous handling, as it often does in distribution—the numbers employed and the wages paid may both be affected. This, however, is a different point. In general, the demand for credit is, but the demand for cash is not, much affected by the structure of business enterprise as between serial and vertically integrated firms.

The demand for 'money', then, can be expressed as the sum of (*a*) the final selling value of the current output of goods and services which are actually sold during the period under review; (*b*) the total of the successive selling values of the ingredients of which the final output is made, including selling values at intermediate stages of distribution; and (*c*) the selling values of such pre-existing durable or second-hand goods as are actually exchanged during the accounting period. It would be possible to refine further upon this formulation; but such refinement would, at the present stage, only confuse the issue.

This constitutes the demand for 'money'; but it does not mean that the amount of money must be equal to this demand. For money, as we have seen, does not perish in a single act of exchange. It goes on circulating, or at all events some of it does, from one transaction to another. The employer pays the workman his wages; the workman pays them away to a shopkeeper, or a rent-collector, or an insurance agent. The recipient probably takes them to the bank, which re-issues the same money for the payment of wages next week or the week after—and so on, until the money is worn out, when of course it can be replaced if a fresh supply is wanted.

Let us confine ourselves for the moment to the circulation of one particular kind of money—cash. Obviously, the faster it circulates and the more speedily it returns to the bank for re-issue, the less of it will be needed to finance a given volume of payments. If all the money returns to the bank in a week, the bank will need to keep a much smaller total stock than if the process takes a fortnight or a month; and to the extent to which ordinary people finance their mutual transactions by passing money to and fro among themselves without paying it back into the banks, the cash will be doing more work than if each holder of money simply keeps it by him unused for a longer time. The rapidity with which money, on the average, changes hands is known as its 'velocity of circulation'; and it has often been said that the amount of money needed to finance a given

volume of transactions over a period is the sum of the money involved in the transactions, divided by the velocity of circulation—that is, by the average number of transactions each unit of money performs during the period in question.

This sounds simple enough as long as one is speaking only of cash money.[1] But what sense are we to attach to the notion of the velocity of circulation of bank deposits? Statisticians do, indeed, calculate such a velocity. They do it by finding out the total money value of all the cheques cleared between the principal banks, and then comparing this total with the total of bank deposits as shown in the published statements of the same banks. This, to be sure, does not measure the actual velocity of circulation, in any sense; for the only cheques of which we have a record are those which involve a debit from one bank to another. If I bank at Barclays, and write a cheque to someone who also banks at Barclays, the cheque will not go to the Bankers' Clearing House through which the leading banks settle their mutual debts. A sum in Barclays books will be transferred from my account to someone else's; and that is all. There will be no published record of such a transaction.

What, however, the statisticians are trying to measure is not the absolute velocity of circulation of bank deposits, but changes in this velocity. If the cheques passing through the Clearing Houses represent roughly a constant *proportion* of total cheques, changes in the ratio of bank deposits to such clearances will give a reasonably good picture of changes in the pace at which the possessors of bank accounts are writing cheques against them. For most practical purposes, it is necessary to break up the totals—for example, it is of importance to do what can be done to get separate pictures of the state of transactions relating to trade and industry and of those arising out of stock market speculation. This is attempted very roughly by regarding the cheques cleared between banks in central London (Metropolitan Clearings) as belonging to the 'financial circulation', and cheques for the rest of the country, including the rest of London (Country, and Town, Clearings), as belonging to

[1] It is simple; but it is not the most useful way of looking at the circulation, even of cash. It is much more illuminating, and nearer the truth, to regard the banks as needing to keep a supply of cash sufficient to carry the 'peak load'—that is, to meet the highest demand that is likely to occur at any time during, say, a week. This is not the same as a measure of velocity; for the velocity with which the cash circulates at all times outside the period of the 'peak load' is practically irrelevant to the amount which the banks need to hold in readiness.

the 'industrial circulation'. It is possible from the figures to get some sort of an idea of the extent to which a rise or fall in total clearings is due to up or down movements in the 'City' or in the world of industry and trade.

Such indicators are clearly useful; but has the notion of a 'velocity of circulation' of bank deposits any fundamental validity? Cash and notes, once put into circulation, remain in existence until they are worn out or deliberately withdrawn. But bank deposits are mere entries in a book, which can be created or annihilated by the banks almost at will. If a commercial bank lends £500 to Messrs. A, and then, after Messrs. A have paid it back, lends £500 to Messrs. B, is there any real sense in which the two sums of £500 are the same money performing two successive acts of circulation? If it were true that bankers did not really create money, but only lent out to one person sums left in *their* hands by others, as some people used to believe they did, there would be some reason for regarding the sum-total of bank deposits as constituting a money-fund and for treating successive advances as successive circulations of the same money. But this is not what happens. If it were, the making of an advance could not, as it actually does, increase the total of bank deposits by the amount of the advance. The amount of deposits would be fixed, and it would be only a question of transferring them from one possessor to another. However, as everyone knows, the amount of bank deposits is not fixed, but fluctuating. It depends mainly on the action of the Central Bank. The commercial banker may be under the delusion that he is not a creator of money, because the amount he is able to create is settled for him by the Central Bank. But that cannot alter the fact that bank deposits are created and annihilated by someone; and it seems most natural to regard them as created by the commercial bank when it makes a loan, to be annihilated as soon as the loan is repaid. That is, in fact, what does occur.

On this view, bank deposits constitute, not a perpetually circulating stock or fund, but the result of a recurrent process of creation of new deposits. We can legitimately talk of the rate of turnover of cheques through the Clearing Houses, and we can compare this turnover with the published totals of bank deposits. But we cannot speak of a 'velocity of circulation' of bank deposits in the same sense as we can of the 'velocity of circulation' of cash. Cash does circulate from hand to hand: bank deposits follow a different process. There is a close analogy between the cash circulation

and the transfer of deposits between depositors in the absence of bankers' loans; but, as soon as the factor of loans comes in, an essential difference appears. If banks were merely institutions through which persons could transfer balances which belonged to them from one to another, we could speak of the 'velocity of circulation' of such deposits. We cannot speak of the 'velocity of circulation' of something which is continually being created and destroyed. We have, however, no means of separating bank deposit transactions into two groups, one representing transfers of sums between their owners and the other transfers of sums created by the banking system. The two cannot be distinguished. If somebody pays me by a cheque based on an overdraft, and I pay it into my bank account, it becomes indistinguishable from money paid to me out of somebody's balance, without any advance from a bank. We have to treat bank deposits as a single category, because there is no means of breaking them up.

The purpose of the foregoing paragraphs has been to show that, under modern conditions, the amount of money and the velocity of its circulation are not really two separate things, so that we can multiply the one by the other and arrive thereby at a measure of the total efficiency of the available supply of money in effecting purchases and sales. That this could be done was the belief on which rested the traditional formulation of the theory known as 'The Quantity Theory of Money'. According to this theory, which was customarily expressed in quasi-algebraical form, the level of prices would depend on the ratio between the volume of transactions needing to be financed on the one hand and on the other the amount of money available multiplied by its velocity of circulation. $MV = CP$—the amount of money (M) × the velocity of its circulation (V) = the volume of transactions (C) multiplied by the average level of prices (P). That there is a truth underlying the Quantity Theory no one, I suppose, denies; but the apparent precision of the formula conceals the fact that it is made up of a number of immeasurables. M and V are not two separate things, but a complex single entity. Moreover, what on earth is the volume of transactions apart from the prices at which they take place? There is no way of comparing or adding up the magnitudes of the sale of a ton of coal and an acre of real estate except in terms of their prices. CP, like MV, is not made up of two separable entities, but is a single complex thing.

Yet it is obviously true that the more money there is changing

hands, the higher on the average prices are likely to be—as long as the supply of things to be exchanged does not increase as fast as the amount of money changing hands. Common sense and experience alike endorse this; and no one who has been through, or studied the effects of, a period of inflation will be likely to deny it. What we cannot say is that an increase of so much per cent. in the recorded total of bank deposits will produce a corresponding increase in the level of average prices, or a decrease of so much per cent. a corresponding decrease. Even if we set aside the undoubted fact that nobody ever has measured the average level of *all* prices, and nobody ever will, there remains the further fact that a change in the amount of money changing hands will be accompanied by a change in the volume of production and also by a change in the amount of durable and second-hand goods exchanged. The changed 'quantity of money', if I may be allowed the inexact phrase, will not have to finance the same 'quantity of transactions'—another inexactitude —as before.

It can, I hope, already be seen that the question 'How much money do we need?' is not easy to answer. How can we tell how much money we *need*, when we cannot even say without ambiguity how much money we have already *got*? The very notion of 'quantity of money' dissolves as soon as one starts analysing it. Does this mean that we must reach a purely negative and destructive conclusion—that nothing useful can be said on the subject? Not at all. There is plenty to be said; but it is not of a sort to be reduced to formulae that look like algebra, and *are* devices for concealing ambiguity under a false appearance of precision.

What, then, can we say? That the proof of the pudding is in the eating. The 'amount of money' we need, or rather let us say the amount of facilities for effecting payments, is that amount which will suffice, and only just suffice, to keep the resources of production in reasonably full employment. How are we to tell what this amount is? By careful observation of economic facts and tendencies. If, on such observation, we find that resources are being underemployed, that constitutes a good *prima facie* reason for supposing that the means of effecting payments ought to be made more plentiful. If, except in time of war, we find that there is an acute shortage of productive resources, leading to a scramble for their use, and to their overwork, that is a good *prima facie* reason for making the means of payment less plentiful. It should of course be understood that I am speaking of things as they are under the present economic

system in Great Britain and other capitalist countries, and not as they might be under a quite different system, or as they are in the Soviet Union, where money plays an essentially different role. Under our system, as it existed up to 1939, the *prima facie* case is good. It is not, however, a conclusive case in itself. It may be that the under- or over-employment of resources is confined to a particular sector of the economy, and is traceable to some non-monetary cause—for example, to a world decline in the demand for coal, or to the obsolescence of Lancashire as a centre for supplying the world with cotton piece-goods. In such cases, the remedy is not mainly monetary, though it may turn out to have a monetary aspect. It is to be sought rather in a shift of productive resources from the declining forms of production to others which cater for more expansible demands. If, however, the under-employment or over-employment of resources is general, or at least widely diffused, it is a pretty safe bet that a change in the supply of means of payment will be one essential element in the cure.

We need, then, just enough means of payment to secure and maintain full employment. To say this is not to say that the provision of these means will by itself suffice to bring about and to sustain such a level of employment of productive resources. It will not. But unless the means of payment are in sufficient supply, nothing else will avail to keep employment at a satisfactory level. If the means of payment are deficient, unemployment, under the capitalist system, will inevitably arise.

Objection may be taken to this conclusion, on the ground that, even if unemployment does arise for a time, in the long run prices will be scaled down to the required extent, so that the supply of means of payment will no longer be deficient in relation to the reduced demand for money corresponding to a level of full employment of the available resources. I neither affirm nor deny this. I am not interested in it. What I do know is that, as Lord Keynes has somewhere written, "in the long run we are all dead", and that the process of adjustment is likely to be so painful and so unjust in its incidence upon different groups, classes and individuals, that no one ought to wish to face such a catastrophe unless there is no way of avoiding it. A scaling-down of the supply of means of payment, with the object of forcing down prices and incomes to levels corresponding to the reduced supply, will begin by bankrupting many people who, through no fault of their own, are in an especially vulnerable position. It will increase the real incomes of those

whose money-incomes are fixed, and reduce the real incomes of those whose money-rewards are variable. It will confront wage-earners with the painful dilemma of either standing out against wage-reductions at the cost of increasing unemployment or accepting them at a sacrifice of their standards of living when they are employed. It will confront capitalist associations with a similar dilemma of either maintaining prices and reducing output or cutting prices in the hope of attracting to their wares a larger proportion of the reduced total of money-demand. It will in both these cases help the strongly placed or organized at the expense of the weak. It will upset the relations between prices and incomes, not so as to correct injustices, but in an arbitrary and irrational way. Perhaps, in the long run, things will settle down to be no worse than they were before the process started, but I cannot for the life of me see that they are likely to settle down to be any better; and what, pray, is to compensate for the sufferings and injustices of the transition?

No. When a particular arrangement of prices exists, it is best to adjust the supply of means of payment to that level, rather than to use an alteration in the supply of means of payment as an instrument for making it different. This must not be confused with the contention that prices ought to be artificially stabilized, either generally or in particular. That is quite another question, to which I shall come later on. Prices of particular things will naturally alter, and their relation to other prices be altered, as technical conditions of production change; and I can see no reason for supposing, in view of this, that there is any virtue in stabilizing the 'general level of prices', which is, after all, only some sort of average of these particular prices. But I wish to defer argument on that issue; and I mention it here only in order to stress the difference between allowing prices to alter as technical conditions change and trying to alter them deliberately by monetary manipulation. What I am arguing is that monetary management ought to be based, broadly speaking, on accepting an existing price-structure, and not on creating a new one. This doctrine may not hold good under all circumstances—for example, it may not be fully valid where prices have been upset by a process of runaway inflation. But where the existing price-structure has become the basis for a complicated structure of long-term contracts, incomes, and supply and demand relations of all sorts, it is in general exceedingly unwise to attempt to alter it by monetary methods, if there is any alternative to doing so. In

general, the right course is to adjust the supply of means of payment to the existing price-structure and the existing productive resources, so as to achieve and maintain full employment with the minimum of disturbance. But, let me repeat, this does not mean that prices ought to be artificially stabilized: it means that they ought not to be artificially upset.

III

CREDIT CONDITIONS AND THE GOLD STANDARD

THE conclusions reached in the preceding chapter were empirical. Banking is an art and not a science; and the determination of the conditions governing the issue of means of payment is a matter in which statistics may help but cannot furnish absolute guidance. Plainly the decisions which are made will be of vital importance to every section of the community. They will affect both the volume of employment for productive resources of all kinds—capital and land, as well as labour—the distribution of incomes between groups and classes, as well as their amount, and the relative as well as the absolute prices of all sorts of goods and services. They will not, of course, be the sole determinants in any of these fields; but they will be of very great influence. It is therefore evidently of the greatest importance that those who make them shall act both expertly and wisely, and in such a way as to further the social and economic policies which the community is endeavouring to pursue.

These considerations apply with special force to those who are in charge of the Central Bank; for it is on the policy of the Central Bank that the most far-reaching consequences depend. The commercial banks are in the main *distributors* of credit, or perhaps better *retail manufacturers*. They depend, for the amount of credit they are able to manufacture, on the materials for this manufacture that are placed at their disposal by the Central Bank. They may make less than the Central Bank allows them to make: they cannot in general make more. As against this, the Central Bank appears rather as an autonomous creator, following its own ideas of the amount of purchasing power that is needed.

But is the Central Bank as autonomous in its creation of the basis for credit as this description suggests? In the past, most Central Banking experts, and most economists, would have flatly denied this, and would have argued that the Central Bank itself is only a *wholesale distributor*, or at most a *wholesale manufacturer*, of means of payment, dependent for the materials of this manufacture on forces outside its control, and therefore, equally with the commercial banks, limited in the amount of purchasing power that it is in a position to create. There would perhaps have been more dispute over the question whether the Central Bank *had* to create all the

purchasing power it *could* create, or was free to create less, or at all events about the extent of its freedom to create more or less within the maximum limits open to it. Some preferred to regard the action of the Central Bank as being almost automatically determined for it by rules which it was compelled to obey; whereas others put greater stress on the powers at its command for varying within limits the supply of means of payment.

The traditional theory of Central Banking was worked out on the assumption that Central Banks would either be operating under the Gold Standard, or would be regarding that standard as an ideal to which it was their affair to approximate as closely as their circumstances allowed. The Gold Standard is, in brief, a system under which the value of a national currency is fixed in terms of gold. It is laid down by law or binding regulation, under such a system, that a unit of the national currency (e.g. the pound sterling) is worth a fixed weight in gold of a standard fineness. The Central Bank is under a permanent obligation to buy gold at this fixed rate, giving national currency in exchange—or at a little less where a charge, *seigniorage*, is made by the State for the act of coinage. The Central Bank is under a similar obligation to sell gold, that is, to give gold in exchange for national currency, at the fixed rate. The Central Bank's rates for buying and for selling gold may thus be the same, where there is no seigniorage, or slightly different; but the difference has been, hitherto, not large enough to constitute a major feature of the system. In Great Britain, under the gold standard, there was no seigniorage: buying and selling rates for gold at the Bank of England were the same.

It is also an essential feature of the gold standard, in its complete form, that there shall be freedom to import and to export gold. Anyone, under the gold standard proper, could bring gold into the country; and anyone could take it out. Consequently, the stock of gold fluctuated, not only because newly mined gold could always be brought in for sale—as it was continually brought from South Africa to England—but also because anyone who pleased could move gold into or out of the country, either as a means of paying debts or as a means of moving capital across national frontiers. There was no necessity for all the gold that was in the country to come to the Central Bank or to the Mint. There was also an industrial market for gold—for rings, watches, gold plate, and so on—and in addition anyone who pleased could hoard gold privately, or sell it to anyone else, either inside or outside the country. Gold

had a market price for non-monetary uses; but this market price, and consequently the amount of gold which the owners of gold-mines found it worth while to produce, was in effect settled by the monetary demand for gold from Mints and Central Banks, with the Central Banks' buying and selling prices setting a minimum level below which it could not fall.

On the 'automatic' theory of Central Banking, the Central Bank was merely a passive agency in receiving and getting rid of gold. It took what people brought to it, and paid out what people demanded from it. What remained in its vaults as a result of these operations was its fund of monetary gold, on which its action in the making of credit facilities had to be based. While sovereigns, worth their weight in gold, circulated in the hands of the public, the gold reserve in the hands of the Bank was relatively small. In England, before 1914, there were, and had been since the first quarter of the nineteenth century, no paper notes of a value smaller than £5; and the gold reserve was 'cover' only for these larger notes, to the extent to which their total value exceeded the then permitted fiduciary issue, which was just under £20 millions. The Bank, at any rate in theory, issued notes covering its entire holding of gold bullion as well as the fiduciary issue; but it did not put into circulation all the notes it issued. The Bank was nominally divided into two departments (by the Bank Charter Act of 1844)—an Issue Department, solely responsible for the manufacture of notes against gold holdings and the securities covering the fiduciary issue; and a Banking Department, through which all the rest of its business was done. The Issue Department passed all its notes over to the Banking Department, which then put into circulation through its customers such as were demanded of it, and held the rest as a reserve, together with a smaller reserve of gold sovereigns and lesser coins. The active circulation of bank-notes was thus smaller than the issue by the amount held in the Banking Department[1]; but in addition to the note circulation there was a large active circulation of gold coins.

[1] And also, if we wish to be precise, by the amount hoarded or held in reserve by the commercial banks. See p. 35.

TABLE I

TOTAL COIN AND BULLION IN THE BANK OF ENGLAND AT VARIOUS DATES

(From Feavearyear, *The Pound Sterling*)

	£000s	
1792	7,000	Before French War.
1796	6,000	Suspension of Cash Payments.
1809	4,500	Before Bullion Report.
1819	4,500	Before Restoration of Gold Standard.
1824	9,000	After Restoration of Gold Standard.
1844	15,250	Bank Charter Act.
1846	14,500	
1856	11,000	
1865	15,000	
1889	19,750	
1893	26,500	
1894	34,250	
1895	39,000	
1896	44,250	
1900	33,250	South African War.
1906	34,000	
1913	37,500	
1914	88,000	European War.
1928	159,750	Transfer of Treasury Notes to Bank.

TABLE II

GOLD RESERVES OF THE BANK OF ENGLAND, 1913 and 1920–1939

£ Millions. End of Year

	Bank	*Treasury*
1913	35	
1920	128	28·5
1921	128	28·5
1922	127	27
1923	128	27
1924	129	27
1925	145	
1926	151	
1927	152	
1928	153	
1929	146	
1930	148	
1931	121	
1932	120	

TABLE II—(*continued*)

	Bank	*Exchange Equalization Fund*
1933	191	
1934	192	
1935	200	
1936	314	
1937	326	170 (September)
1938	326	92 (September)
1939	279 (September)	367 (March)
1940	—	69 (December)
1941	—	36 (September)

When Great Britain restored the gold standard in 1925, there was no return to the use of gold coins, which had been withdrawn from circulation in 1914 and replaced by Treasury Notes; and a little later, in 1928, the Treasury Notes were replaced by Bank of England Notes for £1 and 10/-. Under the new conditions, the reserve of gold in the Bank had to serve as cover for a far higher proportion of the currency in circulation; for it had to cover the notes used in substitution for gold coins as well as the notes for £5 and upwards. But it was not necessary for the Bank of England to hold a proportionately higher gold reserve. The fiduciary issue was raised from under £20 millions to a normal £260 millions. Great Britain, though again on the gold standard, was no longer using what was in effect a gold currency supplemented to a quite small extent by paper not covered by gold, but had adopted instead a paper currency backed by what would prove, it was hoped, a sufficient gold reserve to meet the claims actually made upon it.

There was a second change. It was no longer possible for anyone who pleased to go to the Bank and demand gold in exchange for paper money. That right was reserved, as it had really to be now that gold coins were no longer in circulation, to persons who wanted gold in large amounts. This meant in effect that the right to demand gold was limited to professional dealers or speculators, including of course bankers. As long as such persons could get it, and were free to send it abroad, the essence of the gold standard was preserved and the British currency was tied to gold as effectively as before, without the need to lock up nearly so much gold in unproductive monetary use. Gold, coined into sovereigns or kept in a bank vault, yields no interest or profit beyond what can be yielded by the paper that can be substituted for it. It is therefore more economical to use paper than gold, and to keep down the reserve

held in gold to as little as is deemed enough to do what is needed of it.

Under the pre-1914 conditions, when most of the monetary gold in Great Britain circulated in sovereigns and the note issue played only a secondary part, the Bank of England's gold holding was quite a modest amount. In December 1913 it was £35 millions. In December 1925, after the restoration of the gold standard, it was £145 millions. The note circulation, on the other hand, was £35 millions at the end of 1913, and £391 millions at the end of 1925. Of the number of sovereigns in circulation in 1913 there is no exact account: it has been estimated at £115 millions. Gold coins constituted the greater part of the active circulation: a large proportion of the notes were in fact locked up in the vaults of the commercial banks. The Bank of England could always get gold coins from the Mint when it wanted them; and the Mint bought its gold as it needed supplies in the gold market, with cheques drawn on the Bank of England as the Government's banker.

The function of the Bank of England, as guardian of the currency, under this system, was primarily to watch the movements of its own gold reserve, and to expand or contract credit supplies in accordance with these movements. The Bank could lose gold in either of two ways—an internal or an external drain. An internal drain would mean that more gold money was being demanded for home circulation, or that gold coins or bullion were being drawn out of the Bank for hoarding. An external drain would mean that gold was being taken out of the Bank for export. The second of these drains was in practice by far the more important. There was little temptation to hoard gold under the pre-1914 conditions of monetary stability, and a demand for more sovereigns for internal circulation would be only one of many indicators of rising commercial activity.

An external drain was the phenomenon for which the Bank was always on the watch. There was more than one possible cause. It might arise because British people, or people operating in Great Britain, were buying a higher total value of things abroad than could be balanced by foreigners' payments for British exports, shipping and financial services and for the use of British capital invested overseas. In other words, British imports *plus* British exports of long-term capital might amount to more than British exports *plus* any long-term investments by foreigners in Great Britain—'invisible' exports of shipping and financial services and dividends and interest on past investments abroad being included

on both sides of the account. A lack of balance in this form might be mainly due to heavy imports or a fall in exports, to a pronounced increase in overseas investment, to a fall in shipping freight rates or to any of a number of other causes. But a lack of balance could also be due to other factors. If, for example, there was a boom in the United States and interest rates there rose to high levels, persons who had previously kept their money in Great Britain might move some of it to America, not only for the purpose of buying long-term securities on the American stock markets but also for the purpose of lending it out temporarily at high interest to American speculators. There were short-term as well as long-term capital movements to be taken into account; and there were always professionals who made a practice of moving money about from country to country in pursuit of the largest return.

Any such movement, as well as any disequilibrium in long-term capital movements in relation to the balance of 'visible' and 'invisible' trade, might either send gold out of the country or, if they acted in the reverse direction, send gold flowing in. The Bank of England would adjust its note issue to the amount of gold left in its possession by the combined operation of all these forces; but it would also endeavour so to act as to induce the commercial banks, and the financial world in general, to accommodate their doings not merely to the actual flows of gold, but also to its anticipations of the probable trend of gold movements. The Bank of England had two main weapons for bringing about this accommodation—Bank Rate and Open Market Operations. Before 1914 the chief stress was laid on the former: nowadays, under greatly changed monetary conditions, it has shifted to the latter.

Bank Rate, as we have seen, is technically the rate of interest at which the Bank of England is prepared to re-discount bills of exchange of certain approved types. But actually it is, or at all events was up to 1914, chiefly important as a signal to the entire financial world of the Bank of England's estimates and intentions relating to monetary conditions. A rise in Bank Rate was a signal to expect, and to act upon, conditions of monetary stringency: a fall was a signal that money could be regarded as plentiful in relation to the demand for it. When the Bank of England raised its rate, the commercial banks were expected not only to raise the rates which they charged to their customers, but also to go warily with the granting of new loans and to reduce their outstanding advances of short-term money. When the rate fell, the reverse processes were

to be set in motion. And, in general, the expectation was that these influences were likely to be effective, even in the absence of other action by the Central Bank; for, as a rule, the commercial banks did do with little hesitation what the Central Bank expected of them.

Under these conditions, the Central Bank's second weapon, Open Market Operations—the buying or selling of securities on the open market—could be regarded mainly as a weapon to be held in reserve, or occasionally as an instrument to be used for bringing about small adjustments which did not require action so drastic as a change in Bank Rate. If the commercial banks did not act promptly upon the advice given them through the medium of Bank Rate, the Bank of England could, by means of Open Market Operations, increase or decrease the amount of their 'cash' resources, in the way described earlier, and thus bring them into line—at any rate when what it wanted was a tightening of conditions. And the Bank could also, when it wanted to make a quite small adjustment of credit conditions, act directly on the commercial banks' resources by Open Market Operations, without altering Bank Rate.

In doing any of these things, the Bank of England up to 1914 regarded its role as mainly passive. Even if it sometimes acted in anticipation of events, it was not, in its directors' estimation, going beyond doing promptly what would have to be done later on, and perhaps by its promptitude lessening the amount of adjustment that had to be made. It was guided, in what it did, almost entirely by the flow of gold into or out of the country: it regarded this movement of gold as the governing factor in determining day-to-day monetary policy, because it regarded its duty as that of preserving the gold standard and accordingly of keeping at the required level the value set on the pound sterling all over the world. If gold went on flowing out, the Bank would have to cut down its note issue to balance every ounce it lost, and in the end, when there was no more gold left to pay out, the country would be forced off the gold standard and there would no longer be anything to keep the pound firmly worth so many dollars, or francs, or marks, or crowns. For when those who wanted gold could no longer get it in exchange for British currency at a fixed rate, there would no longer be any automatic fixing of the pound's value in gold, or in other currencies which represented a fixed amount of gold.

It was therefore necessary, as part of what has been called the 'gold standard game', to take prompt measures to correct any

tendency for gold to leave the country. This, under free trade conditions which did not allow any direct control over the volume of imports, or any beyond mere suasion over that of overseas investments British subjects chose to make or over the movement of short-term funds, could be achieved only by making the economic conditions such that the wish to take gold out of the country would evaporate. Higher interest rates would induce the owners of 'free' money to leave it in London rather than elsewhere: scarcity of bank credit would force down prices and costs, and would thus make British goods cheaper in relation to foreign goods, encouraging exports and discouraging imports: and conditions of 'tight' money would also discourage overseas investment. By these influences a gold drain could usually, before 1914, be fairly easily put a stop to; and the textbook theory of those days in the main reflected the actual and successful practice of the Bank of England.

It is true that this entire process was carried on with hardly any direct regard to its effects on employment and production in Great Britain. If, as a result of monetary stringency, factories were shut down and men and women thrown out of work, that was an unfortunate consequence for which the bankers did not accept any responsibility. The remedy, in their view, was plain. It was to cut costs, including wages, until prices had been brought down to the level needed for the stimulation of exports and the resumption of profitable business, at a lower money-level, in the home market as well.

I have spoken earlier in this book of the way in which such enforced price-cutting under the orders of the financial authorities actually works out. It was tolerated up to 1914 because the adjustments which the Bank had to carry through in order to remain on the gold standard were usually fairly small, and the consequences therefore fairly small also. Great Britain, as the effective centre of the entire financial world, the market in which the gold from South Africa—the largest source of supply—was regularly sold, and the chief source of foreign investment of long-term capital as well as of short lending, was remarkably strongly placed. The gold standard was in effect a 'sterling standard'; and there was a good deal of room for manœuvre when things threatened to go wrong. But when the gold standard was put back into operation in 1925, conditions were already very different. The United States had supplanted Great Britain both as the leading 'surplus' country —that is, the country with the largest sums available for long-term

foreign investment—and as the country most strongly entrenched, by a vast gold reserve, in a position to make its currency the effective partner of gold. The gold standard was no longer a 'sterling standard': it was coming to be a 'dollar standard'.

Moreover, the terms on which Great Britain returned to the gold standard in 1925 were disastrous. Taking the opportunity presented by a fortuitous and temporary parity, which carried with it an exchange rate with the dollar at nearly the pre-war level, this country returned to gold *at the* 1914 *gold value of the pound sterling.* Very speedily conditions in America changed, so that the natural rate of exchange between the pound and the dollar was shifted to Great Britain's disadvantage. In restoring the gold standard, however, Great Britain had incurred an obligation to hold the dollar-sterling rate at a fixed level, or practically so; but it became clear that this could not be done without a very severe reduction of British prices and incomes. The attempt to enforce this, largely at the expense of wages, was the main cause of the General Strike of 1926; and despite the defeat of the strike the pressure was not wholly successful in this field. In other fields it led to a growth of restrictive monopolies designed to hold up prices, and therewith to unemployment and under-employment of productive resources. The strain continued right up to the moment when Great Britain was forced to abandon the gold standard again in the world economic crisis of 1931.

My point is this. Under the conditions which existed up to 1914 Great Britain was so strongly placed as to be able to a great extent to set the economic tone to the rest of the world, apart from occasional upsets due to speculative booms and crises in the United States. This power meant that on the whole a gold standard policy was broadly consistent with monetary conditions that suited internal British needs, and that the adjustments required on account of gold movements were not often so large as seriously to upset employment and production. On the other hand, after 1926 the gold standard worked out in quite a different way, and the adjustments which the Bank of England felt itself called upon to enforce were on such a scale as to dislocate production and give rise to mass-unemployment.

Under these changed conditions, Bank Rate was no longer a sufficient weapon. It had, moreover, the disadvantage that, to the extent to which it did its job, it reacted on all types of transactions involving the use of capital or credit, and not only on those which

it was really necessary to damp down in the interests of exchange stability. High interest rates, for example, increased the cost of building, and this, as houses were urgently needed, meant higher State subsidies for erecting them. High interest rates damped down other forms of capital construction, and therefore checked the modernization of industrial plant. They were a factor in making business men more cautious than they would otherwise have been —though not, perhaps, to a great extent outside a few industries which are heavy users of capital. In general, in face of the 'stickiness' of money prices, they tended to damp down production and to react very seriously on those who could not hold up their particular prices by some sort of monopolist action.

Open Market Operations, which were also used on a much larger scale than before 1914, reinforced these effects. More money was needed to circulate the goods and services that could be produced, unless prices were sharply diminished; but less money was being made available, and money prices were not coming down fast enough to meet the needs of gold standard equilibrium.

This was still the situation when Great Britain was forced reluctantly off the gold standard in 1931. What happened then? The fall in the external value of the pound sterling immediately relieved the situation of the Bank, by making British exports cheaper to foreign buyers and imports from abroad dearer to British consumers. Over and above this, imports were checked by the introduction of a tariff, and Great Britain's traditional adherence to Free Trade was at an end. The pressure on the sterling exchange was eased, because holders of sterling, no longer able to withdraw gold, hesitated to attempt to withdraw their money now that it could be exchanged only for a lower, and varying, amount of any other money into which they might seek to convert it.

In leaving the gold standard, Great Britain had abandoned fixed for fluctuating rates of exchange with the monies of other countries. It would have been possible to attempt to meet the crisis of 1931 with a single act of *devaluation*—that is, by fixing a new and lower gold equivalent for the pound. In that event, most of the same immediate consequences would have followed; but Great Britain would have remained on the gold standard at a lower parity. This was not done. The pound was not devalued: it was allowed to *depreciate*, and to find for itself a lower, but not a fixed, value in terms of other currencies, corresponding to the conditions of supply and demand.

At least, this was what happened at first. But before long people began to say that the Bank of England was behaving as if Great Britain were still on the gold standard, albeit at a lower parity. It seemed to be the Bank's policy to keep the pound worth about 70 per cent. of its pre-1931 gold value, and to continue to operate the old techniques, with only the difference that considerably more room was allowed for seasonal and other short-term fluctuations. This policy, however, did not last. In April 1932 the British Government established an Exchange Equalization Account—a fund created by Government borrowing to be used for the purpose of checking and limiting fluctuations in the exchanges—especially in the dollar-sterling exchange, and especially in relation to speculative movements. The method of operation of the fund was to buy or sell dollars, or other currencies, or gold for sterling in such a manner as to offset forces which were threatening to alter the exchanges in ways which were deemed inappropriate. Now, by its very nature, a fund such as this cannot stand out against a persistent and marked tendency for exchange rates to move either for or against sterling. If it did, it would run out of the funds needed for continuing its operations. It would come to consist either all of sterling, or all of other currencies and gold. Accordingly, the purpose of the Exchange Equalization Account was not to make the long-term value of sterling in terms of gold or other currencies substantially different from what it would otherwise have been, but to reduce short-term fluctuations and to prevent speculators from upsetting the exchanges in the hope of reaping high profits for themselves. In these objects much success was achieved; and, as the fund got into its stride, its size was increased and larger and larger use was made of it, especially for buying up and sterilizing gold which was brought to this country by foreign owners who were afraid of monetary upsets in their own countries.

Meanwhile, in 1933, the United States itself was driven off the gold standard by the world crisis. But the American conditions were widely different from those which had prevailed in Great Britain in 1931. The United States went off the gold standard, not from fear of losing gold—the American gold stock was enormous—but in an attempt at once to push United States exports by making them cheaper and to force up dollar prices in the United States, where there had been a sensational price-collapse. This is not the place to discuss the theoretical basis, or the practical effectiveness, of this policy. What we need to observe is that the United States

did not allow the dollar to find its own level, but *devalued* it to a new fixed level, taking power at the same time further to alter its value in gold, either upwards or further downwards, by similar definite executive acts. The United States, then, never left the gold standard in the same sense as Great Britain had left it in 1931. It only altered the dollar's gold value, and thereby affected its value in terms of other currencies. Actually, after this devaluation, the pound sterling, which had had an exchange value of nearly 328 cents in December 1932, was worth nearly 512 cents in December 1933. Presently the Americans set up an Exchange Equalization Account of their own; and thereafter the sterling-dollar exchange came to be in effect 'managed' jointly by the monetary authorities of the two countries.

Even between 1926 and 1931 it had been impossible for the Bank of England to hold that the gold standard was any longer working automatically, and that its essential role was one of passive interpretation of the trend of events. The directors of the Bank were, however, during this period trying to get back as nearly as they could to the old system. After 1931, when the gold standard had been given up, it was necessary to choose between an attitude of sheer passivity, which would have left the exchanges to fluctuate freely from moment to moment, and a policy of deliberate management. The first of these policies would have been clearly disastrous. It would have opened the way to all manner of speculative excesses, and it would have exposed Great Britain to great and continuous upsets in the supply of means of payment as well as in the relation of British to other money. Some sort of 'management' had to be resorted to; and, as we have seen, there was at first a marked tendency to 'manage' the currency so as to imitate as nearly as possible what would have happened if the gold standard had still been operative at a lower parity.

Events in America, more than anything else, soon altered the actual working out of this policy. When President Roosevelt came into office at the worst point of the American crisis, his administration set to work to bring about a revival of economic activity by various methods, among which was an attempt to increase the active circulation of money. As the supply of money expanded in America—which it could do indefinitely without being brought up against any shortage of gold—it became possible to expand the supply in Great Britain also, without fear of provoking adverse reactions on the exchanges. There was no risk of a flight of 'free'

money to America in search of profit: interest rates in Great Britain could be kept down without fear of the development of a shortage of funds. The policy of the Bank of England subtly changed. It began to encourage, in a modest way, a policy of monetary expansion.

Interest rates were kept low, as recovery from the worst of the world crisis set in. Under a regime of stably low interest rates, Bank Rate lost its position as an instrument of Central Bank policy; for the Bank did not want to upset things by altering its rates. Almost the entire emphasis shifted over to Open Market Operations as means of adjusting the resources of the commercial banks, and thus of influencing the general supply of means of payment. Instead of using Bank Rate as a signal, and leaving the commercial banks to make the appropriate adjustments, the Bank of England regulated the monetary supply directly by adjusting the level of the 'cash' balances of the commercial banks.

These changes were not without their reaction on commercial bank practice. The commercial banks, taking their cue from the general loosening of the old orthodoxies, began to allow themselves more latitude than they had been used to do in raising a credit superstructure on the 'cash' foundation allowed them by the Central Bank. The old principle had been that, roughly, £1 of 'cash', including commercial bank balances at the Bank of England, would bear £10 of credit in the form of commercial bank deposits. This ratio was still broadly adhered to, but with more elasticity than before; and the banks began increasingly to work in terms, not of a single ratio between 'cash' and credit, but of a more complex formula in which a distinction was drawn between credits of different kinds.

If we look at a commercial bank statement, we shall see that the liabilities, apart from the capital and reserves, consist of deposits, some on current and some on time-deposit account.[1] The assets consist of (*a*) cash in the bank's own possession; (*b*) 'cash' in the form of its deposits at the Bank of England; (*c*) 'money at call and short notice', which consists of advances made from day to day or for a few days at a time chiefly to dealers in Treasury Bills and bills of exchange, but also to stock exchange operators; (*d*) bills discounted, including both Treasury Bills and bills of exchange held by the bank itself; and (*e*) investments, which are largely, but not exclusively, long-dated Government securities. Now, these assets

[1] See p. 30.

possess varying degrees of what the banker calls 'liquidity', i.e. ready availability in the form of cash. Cash itself is obviously a perfect example of liquidity, in this sense; and balances at the Bank of England are almost as liquid, in that they are convertible on demand and without notice into cash. 'Money at call and short notice' is also highly liquid: the banks can recall loans in this category at a day's, or at most a few days' notice, and can thus reduce their obligations without risk of loss. They can also in practice, by recalling them, replenish their supply of 'cash'; for the bill-dealers who find their commercial bank loans withdrawn will be driven to re-discount some of their bills at the Bank of England, and the cheques paid by the Bank of England for these bills will, on being paid in to the commercial banks, swell their 'cash' balances at the Bank.

Bills discounted are less liquid; for they may have as much as three, or even six, months to run. The commercial banks, however, usually prefer to buy bills which have already run the greater part of their course, and have only a short time left before they mature. The commercial banks make a practice of not re-discounting bills they have once acquired; but this method of buying chiefly bills already well advanced towards maturity gives their bill-holdings the liquidity they desire, without involving the risk that a change in the rate of discount may mean a loss. Such a risk they leave to the bill-dealers: the bills they hold are collected at full face value when they mature.

Advances in the form of loans and overdrafts to customers are much less liquid than bills. They are generally given for six months, and often in the expectation that they will be renewed. The manufacturer or trader cannot afford to operate on a basis of day-to-day or week-to-week loans. He must be sure of the money for the time it will take him to collect payment for his goods. He pays for this assurance a much higher rate of interest than is paid for shorter-term loans; and accordingly the less liquid advances are the more remunerative to the banks.

Investments are commonly regarded by bankers as their least liquid assets. Yet British Government securities, and indeed most of the securities banks hold, are easily saleable at any time. They are not, however, saleable for a fixed amount of money, unless the banker holds them until their date of maturity—if they have one—and this date may be many years off. Quick realization of them involves a risk of capital loss. The banks accordingly prefer either

to hold them till they mature—which causes them to have a preference for relatively short-term securities—or at any rate to choose their own time for selling and not be hurried into realization at an unfavourable moment. This causes the bankers to regard such securities as 'illiquid', despite their ready marketability.

The rules on which the commercial banks, subject to some elasticity, now appear to work are these. They aim at keeping approximately 9 per cent. of the amount of total deposits in cash, including 'cash' balances at the Bank of England. This is known as the 'First Liquidity Rule'. Secondly, they aim at keeping approximately 30 per cent. of total deposits in fairly liquid form, including 'money at call and short notice' and bills of exchange or Treasury Bills as well as 'cash'. This is known as the 'Second Liquidity Rule'. The remaining 70 per cent. of their assets they distribute, according to the prevailing conditions, between 'Advances', i.e. ordinary loans and overdrafts, and 'Investments'. When business is active, advances rise and investments fall off: when business is slack, the reverse happens. The banks also feel free to allow some elasticity between 'cash' and highly liquid assets. If their holdings of 'money at call and short notice' and of bills is high, they may let their 'cash' fall below 9 per cent. If bills and short loans are scarce, they may increase their 'cash holdings' above 9 per cent. of deposits.

There is, then, a good deal of elasticity in the credit superstructure which the commercial banks feel entitled to raise on any given 'cash' basis; and this means that the control exercised by the Central Bank is by no means rigid. There is, however, always a limit which the commercial banks do not feel themselves entitled to pass; and there is always an inducement to approach this limit because 'cash' earns nothing, whereas the less liquid assets are on the whole the more profitable. This is not quite true, on the descending scale of liquidity described above; for loans and overdrafts are usually more profitable than investments in gilt-edged securities. The banks have therefore an inducement to lend to producers and traders as much as they dare, such loans being their most profitable outlet. If they lend less than they should in these forms, the explanation is caution and timidity, overcoming the appetite for profit. Banking is in general so profitable a business that bankers are under no necessity of taking many risks in order to satisfy their shareholders' avidity for profits.

The commercial banks thus operate, with some elasticity of practice, on a 'cash' basis which is determined for them, broadly,

by the Central Bank, chiefly through the medium of Open Market Operations. When a country is on the gold standard, the principal factor which affects the Central Bank in deciding what the size of the 'cash' basis shall be is the supply of gold at its command. This statement, however, requires some qualification in the light of recent conditions. The United States, because of its creditor position and its excess of exports over imports, as well as of a tendency for 'refugee' capital to seek security by migration to America, has received in recent years so much gold that, if the augmented gold stock had been allowed to produce its full effect on the supply of means of payment, there would have been a gross inflation of credit and prices would have been driven out of hand. Accordingly, much of the gold imported has been 'sterilized' by various methods, and thus prevented from producing its effect. One such method has been to alter the legal provisions prescribing the 'cash' reserves to be maintained by the commercial banks. In America, such reserves are controlled by law, whereas in Great Britain the reserve ratio rests only on convention. The United States is, of course, not strictly on the gold standard; but the *de facto* stabilization of the dollar in terms of gold makes conditions there resemble in many respects those which apply to gold standard countries. The American conditions are, however, absurd, in that no country has ever before had so vast a gold stock as to involve the ignoring of the available supply of gold in the fixing of internal monetary arrangements.

When a country is off the gold standard, and the freedom to export gold does not exist, there can be no fear of a drain of gold due to the withdrawal of gold stocks from the Bank. The attention of the Central Bank then comes to be fixed, not on gold movements, but on the fluctuations of the rates of exchange between the national currency and the currencies of other countries, or on the fluctuations that would occur if no steps were taken to prevent them. There is, under such conditions, no absolute reason for taking any particular rate of exchange as a standard to be aimed at. The monetary authorities, unless they have tied themselves down by international agreements, are free to select any rate of exchange as that which they desire to maintain, to lay down any limits they please within which fluctuations are to be allowed without any attempt to check them, and to alter the standard aimed at as often and as far as they please. In reaching their decisions, they will be torn between two objectives—that of adapting the supply of means of payment to

internal needs, so as to secure the fullest possible employment of productive resources with the least possible dislocation of the price-structure, and that of securing enough stability in the external value of the national currency to enable exporters and others engaged in foreign trade and the recipients of incomes from foreign investments to have as much assurance as possible in placing contracts, selling goods abroad, or estimating the value of prospective incomes from foreign capital holdings. There may well arise a conflict between these two sets of objectives; and the monetary authorities will then have to compromise as best they can. The more a country depends on foreign trade and overseas investment, the greater will be the importance attached by its monied classes to the factor of exchange rates: the greater the volume of its production consumed at home, the more stress will tend to be laid on the need for adequate supplies of money to finance home industry and trade. It may be added that the more a country suffers from unemployment and seeks to escape from this curse, the greater will be the pressure on its monetary authorities for a liberal provision of credit facilities for its home industries.

There can be, then, no automatically fixed rule to which monetary policy must conform in a country which is off the gold, or some other fixed international, standard. The case must be one for decision on grounds of expediency, not for conformity to a predetermined rule. When the gold standard operated, there were critics who objected to it, and wanted to see it done away with; but, as long as it did operate, there was room for no more than minor differences about the credit policy that had to be pursued. As soon, however, as a country is 'off gold', there is room for much more difference of opinion. It will be a disputed point how much money is needed in order to sustain conditions of 'full employment', and there will be in addition disputes about the definition of 'full employment' itself; and about the relative importance to be attached to maintaining 'full employment' and to exchange stability. Monetary policy is bound, under such conditions, to become a highly controversial matter; and the knowledge that this is bound to happen, and the fear of the results of it happening, are among the principal reasons why many financiers and financial experts cling to the gold standard as an ideal, and desire ardently to return to it, even though they recognize that it has disadvantages. These gold standard advocates are so sceptical of the power of communities to devise systems of monetary 'management' that will

work well, or what they regard as well, that they prefer an 'unmanageable' objective standard, even if it may involve from time to time a maladjustment of the supply of means of payment to the community's internal needs. They would sooner have unemployment, enforced by the rules of gold standard finance, than trust anyone who can be put in authority over the banking system to manage credit conditions sensibly and well. Such an attitude is quite intelligible on the part of bankers, who can usually make quite good profits even when industry and trade are deeply depressed. It is not so easy to understand when it is embraced by persons who stand to lose heavily as a consequence of business depression. When such persons do hold this view, their attitude is to be explained largely as a by-product of their hostility to State control over economic affairs, and is to be attributed to their recognition that, if day-to-day banking policy becomes a matter of acute controversy between groups and classes, it will not be long before political pressure is exerted to bring the entire banking system under political control.

IV

PRICE REGULATION—THE TRADE CYCLE—SPECULATION

A GREAT deal has been written in recent years about the paradox of 'poverty in plenty'. Men have asked in growing numbers and with increasing vehemence why mass-unemployment and under-consumption are allowed to exist in a world technically equipped to produce abundance. In many cases, the complainants have put the major part of the blame—sometimes the entire blame—for this paradoxical situation upon money. They have alleged that the advanced countries, and indeed all countries, are suffering from gross mismanagement of their monetary affairs; that there is somewhere a flaw in the money system which leads to a persistent, or to a recurrent, deficiency of purchasing power; that men are the victims of 'gold standard finance' or, alternatively, of the 'flood of worthless paper'; that the monetary system is too little, or too much, 'managed' by bankers and/or politicians; and that everything, or at least most things, can be put right by well-designed and sweeping measures of monetary reform. Others more modestly assert that monetary factors, even if they are not at the bottom of all our troubles, have at any rate been mainly responsible for the recurrent economic crises which have swept across the world ever since the capitalist system began, and that there is about money an inherent 'instability' which it should be the object of public economic policy to keep under control.

Both the diagnoses of what is amiss and the suggested remedies are diverse and numerous; and it would be quite out of the question, in a volume such as this, to examine even cursorily a tithe of the writing that has been published on the subject during the period of economic instability between the two wars. All that is possible is to pick out from the welter of critiques, plans and proposals, a few key points of attention, on which many of the critics have seized, and a few typical projects of reform.

It seems best to begin with those critics who see the root of the evil, not in money itself, but rather in the workings of the price system. It is, of course, a matter of general agreement that the extreme instability of prices in recent years has been a most upsetting factor for producers and traders in many countries and in many lines of business. Some of the projectors hold that this instability

of prices is to be attributed to the mismanagement of monetary affairs, and that accordingly the remedy must be sought in the field of monetary policy. Others, however, believe that the remedy is to be found rather in the regulation of prices, holding that price-changes set up undesirable reactions on the demand for money and that a stabilized price system would of itself induce a much greater stability in the sphere of monetary supply. These advocates of price-stabilization fall broadly into two groups—those who wish to operate mainly on the prices of particular goods and services of key importance, and those who propose action designed to steady the 'general level of prices'. I shall begin with the latter.

What is the 'general level of prices'? As far as the notion has any precision, it must refer to some sort of *average* of the prices obtained for particular things. In most countries there are nowadays certain series of index numbers by means of which an attempt is made to measure changes in the level of prices. The two best known and most widespread types are, first, the series giving index numbers of Wholesale Prices in particular countries, and, secondly, the parallel series measuring either Retail Prices of commodities or, on a somewhat broader basis, the Cost of Living. In index series of these types there is usually a single base year or month, or sometimes a base which is itself an average of several years or months. Average prices in the base period are taken as 100; and the index numbers for other years measure changes from this standard. Thus, the Board of Trade Index of British Wholesale Prices stood at 165 in March 1943, as compared with 100 in August 1939, just before the outbreak of war; whereas the Ministry of Labour's Cost of Living Index stood at 128 at the beginning of March 1943, as compared with 100 at the beginning of September 1939. Examples of other index numbers are given in the accompanying table.

TABLE III

Index Numbers of Prices

1929=100	*Wholesale Prices*							*Cost of Living*		
	United Kingdom			*U.S.A.*		*Germany*	*France*	*U.K.*	*U.S.A.*	
	Board of Trade	*Economist*	*Statist (Sauerbeck)*	*Labor Bureau*	*Irving Fisher*	*Official*	*Official*	*Ministry of Labour*	*Bureau of Labor*	*Industrial Conference Board*
1929	100	100	100	100	100	100	100	100	100	100
1930	87·5	84·0	84·2	90·7	89·6	90·8	88·4	96·3	97·5	96·6
1931	76·8	70·2	72·8	76·6	74·1	80·8	80·0	89·9	88·7	87·1
1932	74·9	67·7	70·7	68·0	64·0	70·3	68·2	87·8	79·7	77·8
1933	75·0	68·2	69·8	69·2	67·1	68·0	63·6	85·4	75·4	74·8
1934	77·1	71·0	71·7	78·2	79·5	71·7	60·0	86·0	78·1	79·3
1935	77·9	74·1	74·1	83·9	86·2	74·2	54·0	87·2	80·1	82·1
1936	82·7	78·6	77·8	84·8	86·9	75·9	65·5	89·6	80·9	84·0
1937	95·2	89·3	90·0	90·6	94·2	77·2	92·7	93·9	83·8	87·7
1938	88·8	77·8	80·1	82·5	84·3	77·1	104·1	95·1	82·3	85·6
1939	90·0	80·3	84·3	80·9	84·0	77·7	—	96·3	81·1	84·4
1940	119·8	104·8	113·0	82·5	86·8	80·2	—	112·2	81·7	85·2
	First half of 1939 =100									
1940	140	139	144	103	105	103	—	121	101	101
1941	157	151	159	114	117	105	—	129	106	106
1942	164	160	169	129	134	107	—	130	118	116
1943 (June)	168	165	—	136	140	108	—	130	126	124

Evidently, all index numbers must be based only on a selection of prices; for it would be out of the question to record and average all the prices actually charged over any period. Moreover, if price-changes are to be recorded over a period of time, care has to be taken to compare like with like. It would tell us nothing about the movement of prices for cars to be informed that an Austin Seven cost £145 at one date, and a Rolls-Royce £1,500 at another. The quality of the things compared must be as far as possible the same at each date; and accordingly only standardized articles lend themselves to comparison with any degree of accuracy. This means that price-changes are much more difficult to measure for some kinds of things than for others; but, even where a high degree of standardization exists, there may be a large number of different standard articles belonging to a particular group. To measure one of them may not give any accurate gauge of price-changes affecting the others; and to measure them all may involve great labour. Moreover, as soon as we try to put together the results of two or more measurements of price-changes for particular things, a further problem arises. Are we to give each measurement an equal importance, or are we to attempt some sort of *weighting* in accordance with the relative importance of the different things? If there are a hundred times as many transactions in one commodity as in another, or a hundred times as much of it being bought and sold, are we, in making up our average index of price-changes, to give it a hundred times the *weighting*?

This problem arises as soon as we attempt to measure the change in price within a single commodity group including different species or qualities. It arises again when we try to put together the indexes for these groups into any sort of combined index measuring changes over a wider field. Statisticians have various ways of resolving these difficulties. Take such a substance as wheat. There are many varieties—hard Canadian, soft English, Argentine, Australian, and so on—and many sub-varieties within each variety. What the Board of Trade does, in arriving at its estimate of the change in wheat prices generally, is to pick out a few of the most important sub-varieties and ignore the rest. It does the same with other commodities, taking a larger number of varieties for the more extensively traded-in goods and a smaller number for goods of less importance in the total of trading transactions. In this way it arrives at a rough weighting of the relative importance of the commodities included in its list, by taking more examples

of one than of another. By averaging, both by groups and over the entire range of goods, it then arrives at a series of group indexes —for cereals, meat, textiles, metals, and so on—and at a general index of wholesale prices covering the whole range of goods included within the scope of its study. This last is what is called the Wholesale Price Index, and is widely used as an indication of the general level of commodity prices apart from retail trade.

The Ministry of Labour's Cost of Living Index is made up in a somewhat different way. It was originally based, nearly forty years ago, on a collection of household budgets gathered from individual working-class households and showing how these particular households then spent their incomes on different kinds of goods and services. From these budgets a selection was made of the more important items recurring in most of them, leaving out such things as beer and tobacco, which were consumed by some but not by all, and also such highly variable expenditure as doctors' bills, travel and transport, and most forms of luxury or semi-luxury spending. An average budget was then made up, showing the average distribution of the weekly expenditure among the various items—the main kinds of food, clothing, and household necessaries. The various commodities were then given *weights* in accordance with the composition of the average budget. Each month the Ministry of Labour collects from a large number of shops records of the prices currently charged for the various kinds of goods—as far as possible, for uniform qualities—and compares these prices with those current in the base period. A separate index number is thus arrived at, where necessary by averaging several varieties, for each group of commodities; and these index numbers are then brought together into a weighted average covering them all. Rougher methods are used to measure changes in rents and in a few other things; and these are also weighted in relation to the items already included. The final outcome is a general index which purports to measure average changes in working-class costs of living.

Many other methods, used in compiling other indexes, could be cited. But these two are enough for purposes of illustration. Clearly, neither measures at all exactly what it sets out to measure. In the case of wholesale prices, it is in general much easier to find standard varieties of raw materials, such as wheat or cotton, or of semi-manufactures, such as pig iron or steel or cotton yarn, than of finished goods, which are apt to be much more diversified.

Accordingly, index numbers of wholesale prices generally represent much more the price-movements of raw and semi-finished materials than those of finished capital goods or consumers' goods, and, as the prices of finished goods do not necessarily alter in proportion to changes in the prices of the materials of which they are made, the Wholesale Index may not accurately reflect either the price-movements of finished goods or the general average of wholesale price-movements for goods at all stages. Similarly, the Cost of Living Index may fail to reflect real changes in retail costs if the prices of goods not represented in it, or inadequately represented, move differently from the average prices of the things it does cover.

Such index numbers as these cover between them only a part of the current transactions which go to make up the total movement of prices. They omit altogether transactions in land, in stocks and shares, and in all classes of goods that are not current products of industry. They omit wages, salaries, and other payments which constitute incomes for the recipients and costs for those who pay them. One or two attempts have been made, by bringing together the Wholesale and Retail Indexes, together with separate indexes for a number of these other things, to arrive at a more general index of all types of current prices. But the difficulties of both measurement and weighting are very great, and the results command little authority. We cannot at present measure changes in the general level of all prices: we can measure only certain wide groups of price-changes, and even these measurements are by no means accurate. When, for example, several authorities compile Wholesale Price Indexes by different methods and with different weightings, quite wide divergences sometimes appear. In April 1943, on a common basis of January to June 1939, the three best-known British indexes stood as follows: Board of Trade 167, *Economist* 165, *Statist* (the well-known Sauerbeck Index) 173.

If measurements of average prices are difficult within a single country, they are much more difficult when any attempt is made to apply them on an international scale. There are, indeed, certain goods which are traded in extensively on a world-wide market and are therefore likely, in the absence of restrictive combination, to have much the same value everywhere, subject to differences arising out of the costs of transport. But these commodities are relatively few, and they are of very varying importance in the make-up of the national economies of different countries. Their prices can no doubt be expressed in terms of gold or of the money

of some one country which is taken as a standard, and the fluctuations of their average prices, thus ascertained, can be measured. Such measurements have their uses; but obviously any such calculation must fall a long way short of giving any indication of world price-movements as a whole.

Stabilization of the 'general level of prices' is usually advocated as a national policy, and its object defined as that of holding steady whatever internal measure of prices is deemed the most significant for the purpose. This generally means the Index of Wholesale Prices rather than that of the cost of living, partly because the Cost of Living Index is a good deal narrower in its scope, applying as a rule only to working-class costs, and partly because the end in view is as a rule stability in commercial dealings rather than in standards of life. What I am about to say applies, however, whatever index is used.

Any policy designed to stabilize an average presupposes fluctuations in the items of which the average is made up. If some prices fall, the average will fall, unless other prices rise to a counter-balancing extent. Price-changes for particular commodities may arise from any of a number of causes. The price of, say, leather may fall, either because there has been a technical improvement in tanning processes, or because hides have become cheaper, or because a monopoly which was previously holding up the price has collapsed or altered its policy, or because the demand has fallen off and manufacturers are trying to reduce their stocks, or because the wages of the leather-workers have been reduced. Hides may have become cheaper, either because an increased demand for meat has caused a larger number of cattle to be bred, or because wages have fallen in the stock-raising areas, or for any of a number of other reasons. The demand for leather may have fallen off because of changes in fashion, or the development of substitutes, or changes in the incomes of the consumers. So, through the whole range of prices of particular things, there are a host of reasons which may lead to a change in the price of a particular commodity. Some of these causes will apply to a wide range of other commodities as well, whereas some will apply only to the commodity or group in question; and even causes which apply in some measure to most commodities will not affect all of them to the same extent.

If the general level of prices is to be held stable, any fall due to a particular cause must be counteracted equally with any arising

out of a more general cause. If it becomes cheaper, or dearer, for purely technical reasons, to produce coal or steel or cotton goods, action must be taken to offset the change in their prices by bringing about changes in the opposite direction in the prices of other kinds of goods. But why should the price of, say, boots be raised because the price of stockings has fallen? If, indeed, there has been a widespread fall, not traceable to technical causes affecting the costs of production, there may well be a valid reason for intervention to bring prices back to a higher level. But, even so, is there any virtue in aiming at the stabilization of the average level as shown by the Wholesale Price Index at any particular moment? If the aim is that of offsetting monetary causes of price-instability, while leaving technical forces to operate freely on the prices of particular goods, the 'general level' ought to be left unfixed, in order to avoid forcing particular prices up or down for the purpose of keeping the average stable.

This is the more important, because in any particular country there will be some prices which are much less amenable than others to any manipulation on a purely national basis. In the United States, for example, the prices of such bulk exports as cotton are determined mainly by international factors of supply and demand, and cannot easily be influenced by national action. If the prices of cotton and other world-traded materials and foodstuffs are tending to fall on account of world conditions, and if the accepted American policy is that of keeping the general level of prices stable, it will be necessary to force up artificially the prices of those things which are less subject to world influences. Instead of correcting the evils arising out of the fall in the prices of basic materials and foodstuffs, such a policy will make the position worse; for the farmers, while getting less for their own produce, will be compelled to pay more for the goods they need to buy. What is called the 'farmers' ratio'—that is, the relation between agricultural and other prices—will be worsened to the farmers' detriment; and the result will be seen in an increase of industrial unemployment owing to the farmers' reduced ability to buy.

The position is less clear-cut in Great Britain; but the same conclusion holds good. If the prices of particular things are to be allowed to alter as the conditions under which they are produced change, there is no good reason for trying to stabilize the average of all these fluctuating prices.

Yet it is obviously a bad thing for prices to alter, not because

the conditions of production or demand have changed, but for some quite irrelevant reason. It is bad for producers to work in the dark about the selling value of their products, and for consumers not to be able to anticipate, even within fairly wide limits, what they will have to pay even a little while ahead. Such huge fluctuations in prices as occurred between the wars were manifestly bad; and the proposal to stabilize prices is accordingly attractive to very many persons who have experienced the evils of instability.

What, then, of proposals to stabilize not the general average of prices, but the prices of particular kinds of goods? It is one of the advantages claimed for the cartels which have grown so powerful of late years that they exert a stabilizing influence on the prices of the goods they control. So they do; but this stabilizing influence is much more commonly used to hold up prices against a fall than to check a rise. What happens where cartels are strong in a number of industries and weak or non-existent in others can be seen clearly in the price-history of the inter-war period. In Germany, for example, under the Weimar Republic, separate indexes were kept for the average prices of goods controlled, and not controlled, by cartels. The two indexes diverged sharply; for the cartels were able to a substantial extent to check the fall of the prices of their goods in periods of slump without losing their ability to raise them in periods of boom.

The moral, however, may not be that it is wrong to take any action to steady the prices of particular goods, but only that it is wrong to entrust such powers to cartels representing the profit-making interests in the trades concerned. It would, indeed, under any form of control be manifestly unwise to stabilize the price of anything for ever, or for an indefinitely long period. But there is much to be said for stabilizing over short periods the prices of the main farm products, and perhaps of others, or at least of setting limits to their short-term fluctuations. There is much to be said for offering the farmer a firm price on which he can base his decisions about cropping, while reserving full freedom to alter the price, with due notice, as the conditions of supply and demand change. What must be insisted on is that price-fixing on these lines must not be left to the producing interests alone, but must be done by agreement between producers and consumers or, in the case of the major commodities, mainly between producing and consuming countries. The provisional International Wheat Agreement of 1941 was an embryonic attempt to create a controlling

agency, representing producing and consuming countries, which would be capable of acting in such a way; and there may be a big future for Commodity Agreements negotiated for particular classes of goods either by Governments representing the producing and the consuming points of view, or by associations or groups acting under effective Government supervision.

Stabilization of particular prices must, however, be only for limited periods, because costs alter as the conditions of production change, and a price appropriate at one time becomes either too high or too low as technique alters, or as it becomes necessary to enlarge or to reduce the scale of output under changing conditions of demand. No one, I think, would uphold a policy of stabilizing permanently the price of any single commodity: yet quite a number of people seem to favour permanent stabilization of the average.

Can we not achieve what is really aimed at by the advocates of stable 'general prices' if we (*a*) take the right steps to limit the fluctuations over short periods of the prices of those important commodities which are most subject to price-instability, and (*b*) take action to limit irrational fluctuations in the prices of all, or most, commodities, where these are traceable to general conditions of economic instability? Should not our object be, not to stabilize the 'general level of prices', but as far as we can to prevent prices from fluctuating irrationally owing to circumstances which have nothing to do either with changes in the techniques of production or with changes in consumers' desires, as distinct from consumers' ability to pay?

If this is agreed to be a reasonable objective, the question at once arises: How are we to set about it? The answer to this question will necessarily depend on the view taken of the underlying cause of that kind of economic fluctuation which commonly goes by the name of the 'Trade Cycle'. If it is held, in a phrase coined, I believe, by Dr. R. G. Hawtrey, that "the Trade Cycle is a purely monetary phenomenon", or in other words that the causes of major ups and downs in general economic activity are to be sought mainly or exclusively in the realm of money, the prescribed course of action will also be monetary. If, on the other hand, the causes of the Trade Cycle are held to lie mainly or exclusively elsewhere, the remedies proposed will be different according to the causes assigned and the relative importance attached to them.

The purely monetary theory of cyclical fluctuation rests on the

assumption that there is an 'inherent instability' in the supply of money. If, for any reason, the prospects of profit from expanding production are good, more persons will want to borrow more money in order to take advantage of them. Bankers, who have, within limits, the power of creating money, will wish to respond to these demands, because the effect will be to raise their own profits and they will be able to take under the prevailing conditions a more favourable view of the credit-worthiness of would-be borrowers than they could if the prospects of profit were worse. The response of the bankers in providing more credit will for the time make the prospects of profit yet better; and the process of credit-creation and borrowing by business men will therefore tend to be cumulative. Presently, however, the bankers will approach the limits of their power to create further credits. Where a country is on the gold standard, these limits are set by the limits of the Central Bank's power to enlarge the cash basis without imperilling the supply of gold to meet foreign drains: where there is no fixed standard the Central Bank's power is unlimited, except by such legal restrictions as the State may have laid down, but is in practice usually restricted by the Central Bank's unwillingness to allow the foreign exchanges to become adverse beyond a certain point. The stage is therefore reached when the Central Bank refuses further to enlarge the 'cash' basis on which the commercial banks rear their credits; and as usually the Central Bank thinks it necessary at this point not merely to stabilize but actually to contract the 'cash' basis, the commercial banks have to institute a reverse process of credit restriction, which becomes cumulative in its turn. Every reduction in the supply of credit incommodes somebody, whose difficulties then incommode others. The prospects of profit not merely worsen, but look like worsening further. The number of would-be borrowers for *new* enterprise falls off sharply, and the total of borrowing is sustained largely by borrowers who want money not for new production but for holding stocks of which they cannot profitably dispose. Economic activity comes sliding down as fast as it was previously mounting up; and as long as it is expected to fall yet further there is no incentive to expand. Current production falls below even the reduced level of current consumption due to the fall in incomes and employment. Stocks of goods are gradually worked off, until in the end they approach exhaustion at prices at which they cannot be profitably replaced. The point is reached at which prices are

felt to have touched bottom and an increase of production to be certain before long. It then pays to get in early—to order new instruments of production and to produce fresh stocks of goods while costs are still low, in the expectation of being able to sell in a rising market. The wheel has come full circle; and the cumulative process of expansion begins again.

This is a highly abstract and theoretical account of the course of a 'Trade Cycle'. In practice, things never happen quite like that, because neither is any single country a closed system within which the internal forces of instability can work themselves out unaffected by what is going on in the rest of the world, nor is the world as a whole so integrated economically that we can study its economic history as if its division into national States were irrelevant. In practice, the signal for a reversal of credit policy is apt to be, not simply a feeling on the part of the Central Bank that the limit of permissible expansion has been reached, but some adverse conjuncture arising in another country, or in the world market as a whole. Again, the signal for expansion may be given, not by the running down of stocks or the belief that internal demand has touched bottom, but rather by some favourable factor manifesting itself in some other country, or in a general recovery of export demand. Booms and slumps are, no doubt, in these days in the main common to all the leading capitalist countries; but they neither start nor end simultaneously in all these countries, and events occurring, or policies followed, in any one country may give the signal for either depression or recovery elsewhere.

In general, there was throughout the past two centuries, or at any rate up to 1914, a powerful expansive tendency in the world's economy. This tendency was towards a continuous widening of the market, due both to the increase of population in the older countries and to the rapid opening up of new territories for settlement, as well as to the invasion of old but economically backward countries by the new techniques of production and transport of which the more advanced countries were the pioneers. This underlying expansive tendency was a powerful force in bringing depressions fairly speedily to an end; for it meant that fresh opportunities for profit-making were being continually presented. Only after 1918 did conditions in this respect appear to have significantly changed. The process of economic development was indeed continuing fast in Japan, in parts of China and India, in

Latin America, and of course in the Soviet Union. But the growth of population was undergoing a severe check in the more advanced countries; and in the United States there was no more free land and the restrictions on immigration were also slowing down the population increase. This last factor was reacting on many of the less advanced countries in which population was still increasing fast, by confronting them with a severe problem of agricultural over-population, no longer relieved by migration in search of better economic opportunities in the United States.

Thus, the influence of monetary instability in engendering depressions was no longer corrected, as it had been, by powerful underlying expansionist tendencies in the world economic system as a whole. Depression in some countries, including Great Britain, tended to become endemic, instead of epidemic: there appeared the industrial problem of long-term unemployment, and side by side with it the problem of 'concealed unemployment'—that is, redundant population on the land—in the peasant countries. But why, it may be asked, if the underlying tendency towards expansion was no longer present, did the credit system retain its instability? Why did credit still expand till it reached a point at which bankers saw fit to contract it? Why did it not settle down to a stability corresponding to relatively stable conditions of 'medium' economic activity?

The answer is to be found largely in the peculiar conditions which existed in the United States. There, as we have seen, the 'frontier' no longer existed, in the sense that there was no more free land. Nor was population increasing as it had increased during the latter days of unrestricted immigration. Nevertheless, the American economy was still expansive, because it had vast unexploited resources at its command, great current power to produce, immense opportunities for taking advantage in its home market of the economies of large-scale production, and a big section of its population still living at a low standard of life quite out of harmony with the 'American standards' prevailing in the wealthier areas and among the better-paid classes of industrial workers. In the 'twenties, the American state of mind was still thoroughly optimistic and expansionist; and the United States had emerged from the first World War so strongly placed and so wealthy, in a corporate sense, as to be able to take the lead in influencing the course of world economic affairs. Devastating in proportion were the effects when, in the early 'thirties, the American

economy plunged suddenly into a depression beyond all parallel in its intensity and in the range of its social effects.

The causes of this depression it is not necessary to analyse at this stage. The relevant point is that the United States was placed, after 1918, in a position to lead the rest of the capitalist world either into or out of depression, and that the great American depression of which the first signs were plainly visible in the autumn of 1929 was the effective starting-point for crisis and mass-unemployment throughout the capitalist world. The American collapse reacted in particular on European monetary conditions. At first, in the hope of maintaining the gold standard intact, the banks in Europe set about a contraction of credit which, by lowering the prospects of profit, restricted production and reduced the volume of new investment. When these measures proved to be inadequate in face of the deepening of adverse conditions in the United States, the European countries were either, like Great Britain, driven off the gold standard or, like Germany, able to preserve it in form only by giving up the substance and resorting to drastic restrictions on the supply of foreign exchange and to special measures for the subsidization of export trade. Up to 1914, Great Britain had been the principal centre from which radiated the influences making for boom or depression in the world economy as a whole. After 1918, this key-position passed mainly into the hands of the United States, with the difference that, whereas Great Britain had on the whole transmitted favourable and unfavourable influences with an impartial hand, the United States became a force operating much more readily to induce depression than prosperity elsewhere. Other countries could not resist the adverse reactions of sharply falling prices and demand on the North American continent; but in face of the high American tariff and the wide range over which the United States was self-sufficient in the supply of manufactured goods, American prosperity was by no means so favourable a factor for the economic activity of other countries as British prosperity had been as long as Free Trade left the British market open to all comers.

In the nineteen-twenties, while Great Britain was first preparing to return to the gold standard and thereafter operating under it, the limiting factor in the supply of credit to British industry was not so much the available supply of gold as the desire to maintain a certain relative value between the dollar and the pound sterling; and this desire not merely set limits to the expansion of credit

but involved an almost continuous policy of credit restriction designed to compress incomes and prices in Great Britain. Moreover, when boom conditions developed in the United States, the effect was apt to be that of stimulating British and foreign speculators to endeavour to move funds from London to America, in order to earn the high interest offered for available money and to get a share in the capital gains accruing from stock market speculation. Thus, whereas the effects of American depression were at once passed on to Great Britain, American prosperity, instead of loosening British credit, was apt to tighten it up, on account of the flow of funds to the American stock markets. As long as the Americans maintained a high level of investment in European securities, and thus provided in effect the funds out of which the return on their earlier investments could be paid, Europe could carry on. But the withdrawal of much of the American short-term money from Europe, for use in the stock market boom of 1928-29, together with the virtual cessation of new long-term lending of American capital, brought financial disorganization to the European countries and led up to the European economic crisis of 1931.

The passing of world financial leadership—in the sense of power to affect the financial affairs of other countries—into the hands of the United States introduced a fresh element of instability into world financial conditions, because the economic system of the United States was itself unstable in a very high degree. Thus neither in the 'twenties nor in the 'thirties did world finance settle down. European conditions, including conditions in Great Britain, were liable to recurrent upsets owing to the march of events in the United States, as well as to those arising out of forces inside Europe. The 'Trade Cycle' was coming to be predominantly an American phenomenon, radiating outwards from the United States to other countries, and carrying the rest of the world in the wake of the extraordinarily erratic movements of the American economy.

This digression was necessary in order to make clear that the actual course of cyclical economic movements may diverge sharply from that described in the 'model' account given a few pages back. We can, however, recognize in this 'model' account certain underlying tendencies which, however they may be distorted or modified by the impact of other forces, are nevertheless at work in shaping the course of economic events. It is true that there is about the credit system, as it exists in all the advanced capitalist countries, an essential instability, any movement in the direction

of prosperity for the seekers after profit stimulating further movements in the same direction, and any adverse movement stimulating further adversities. It is, moreover, true that upward movements are commonly brought to a dramatic end by a contraction in the supply of credit.

It does not, however, follow from this that the contraction of credit is the real reason why advancing prosperity does not go on for ever. It may be; but on the other hand the truth may be only that the bankers step in to enforce credit contraction *before* other forces which would have brought the boom to a catastrophic end have had time to exert their full effect. This is the version of what occurs by which the bankers themselves usually hold. They regard themselves as interpreters of the trend of real economic forces, and as insisting on credit contraction, not because they want prosperity to end, but because they want the inevitable decline in activity to come about in an orderly fashion, and not by way of a catastrophe. At a certain point, the boom becomes in their view unhealthy, and the speculative activities to which it gives rise need checking sharply. They intervene, not to bring disaster, but to limit its extent.

What, then, are the signs of 'unhealthiness' in the development of a boom? Most obviously, the growth of speculative activity, which is in essence an attempt to cash in now on the prospective profits of the future, estimated on the assumption of continued boom conditions. One mark of such speculative activity is that attention is directed away from the creation of new instruments of production to the buying and selling, at rapidly rising prices, of ownership rights in the instruments already in existence. In other words, a stock market boom—accompanied, usually, by a land boom mainly in urban land values and by a boom on the produce markets. Speculators are buying productive assets on the assumption that their prices will go on rising in the anticipation of high future profits; and they are buying up stocks of commodities in the anticipation that their prices will rise further as the boom goes on.

A speculative boom has the effect of making prices rise without stimulating additional production of capital goods. It may develop at any point in the upward movement of the course of economic activity: indeed, there is a speculative element in all such upward movements, because the anticipation of rising prices is always one of the most powerful stimulants of recovery. Recovery has, under

capitalist conditions, always a twofold character. It is partly a rise in the level of economic activity, and partly a rise in prices—each factor reacting on the other. If and when a stage is reached at which all the available resources of production are being as fully used as it is technically and humanly practicable to use them—that is, if and when the community reaches 'full employment'—clearly further additions to the supply of money or credit cannot be effective in stimulating further production; for beyond that point production of one thing can be increased only by reducing production of others. Any further credit supplied beyond this point *must* find an outlet in speculation: there is no other outlet left. But in practice speculative activity can take the lead long before the point of 'full employment' has been reached. Even when there are large productive resources still available for use, and not being used, those who have money at command may prefer speculation in existing means of production to the creation of new ones; and as soon as that occurs, prices are bound to go rocketing up, with adverse effects both on the balance of trade and on the standard of living of those whose incomes are fixed in terms of money. The consequences are that on the one hand the Central Bank experiences pressure on its resources as imports rise and exports fall off, and on the other wage-earners, and any others who can, make demand for higher incomes in order to offset the rise in prices, and thus increase the costs of production further.

All this can and does happen even while unemployment continues to exist on a considerable scale, as it did, for example, in 1929 in the United States. If it be asked why speculators prefer to traffic in existing assets rather than to create new ones, the answer is, in part, that speculation is the quickest road to profit—for it is quick and easy to buy a share, but takes time, mind, and effort to build an efficient factory—and partly that in a boom the different parts of the productive economy do not advance in step. High profits are being made in some branches of production while others are still depressed, and there may be surplus resources and labour in some branches of production even when there is acute shortage in others. So it was in the United States in 1929. Agricultural prosperity especially lagged behind, and there was surplus labour both in agriculture and in branches of industrial production which were out of adjustment to national needs. Thus speculators could do better in the way of profits—in the short run—by speculating in scarce resources than by investing in new enterprise; and there

were real difficulties in the way of transferring the surplus resources to more hopeful fields. Accordingly, speculation got on top at an early stage; and, as soon as the speculators had taken the lead, the boom became 'unhealthy', because it was serving not to bring further resources into use, but only to increase prices and create fictitious capital values based on existing assets.

The worst thing about a speculative boom is that it is impossible to check it gently. If it is checked at all, the effect is to expose the fictitious character of the valuations to which it has given rise: so that, instead of a gentle recession, there ensues a crash. The bankers in America had in the period before the stock market crash of 1929 to face a difficult choice. They were in no danger of a drain of gold, owing to the strong creditor position of the United States and the attraction of foreign capital to share in the profits of speculation. They could point to unused resources as a justification for further extensions of credit, in the hope of achieving 'full employment'. But, when credit was extended, it went, not to employing the unemployed resources, but straight to the speculative markets. Sooner or later, the inflated bubble of stock market values was bound to burst, and to bring the whole economy into crisis. The banking authorities were powerless to prevent this. They could either let it swell till it burst of itself, or burst it by credit restriction which, they knew, would precipitate the ruin of many essentially sound enterprises as well as of those speculators who had not 'got out while the going was good'.

If there had been no complicating factor of speculation, the banking authorities could reasonably have gone on expanding the supply of credit until a state approaching 'full employment' had been reached, to the evident advantage of the American people. But in practice the speculative factor always is present—most of all in the United States; and as long as credit can be diverted from use in expanding production to speculative uses, booms will always become 'unhealthy' and carry with them the germs of coming crisis, long before the point of 'full employment' has been reached. The moral, of course, is that the suppression of speculative activity, at any rate in its more dangerous forms, is a necessary condition of the pursuit of a credit policy designed to bring about the full employment of the available resources of production.

V

THE SUPPLY OF MONEY—IS THERE A 'TENDENCY TO A DEFICIENCY OF PURCHASING POWER'?

THE argument of the foregoing chapter may be summed up in the following conclusions:

1. There is no valid case for an attempt to stabilize the 'general level of prices', which is only an average of particular prices.
2. There is a case for attempting to stabilize, within limits and over short periods, the prices of certain essential basic commodities; but such stabilization must not be left to groups of producers, but must be settled between producers and consumers, usually through the Governments of producing and consuming countries.
3. There is a case for attempting to eliminate those fluctuations in the 'general level of prices' which are due to monetary causes, rather than to changes in the conditions of production.
4. There is, under the conditions of modern capitalism, an inherent tendency towards instability in the supply of credit, and changes in either direction tend to lead to further changes in the same direction, so that, up to a point, booms and slumps go on of their own momentum.
5. There was, in the nineteenth century, a persistent underlying tendency towards economic expansion, dependent on the colonization and opening-up of new areas, the growth of population in the advanced countries, and the supersession of obsolete methods by a spread of new techniques to more and more areas and industries. This tendency has largely ceased to operate to-day, in face of the decline in population increase in the more advanced capitalist countries, the closing of the frontier in the United States, and the consequent appearance of 'concealed unemployment' in the peasant areas.
6. These changes, combined with Great Britain's loss of world financial leadership, have transferred the key influence in causing boom or depression throughout the capitalist world largely to the United States, and have thus added to the instability of world economic conditions.

7. The predominance of speculative factors in the American economy has caused booms to assume an 'unhealthy' character in the United States long before a condition of 'full employment' has been reached, and has confronted the American banking authorities with insuperable difficulties in the way of a satisfactory management of credit supply.

8. It is not practicable to expand credit up to the point required to achieve 'full employment' unless speculative influences can be prevented from intervening before 'full employment' has been reached on such a scale as to make a crash in fictitious values unavoidable.

The discussion from which these eight conclusions emerged began with an examination of proposals to stabilize prices as a means of bringing about conditions of monetary and economic stability. We have had to reject the remedy of price-stabilization in its more comprehensive forms; but it has been allowed that the instability of prices has been greatly aggravated by monetary influences, which ought to be brought under better control. The question that now arises is that of the form which this control ought to take.

This brings us directly to a second group of reformers, who believe that the appropriate remedy lies in stabilizing, not prices, but the supply of money. According to this school of thought, the evil of monetary instability arises out of the power resting with the banking system—in effect, mainly with the Central Banks—to create or annihilate money almost at will, subject only to such restrictions as are imposed by legal requirements about reserves. These requirements, it is pointed out, may be quite ineffective where, as in the United States, the available supply of gold is in effect unlimited, or where they are so elastic as to make the supply of currency, in effect, merely respond to, and not govern, the supply of credit through the banks.

The advocates of a stabilized monetary supply differ among themselves on secondary points. Some of them wish to fix the supply of money absolutely, for good and all, whereas others wish to vary the supply in accordance with changes in population (a fixed supply *per head*) or, over long periods, by occasional adjustment to changes in money-using habits. They are united in wishing to take away from the banking system all power to vary the supply of money over short periods.

It is often difficult to find out exactly what these reformers mean

by the 'supply of money'. If they mean only the amount of coin and bank-notes, is it not evident that the banks will remain free to vary the supply of credit within the wide limits left open to them? The only result achieved would be that of preventing the amount of bank-notes from being affected by the inflow or outflow of gold. This would leave the Central Bank free to regulate credit conditions by open market operations much as it does now. As this is clearly not what is meant, it is to be presumed that the advocates of a stable supply of money wish to stabilize bank credit as well as currency. But how is this to be done? Are the commercial banks to be compelled to lend out always an equal amount to their customers, irrespective of their credit-worthiness or of their will to borrow? It would be easy enough to impose a maximum limit on the total of bankers' loans; but it is not easy to see how bankers could be compelled always to lend up to this maximum. The additional finance which is at present available during an upward movement of economic activity would be effectively cut off; but the protection against a downward movement would remain as inadequate as it is to-day.

Of course, much would depend on the initial level taken for stabilizing the supply of money. If the level were that prevailing during a boom, the check placed upon expansion would be proportionately small; but if the supply were stabilized at the level existing at a period of depression, a very strong obstacle would be put in the way of recovery, which would have to be brought about, not merely without a rise in prices, but to the accompaniment of a fall. Even if the Quantity Theory of Money lacks precise validity, there is enough truth in it for that to be unavoidable. An increased volume of transactions could be financed without an increased supply of money only at falling prices. This, of course, assumes the permitted quantity of money to be actually in use at the time of fixing the level: if some of it were not in use there would be room, without a fall in the level of prices, for such expansion as the unused margin allowed.

It is not easy to see why stabilization of the volume of money should find favour with monetary reformers in these days. If this country had been suffering from a succession of runaway booms, it would be easy to understand why reformers should lay stress on the need for checking the power of the banking system to create means of payment out of nothing. But, so far from this having been the case, Great Britain, over the whole of the twenty or so

years before the outbreak of war, had no major boom and never approached near to a condition of full employment. One would expect British monetary reformers to be more intent on enlarging than on restricting the supply of credit; and so, of course, most of them are. The desire to restrict the supply of money, as a first object of financial policy, is found rather among economists (including refugee economists) who are still haunted by the memory of the runaway inflations which occurred in a number of European countries after the last war. In those inflations, large numbers of persons who lived on fixed incomes (including professors of economics) found their standards of living suddenly cut away. They became so acutely conscious of the evils of inflation as to hold the evils of deflation of relatively light account. Mastered by the fear that inflation might occur again if the creation of money were left in the hands of either banks or Governments, they wanted above all else a binding rule that would tie the hands of both; and the absolute fixing of the supply of money seemed to provide the easiest answer.

It is not, however, a satisfying answer; for it involves that, broadly, as the volume of production increases, prices must be forced down continually, unless ways can be found of economizing in the use of money and thus making any given supply go further. Doubtless, this is what would happen if the stabilizers had their way and the supply of credit were unalterably fixed. Just as the banks by means of the deposit and cheque system found ways round the currency restrictions imposed by the Bank Charter Act of 1844, so in time they and the business community generally would find ways round a restriction on the volume of bank advances. But it might take a long time to find this way round, and in the meantime the effects might be serious.

For it would be necessary under the assumed conditions for prices to fall, not only so as to match economies in the real costs of production, but beyond this so as to offset all increases in output, to whatever causes they might be due—or, of course, all increases in output per head of population, if the supply of credit were fixed at so much per head. Such a rule could not but check the rise in production, by lowering the inducements to produce. It would operate restrictively, not only to the extent of reducing prices, but also to the extent of causing fewer resources to be employed and fewer goods produced.

This, surely, is not the kind of remedy we are looking for. We

want to find ways of promoting, not of hindering, 'full employment'; and it would be altogether too much if, in taking measures against runaway inflation and speculative excess, we were to be led away into actions which would make depression endemic and deprive us of all hope of solving our unemployment problem. That the power of banks to create money may need regulation can be agreed, especially in the sense that steps need to be taken to prevent credit from being used to finance speculative operations rather than an extension of productive activity. But that we should be invited to surrender altogether the right even of the community itself to vary the supply of means of payment is surely nothing short of absurd.

We can come now to those groups of monetary reformers whose minds are set not on reducing the possibilities of monetary expansion but rather on increasing them. First in this group comes the school of thought which urges that the supply of money and credit should be based on the available supply of productive power, and should advance *pari passu* with increasing productive capacity. This type of proposal has a long history behind it. Thomas Attwood and others urged something very like it after the Napoleonic Wars, when falling prices were exerting a powerful depressing influence and unemployment was rife, as it was after 1918. It has always found favour, especially in periods of depression, with large bodies of relatively small-scale employers and traders, who, having for the most part but scanty reserves of their own to fall back upon, have much less power than most of their bigger competitors to last out through periods of depression, and are the loudest in asking why their power to produce useful things cannot be married to the clamant need of the people for these very products. These smaller firms are usually of opinion that the bankers mete out to them less favourable treatment than to the big firms when money is tight: they want to be helped more when times are bad and also to be accommodated with cheaper credit in both bad and good times.

What does the proposal to base the issue of credit on productive power, rather than on actual production, really mean? It cannot mean that anyone who possesses machines and can hire labour ought to be accorded, as of right, enough finance to allow him to put his machines to work. It cannot mean this, because his machines may be so obsolete that they would not be worth using however high the level of demand might be—i.e. it would be better to build new ones and scrap the old—or his machines, even if not obsolete, may

be redundant, because there is no possibility of enough demand for the particular things they are fitted to produce to make their use worth while. 'Full' employment must mean *balanced* employment in making different kinds of goods in relation to a balance of demand. It cannot mean that every machine is to be employed;—or what obsolete machine is ever to be scrapped?

In effect, the notion of making credit available in accordance with the available supply of productive power has no valid meaning except in relation to a formulated *plan* of production designed to achieve the largest practicable total use of the available resources up to the point of 'full employment'. It implies that no man and no machine is to be left idle if its employment would add appreciably to the total social product. It does not confer a right on any producer to receive credit except in accordance with the requirements of the plan; but it postulates that the aim of the plan is to be 'full employment', and not maximum profit.

In this sense, the proposal to make credit available to finance all operations which are embraced within the scope of the national plan of 'full employment' is valid. But it remains an open question how large this supply of credit will need to be. It cannot be taken for granted, as it often is, that the supply must be enough to finance 'full employment' at the existing level of prices for an indefinite period. Increased output for a 'fully employed' market will make it possible, in many instances, to reduce production costs; and such instances should greatly outnumber before long those in which a rise in output involves higher costs, even at the margin of production. If, with a system of private enterprise, credit were to be issued under conditions of 'full employment' on the assumption of unchanged prices, windfall profits would soon make their appearance on a grand scale. The supply of credit required is that which will, on the whole, give just sufficient inducement to keep resources in employment at the desired level; and this supply will vary as the costs and conditions of production change.

Subject to the reservations already made, we can, then, accept the notion that the supply of credit ought to correspond to the available supply of productive power, while insisting that such a policy can be applied practically only as an element in a planned system of production.

At this point, however, we are confronted with a school of monetary reformers who maintain that, under the present system, no amount of credit that can be made available will bring about

conditions of 'full employment', because there is in the 'price system' a fatal flaw which prevents the supply of purchasing power from being ever equal to the costs of production, and thus continually engenders business losses and bankruptcies and throws men out of work in an endeavour to redress the balance.

One's first inclination in answering those who advance this view is to accuse them of proving too much. If this 'flaw in the price system' really exists, how does it come about that we are not much worse off than we are, or that slumps ever end? The most familiar form of this critique of the price system has often been summed up in the conclusion that 'A cannot buy A+B'—when A is the purchasing power in the hands of the final recipients of income, and A+B is the sum of the costs of production, including both wages, salaries, fees, rent, interest, and profits and payments to other businesses for materials, transport, insurance and banking services, and any other 'costs' which do not immediately represent spendable incomes in the hands of the recipients.

But why should A buy A+B? There is no need for B—i.e. the costs which do not represent direct income payments—to be covered by A. The flour and the fuel that go into a loaf of bread do not need to be paid for out of anybody's income. They are paid for by the baker, either out of his own working capital or out of a bank advance, which can be replaced as soon as he gets paid for the bread. The same is true of the wages which the baker pays out to his journeymen. They are paid out of working capital or bank advances till the bread is paid for, and then the capital can be replaced, or the loan liquidated. True, the journeymen's wages immediately become income in the hands of the recipients, whereas the sums paid to the suppliers of flour and fuel do not. But, if we analyse what happens to these latter payments, we shall find a part of them being paid out in wages, salaries and profits, or in rent or interest, to other recipients of income, and another part being paid over to corn-dealers or farmers, to colliery-owners or oil-suppliers or electricity concerns, in just the same way as the baker paid the miller and the coal-merchant. These sums in their turn will break up into 'A' payments to recipients of incomes and 'B' payments to intermediaries; and so on until we come to the primary sources of supply. From these, in turn, will lead a new chain; for the primary suppliers will be buying machinery and fuel, and paying charges for insurance and banking. It would be an endless process to analyse all the successive stages; but it is easy to carry the analysis far enough

to show conclusively (i.) that the 'B' payments resolve themselves ultimately into 'A' payments, which are available for buying all the finished goods which are on the market, and (ii.) that the 'B' payments can all be liquidated out of the 'A' payments, provided that time is allowed for the receipts to come in.

In an Appendix to this book, I have tried to make this plain by means of a Table and a fuller explanation than I have room for here. I must, however, proceed to consider certain more refined forms of the 'A+B' argument. Some of those who advance this argument agree that there is no need for the final recipients of incomes to have incomes large enough to buy both the final and the intermediate goods—which would mean buying the same things a number of times over, at successive stages of production and distribution—but still contend that *some* of the 'B' payments never do resolve themselves into 'A' payments, with the result that, as all the 'B' payments must be covered if the final goods are to be sold at remunerative prices, the recipients of incomes are still left without enough money to buy all the goods on the market at such prices. The 'B' payments about which this allegation is most often made are banking charges, and sums passed by businesses into depreciation or profit reserve accounts.

Take first the question of banking charges. Banks, and we may add insurance companies, are like other suppliers of intermediate goods and services in having costs to meet and dividends to pay. A part of the sums paid for their services goes out directly in wages, salaries and dividends, and constitutes direct income just as much as the similar payments made in any other industry. It is no doubt true that, over and above these income payments, both banks and insurance concerns usually charge highly enough for their services to be able to make substantial appropriations to reserve. But such reserves are in precisely the same position as reserves belonging to other businesses, and can be considered under that more general head.

Allocations to depreciation and obsolescence accounts are destined normally to be spent on the purchase of new and up-to-date machinery and plant. If they are so spent, fairly soon after the allocation has been made, they differ in no essential respect from other sums spent on investment in capital goods. Capital goods, equally with consumers' goods, need, in their finished forms, to be covered by money available for spending. The sums paid by firms into their depreciation and obsolescence accounts cover the purchase

of the capital goods needed for replacements. The only special feature about these sums is that firms are under no obligation to spend them at any particular time. They can be 'hoarded', with a view to being spent later; and if they are hoarded, so much is subtracted from current expenditure on currently produced goods, and a deficiency of purchasing power appears. This, however, is not peculiar to sums paid into depreciation accounts. 'A' payments, that is, direct incomes, can also be hoarded; and, when they are hoarded, a precisely similar deficiency appears. We can, therefore, best come back to this question when we are considering the effects of hoarding over a wider field.

What, then, of allocations to reserves—that is, profits not paid out as dividends, but retained in the business? Such sums may be invested in the expansion of the firm's own equipment, or in the new share or loan capital of other enterprises, or in existing stocks, shares, or other securities of any sort. If they are invested in any of these ways, they do not differ significantly from sums paid out in dividends, and similarly invested by the recipients. They can no doubt be hoarded, and not invested at all; but so, as we have seen, can sums paid out as incomes. Unless they are hoarded, there is no reason to suppose that their being paid into reserve funds will result in any deficiency of current purchasing power. If they are hoarded, such a deficiency will result, but in no different way from deficiencies arising on account of the hoarding of any other form of spendable receipt. This conclusion applies to bank and insurance reserves equally with others. There is no more reason to suppose that banks will hoard idle reserves in such a way as to derive no income from them, than to suppose that other business men will behave in this fashion. This is not to say that reserves will not sometimes be hoarded, just as ordinary incomes are hoarded, but only that bankers have no special proneness to hoard their reserves. To the general question of hoarding and its consequences I shall come back later on.

It appears, in the light of the foregoing argument, that the contention that there is a 'flaw in the price system' leading to a continuous tendency towards a deficiency of purchasing power rests on a fallacy. There is no such *continuous* tendency. It is, however, perfectly true that there is no assurance of the purchasing power actually expended, or of the new purchasing power based on incomes generated in the course of production, in any one accounting period, such as a year, corresponding to the total costs (including

profits) incurred over the same period. There are a dozen reasons why no such correspondence can be assumed. In the first place, there will be at the beginning of any such period goods in stock and in process at all stages of production, and during the period stocks will be drawn upon and renewed. Stocks at the end of the period may not stand at the same total level as stocks at its beginning; and the goods made during the period may incorporate materials and components made at a time when costs were widely different from what they have since become. Secondly, there is, as we have seen, no reason why the flow of payments into and out of depreciation and obsolescence accounts should balance over any particular accounting period; nor is there any reason why appropriations to reserve should balance over any particular period investments out of reserves. There is accordingly every possibility of a divergence in any particular accounting period between the cost *plus* profit prices of the goods and services offered for sale during that period and the disposable revenues available for buying them. But there is no good ground for expecting this divergence to be more in the one direction than in the other, or to lead to any lasting deficiency, unless money needed for purchasing current output is hoarded, not merely for a time, but permanently. Apart from such hoarding, the divergences will cancel out over a longer period; and if, in the interim, bank loans are available for making temporary deficiencies good, there is no reason to expect any serious evils to arise from this cause, unless hoarding assumes large dimensions—a possibility which we shall have to consider at a later stage.

Are we then to come back to the old, orthodox belief that every act of production automatically creates a market for the goods produced, so that no deficiency of purchasing power need ever be feared? This has been for well over a century a cherished tenet of economic orthodoxy, known as J. B. Say's *théorie des débouchés*, or 'Market Theory', and has been used on many occasions to confute those who have attributed the development of economic crises to 'over-production'. Over-production, on Say's showing, is impossible, though there can, of course, be over-production of some goods in relation to others. It is impossible, because incomes are generated in the course of production, are in effect shares in the product, and at the same time constitute the costs of getting things produced. Every cost is, in the final analysis, an income as well as a cost; and accordingly the incomes available for buying goods and services will always be equal to the cost of placing them at the

purchasers' disposal. It is agreed, of course, that there will be, when any single stage of production or distribution is looked at in isolation from the rest, a large number of elements in cost which do not appear to be balanced by incomes paid out to those entitled to receive a share in the proceeds of this particular stage of production or service. The incomes accruing to the makers of any class of goods will always be much less than the sum needed to purchase their products, because a large part of the costs of production will consist of payments made for materials, fuel, transport, and other things used up in the process. This, however, as we have already seen, does not invalidate Say's Law; for we have only to carry the analysis far enough to find these 'B' payments turning into 'A' payments at other stages of the total productive and distributive effort. If we pursued the quest to the very end, we should find that all costs had been accounted for, by being paid out at some stage to recipients who could spend them on either capital goods or consumers' goods or services. Among these recipients would be the State and other public authorities, which would receive rates and taxes levied on economic processes or goods, and be able to spend the sums accruing to them on the public services. In effect, every payment would be found to resolve itself finally into somebody's disposable income—either that of an individual or that of some corporate or collective body, which would have it to spend on some part of the goods and services to the cost of which it had contributed.

Of course, to say that all these cost payments resolve themselves finally into disposable sums available for purchasing the product of industry, in the widest sense, is not to deny that the total money sum of the transactions requiring to be financed will far exceed the sum of the disposable incomes. Precisely what credit is needed for is to finance the excess; but the credit used for this purpose is self-liquidating. It is a use of means of payment over a limited period of time, at the end of which the advance is paid off: it does not destroy the purchasing power so used, but only transfers it. The question of the amount of money needed to finance all transactions —intermediate as well as final—is entirely distinct from that of the *income* needed to purchase the total product at a price sufficient to cover its cost.

The defect of Say's theory is not that it is formally untrue—for it is not untrue in a formal sense—but that it can be so easily misapplied. To begin with, it is true just as much at one level of

production as at another. It is as true when half the nation is out of work as when all the available resources are fully employed. It would be as true if no one were in employment and nothing at all were being produced. It demonstrates, no doubt, the impossibility of general *over-production* in a closed economic system; but it entirely fails to demonstrate the impossibility of general *under-production*. It proves that unemployment cannot be due to general over-production; but it entirely fails to prove that unemployment will not exist. How indeed could it prove any such thing, when plainly unemployment has existed, and does exist, except in time of war, in all capitalist countries?

Say's Law does not prove that any producer who makes goods or services available will automatically find purchasers for those goods or services at prices which will cover their costs. It does not prove to any particular capitalist firm that it will pay to use its productive capacity to the full—in preference to leaving some of it idle. It does not prove that more profit cannot be made by some people by producing less rather than more. All that it does prove (subject to reservations to which I have drawn attention already and to others to which I shall draw attention later) is that, *if* all productive resources are fully employed, there need not appear any deficiency in the supply of purchasing power available for buying the products. The assumption made in Say's Law is, of course, that all the purchasing power that is made available will be actually spent. It does not deal with the effects of hoarding, but only with the sums made available for spending in the course of the productive process. Within these limits it is valid.

One reason why wrong use has often been made of Say's Law is that the classical economists who adduced it were in the habit of assuming, quite apart from it, a condition of 'full employment'. They set out, in their theoretical analysis, from an assumption of perfect fluidity of both labour and capital resources, so that any element in either could be shifted instantly at need from one use to another. They assumed that labourers and capitalists would always take what returns they could get, rather than abstain from production, and that, as a consequence of this complete fluidity of everything, there could be no unemployment. They were not, of course, such fools as to be unaware that unemployment did in fact exist; but they preferred to regard it as the outcome of 'friction' interfering with the smooth practical working of a theoretically perfect system. They did not recognize, though it is in fact the

case, that situations often arise in which there is no conceivable level of wages or of interest on capital that will bring about a condition of 'full employment'. This was largely because, though they asserted again and again that costs were incomes, and incomes costs, they did not sufficiently realize that when the disemployment of any resource has resulted in cancelling the income previously accruing to it, the cancellation of that amount of purchasing power tends to bring with it a new 'equilibrium' at a lower level of output, so that there is no tendency to increase output until the cancelled income has been restored, and no restoration of the income until production has been increased. Say's Law, in effect, tells us nothing about the level at which employment will be maintained; and the classical assumption of 'full employment' finds in it no kind of support.

What has been said in this chapter strongly suggests that those monetary reformers who allege the existence of a continual tendency to a deficiency of purchasing power are going wrong because they confuse a deficiency in what is available for spending with a deficiency in what is actually spent. It suggests that we must look more closely at the phenomenon of hoarding as a possible cause of unemployment and depression. This is, one may add, a much more hopeful line; for, if there really is an endemic tendency towards a deficiency of purchasing power, it is not easy to understand why the capitalist economic system has not collapsed long ago.

Believers in the 'deficiency' theory will, no doubt, retort that it would have done so, had not the gap been filled by the creation of purchasing power by the banks. They will argue that bank credit, in addition to financing the large volume of intermediate transactions, is used to meet the deficiency in final purchasing power by being advanced for the buying of instruments of production and also, at certain times, for enabling Governments to pay out more than they receive as the yield of the taxes. It is, of course, perfectly true that bank credit can be, and is, used in this way—above all, by Governments in time of war. The effect of it being so used, however, is not as a rule to bring about a balance which would otherwise fail to exist, but rather to upset the balance and bring about an inflation of selling prices over costs. The most obvious example is to be found in what is called 'the gap', which exists now under war conditions between Government payments and Government receipts from taxes and loans, is filled by bank borrowing, and is generally recognized as a force making for price-inflation. Bank

credit, applied to the purchase of final goods, need not of course have this effect when it merely adjusts a temporary disequilibrium caused by hoarding; but if the banks make more advances for the purchase of new finished goods than will balance sums withheld by the owners of disposable purchasing power in other forms, the effect must be to create an excess of purchasing power employed over costs, and thus to generate windfall profits somewhere.

Whether this is a bad thing or not, under capitalist conditions of production, we have in effect already inquired, when we were discussing proposals that the total volume of bank credits should be stabilized. It is not necessarily a bad thing, even if it causes windfall profits, if at the same time it causes additional productive resources to be put to use. There may be methods of bringing about 'full employment' which will be better than that of extended bank credit applied to the purchase of finished goods; but, in the absence of such methods, the method of extending credit is much better than none at all. In any event, this issue is quite distinct from that of the alleged deficiency in the supply of purchasing power available apart from credit extended by the banks; and there is no substance in the view that bank credit is *continuously* employed to offset any such deficiency.

"Ah! no", say the exponents of the 'deficiency' theory. "Bank credit is not so employed *continuously*. It is employed intermittently; and the moment it is withdrawn a slump occurs. Surely that proves our view to be correct?" No such thing. A contraction of bank credit can, of course, bring about a slump, by reducing the current supply of purchasing power; but it will have this effect just as much if there is no tendency towards a deficiency of final incomes to buy final products as if there is such a tendency. Any sudden contraction in the supply of means of payment will of course tend to bring about a slump. So much no one, I think, denies: but it is no evidence that there exists a standing deficiency, apart from the supply of bank credit, in the amount of purchasing power issuing from the productive system.

VI

SAVINGS, INVESTMENT, AND CONSUMPTION

REPUDIATION of the view that there exists, under the existing monetary system, a destructive tendency towards a deficiency of purchasing power by no means involves saying that all is well with the system. Is it not manifest that, even if there is no such tendency, there does exist at many times, if not at all save when the world is at war, a deficiency of *demand*? Classical economists made a practice of identifying demand with purchasing power, because they made the assumption that all the purchasing power in men's hands would be actually spent, either on consumers' goods and services or by way of investment in capital goods, including additions to stocks of all sorts. They assumed that no one would merely bury his money receipts away, without spending them at all; or, to the extent to which they took account of hoarding by peasants, Indian rajahs, and other species of burying beetles, they assumed that the things hoarded would be stores of precious metals and the like, and that the hoarding of them would be in general analogous to the buying of any other valuable objects—pictures, for example—for keeping and not for re-sale. The precious objects so hoarded, being products of labour and business enterprise, would have yielded up incomes in the course of their production. The hoarders, in taking them off the market, simply cancelled the equivalent of these incomes against them, and no problems arose of any lack of balance between costs of production and the amount of available purchasing power. No doubt, the disappearance of the precious metal that could have been used as coined money in repeated acts of circulation would, in the absence of offsetting measures, have some effect in driving down prices below the point at which they would otherwise have stood. But this effect would be simply that of an enlarged non-monetary demand for the precious metals, exactly the same as if the demand for wedding-rings or gold plate had increased. It would not lead to any deficiency in the supply of purchasing power, except that a sudden *increase* in hoarding might cause some dislocation by forcing prices down or a sudden *decrease* by forcing them up. Hoarding at a steady rate would be of no adverse effect on the working of the economic system.

If, however, what is hoarded is not something of intrinsic value equal to its monetary value, but token money in the form of paper or bank deposits, the effects are different. The hoarder then is not buying and keeping in his possession something that has cost effort to produce, and thereby withdrawing from the market a quantity of goods equivalent in value to his spending. He is in effect simply refusing to exercise his spending power, and therewith withdrawing money from the market without any equivalent withdrawal of goods. There are still as many goods and services as before left to be sold; but there is less money being used to buy them. Consequently, on the average, the goods and services must be sold at lower prices, or alternatively some of them must remain unsold. It is in the nature of services that they cannot be stored; if they are not used currently, they cannot be used at all. Many goods can be stored without serious deterioration; but the cost of storing them is apt to be high, including as it does both the physical costs of housing and caring for the goods and the cost of locking up the capital which is invested in them. The storage of goods in order to avoid sale at a falling price therefore involves in most cases a loss of value to the owner, who has to choose between selling them at once at a reduced price and holding them in the hope of a higher gross price later, *minus* deductions to cover the costs of storage.

A withdrawal of purchasing power from actual use in buying goods and services therefore involves losses somewhere—in the sense that it means a fall in the value of the current supply of goods and services to less than it would have been if the hoarding had not occurred. At least, it involves this unless any purchasing power thus withdrawn for hoarding is at once replaced by newly created purchasing power which is actually spent. If, as fast as persons in possession of spending power withdrew it for hoarding, the banks, or any other authorities endowed with the right to create 'money', were able to replace it with substitute purchasing power of equivalent amount, and to ensure that the newly created purchasing power would be in fact expended on currently produced goods and services, no deficiency of demand would arise. There would, indeed, be a potential *excess* of demand; for the hoarders of purchasing power would be in a position to bring it back at any time into the market. It would therefore be necessary for the creators of the substitute purchasing power to stand ready at any moment to withdraw such of it as might no longer be needed

to replace sums held back by the hoarders; and if the operations of creating and withdrawing the substitute means of payment could be perfectly synchronized with the acts of hoarding and dishoarding, the effects of the hoarding would be entirely neutralized.

To a substantial extent this is what does actually happen. At any time a considerable amount of the available total of purchasing power is being held idle in one or another way. I do not go to my bank every time I want some money to spend: I keep a small amount by me in coins and notes, and only visit my bank for more when my supply runs low. I do not immediately invest in interest- or profit-yielding securities all the money I pay into my bank: I leave some of it on current account to meet my regular outgoings, and perhaps some on time-deposit while I am looking about for a suitable investment. The working-class household that does not use a bank does not pay out immediately all it receives in wages: it keeps by some for rent, and very likely some for other payments which are not made regularly week by week. The working classes on the whole turn their money over more rapidly than other classes; but in the aggregate a large amount of purchasing power is at any moment lying unused in their possession. All such holding of money is, in a wide sense, 'hoarding': it keeps money idle, instead of circulating from hand to hand, whether the holding of 'cash' take the form of keeping a stock of coins and notes or of allowing money to remain on current or time-deposit in a bank.

The holding of 'cash' in these ways is the extreme form of what Lord Keynes calls 'liquidity-preference'. Assets are 'liquid' in proportion as they are quickly and easily available as generalized purchasing power. Coins, notes, and bank deposits all possess this 'liquidity' in an absolute sense (time-deposits, in practice, hardly less than deposits on current account). Other assets possess it in proportion as they are quickly convertible into 'cash' without thereby losing value. 'Hoarding' is in effect a preference for holding 'cash', or 'near-cash', over holding less liquid assets.

There is, no doubt, a distinction between holding money ready for use in the near future and holding money out of use, without any intention of spending it in the near future. But the difference is psychological rather than economic. To the extent to which the purchasing power is held out of use for the time being, the effect is the same, whatever the reason or the motive may be.

Now, the banks and the Mints which manufacture coined money

naturally take this into account in deciding how much to supply the 'liquidity-preferences' of the public. Or, if they do not do this consciously, the level of prices will adjust itself to any steady habit in this respect that exists in any particular society. If the supply of money were x, and the public regularly held y idle at any moment, the level of prices would adjust itself to an actual circulation of $x-y$. In fact, however, the public's liquidity-preference has in it both relatively stable and unstable elements. Most people have cash-holding habits, up to a point, and these give an element of stability to the demand for cash to be held idle. But clearly people will not hold just the same amounts in 'cash' when they are prosperous as when they are hard-up; and the demand for cash to be held liquid will be considerably greater in some quarters when there is little unemployment and business men are doing well. Under such conditions, the amount of 'cash' held as *pocket-money* will tend to rise sharply.

But as against this, the holdings of liquid cash by business firms may work just the other way. In times of economic activity, most firms will want all the resources they can lay hands on in order to finance their current operations. They will, therefore, be much more inclined to borrow heavily from the banks than to leave funds idle on deposit; whereas in times of depression, when firms are scaling down their activities, they may have on their hands considerable sums which they neither need for their own operations nor feel disposed to invest for the time being elsewhere. Consequently, in bad times, business funds will often tend to pile up in time-deposits in the banks, whereas current accounts will tend to fall because of a decrease in firms' readiness to take up bank advances. The total volume of deposits may or may not fall; but there is pretty certain to be a shift between current and time-deposits. In a prolonged or serious depression, the total volume will fall; but it will fall by less than the decrease in bank advances, because of the tendency for time-deposits to rise.

The demand of the public for liquid funds is thus, in the aggregate, an unstable demand. The more stable elements in it, and also the regularly recurring elements of quite short-term instability, such as the Christmas and summer holiday demands for excess cash, can fairly easily be offset by bank action, where they do not become incorporated into the general structure of prices. But the more seriously unstable elements, which depend on the general level of current prosperity and employment, cannot be so easily offset.

If serious hoarding occurs as a result of the holding back of funds by business men, the banks cannot easily counteract such hoarding by a creation of substitute money. Why they cannot do this at all easily we have seen in an earlier chapter. They can make advances, and thus create money, only to the extent to which they can find borrowers whom they regard as credit-worthy. In times of depression, such borrowers are apt to be scarce, and accordingly it takes very large measures of Central Bank policy to push additional money into active circulation, and if the depression is severe, the task may be in practice beyond the Central Bank's power.

The form in which this serious kind of hoarding chiefly manifests itself is a refusal to *invest*. Under satisfactory economic conditions, the total sum accruing to the community and its members in the form of spending power is divided by its possessors into two streams, of which one goes to meet current costs of consumption and the other current costs of investment. People—private people—spend part of their incomes on goods and services which they consume either in a single act of consumption—e.g. food or theatre tickets—or in a series of acts of consumption spread over a period of time—e.g. a piano or a motor-car. Some, but not all, of them, after meeting these expenses of current living, have some income left over, which they *save*. This saved income they can either hoard (presumably with the intention, unless they are cash-hoarding misers, of expending it on something later on) or invest, either in new instruments of production or by buying a share in existing instruments or some security that will give them a title to future income. If they expend their savings on new instruments of production, they directly take off the market some of the goods currently produced, and thus offset the cost of producing them. If they buy existing assets, they *transfer* their purchasing power to someone else, who then has it to spend. He in turn spends it either on new or on existing assets, transferring to a third party what he spends in the latter way. Purchase of assets not currently produced never cancels the purchasing power so spent, but only transfers it to someone else. In a healthily functioning capitalist economy, all the sums thus transferred will in the end get spent either on new capital goods or on new consumers' goods, and thus the entire cost of producing the current output will be offset by purchases.

In this balance we must, of course, include the spending of the

sums which accrue to the State and the local public authorities, and to other institutions of a public or quasi-public character. These sums arise chiefly by way of taxation, direct or indirect. Broadly speaking, direct taxes are direct transfers of spending power out of private incomes to the public authorities, whereas indirect taxes are similar transfers brought about indirectly by means of additions to the prices of the goods and services offered for sale. Both represent sums which must be spent on the current product of industry if costs are to be fully recovered. Now, the public authorities spend their receipts, broadly speaking, in four ways: as incomes for services rendered by public employees of all sorts; as social service payments to old age pensioners, unemployed, sick or disabled persons, and so on; as interest and sinking fund payments on public debts; and as payments for goods supplied, including both consumers' goods (e.g. for the armed forces, hospitals, and other institutions) and capital goods (e.g. roads, bridges, power-stations, town halls and other public capital works).

These public spendings will go out, equally with private spendings, either in buying the current product of industry, or enabling others to buy it, or in payments for existing assets (e.g. debt reduction, which is the public authority buying up its own capital liabilities). If they go in buying current products, the effect is precisely the same as when such products are bought by private persons. If they go in buying up existing assets, the effect is the same as when private persons buy such assets—a transference of the purchasing power involved. The income of public bodies goes into spending in just the same way as the income accruing to private persons. It involves no special problems relevant to the present argument.

All is well, then, as far as the balance of costs and purchasing power is concerned, as long as the whole of the income that is not used in meeting current consumption expenses is finally spent in buying *new* capital goods. All is not well if a part of the sum thus *not* used for consumption of currently produced goods and services is *not* spent on *new* capital goods, either because it is not spent at all, but hoarded, or because it goes on circulating in a series of speculative transactions in *old* capital goods, and does not get transferred to the financing of *new* investment.

The point about speculation we have discussed in an earlier chapter, and we can dismiss it briefly now. Speculation in existing assets only transfers, and does not cancel, purchasing power. It may, however, if the money passes from one speculator to another,

hold an appreciable part of the supply of money locked up in a series of transactions which do not take any currently produced goods and services off the market; and in that case its effect will be to withdraw a part of current incomes from spending on the current product of industry, and will be the same in its reactions on the balance of current supply and demand as if the money were hoarded and not spent at all.

This, however, is a secondary point. The main point is that spending on new capital assets is very much less stable than spending on consumption. Economists up to the time of Lord Keynes often spoke as if the act of *saving* (i.e. not spending on consumption) were the same as the act of *investing* in new capital goods. In other words, they assumed that all the money people *saved* out of their incomes would automatically get itself *invested* in newly produced capital assets. This, however, is clearly not the case. In an advanced economy such as ours, most investment is not made by the saver buying instruments of production for his own use—as the farmer may buy a tractor, or a reaper-binder, or a new milking-plant, out of saved income. Such investment does, of course, occur; but much more often the saver invests his money by lending it out to somebody else, who is prepared to pay interest for its use, or by buying a share in some company, in the expectation of receiving a dividend, or by taking out an insurance policy, so that the task of investing the money is transferred to the insurance company.

Now, what can be done with the money thus saved evidently depends not on the will of the savers only, but on the nature and extent of the openings for new investment. The lender cannot lend, or take up new shares, unless he can find someone willing to borrow, or to float a company, or increase the capital of an existing company by offering new shares for sale. The willingness of business men to borrow, or to incur liabilities for share capital in companies, determines the available amount of new investment. Indeed, the matter is somewhat more complicated than this; for a number of offers of what are apparently new bonds or shares turn out, on examination, to be mere re-flotations, directed to the sale of existing capital assets and not to the creation of new ones. We can, however, for the moment ignore this complication, and stress only the essential point that savers, with money to invest, cannot, unless they are prepared directly to buy capital instruments for their own use, influence the quantity of new capital assets which business men are ready to create. Business men, in deciding

whether to create new capital assets, will be governed by their expectations of the profit to be derived from them. When they regard the prospects of profit as good, they will be prepared to borrow, or to take up in share capital, large sums to be devoted to the purchase of new capital goods; but when they regard the prospects of profit as poor, they will refuse to float new companies, or to extend old ones, and there will simply not be outlets for more than a greatly reduced investment of capital in new productive assets.

The older economists would have met this argument with the contention that the rate of interest would act as a balancing factor to bring the supply of, and the demand for, new capital for investment into balance. But there is no real warrant for this view, which rests on the assumption that a low rate of interest will deter savers, so as to reduce the amount available for investment, whereas a low rate of interest will encourage borrowers, by widening the prospective margin of profit. This assumption is, in the main, invalid to-day. A low rate of interest will actually cause many people to save *more*, by increasing the sum which has to be saved in order to yield a given income. If a man is saving in order to get an income of, say, £300 for his declining years, he will have to save more if the rate of interest is low than if it is high. This sort of saving is now so important that great account has to be taken of it in considering the total sum available for investment.

Moreover, on the other side, will a fall in the rate of interest encourage borrowers? All other things being equal, no doubt it will; but all other things never are equal. The rate of interest constitutes, in most productive operations, so small a part of total cost that business men are guided very much more by their estimates of prospective market prices and demand than by any consideration of the rate of interest. Moreover, where capital is not borrowed at interest, but invested in shares, the rate of interest does not enter into the picture. The determining factor in regulating the volume of investment is the expectation of profit, quite apart from any question of interest rates. In practice, it is often a question, in any type of new investment, not between making, say, five per cent. or seven per cent. profit, but between making a satisfactory profit and incurring an absolute loss.

Of course, those who are considering the desirability of getting control of invested capital by borrowing or by share issues do not look exclusively to the prospects of profit in the immediate future.

They pay some attention to the prospects of profit in the long run. But immediate conditions are apt to play a very large part in influencing their decisions in any period either of depression or of prosperity, except that they often begin taking longer views when they think a boom or a slump is nearing its end. They are, except at these times, unlikely to be much influenced by the rates of interest: the volume of investment which they promote depends very much more on their estimates of prospective demand in the fairly near future.

Under these conditions, the processes of investment in the capitalist world are exceedingly unstable. There is a rush of projects for the investment of money in capital expansion when conditions are improving, and a widespread refusal to embark on new investment when times are bad. What, we must ask, happens when the recipients of incomes save out of those incomes more than they can either use themselves in the direct purchase of instruments of production or find business men ready to borrow from them, or receive from them as share capital, for a similar purpose?

It is plain that the saved money, if it is not spent on new capital goods either directly by the savers or indirectly, cannot from the standpoint of the community as a whole be really saved at all; for the savings of the community consist of the capital goods which have been purchased by the money savings of its citizens or of itself acting in a corporate way. From the community standpoint, money 'saved' but not 'invested' in new capital assets is wasted. The community cannot, like an individual, make savings by hoarding paper money or balances in the bank. The individual who leaves his money in the bank can later on draw it out and spend it. From his standpoint, a real saving has been made, though for as long as he leaves his money idle he can get no income from it. From the standpoint of the community, the position is much worse. The individual's bank balance is simply a debt of the bank to its depositor: it represents no real wealth. The community would be no poorer, though the individual owner would be, if it simply disappeared.

This, however, is not all. If the individual by leaving his money idle and not spending it on anything can still keep its value for future spending, this must be done at somebody's expense. The effect of the non-use of the money for buying currently produced goods and services is, as we have seen, that the whole of the current product, if it is all to be sold, must exchange for less money. Unless,

then, an equivalent quantity is held off the market and kept as stocks, prices must fall, and losses equivalent to the amount of money withheld from spending must be distributed somehow over the entire body of suppliers. The appearance of such losses, which will, of course, in practice be very unevenly spread, will drive some producers out of the market and cause a great many more to curtail their output. If, on the other hand, goods are withdrawn into stocks, the effect will be that the flow of orders for further goods to producers from those who hold these stocks will be diminished. In either case, unemployment will appear, productive resources will be less fully utilized, and the income of the community will fall off. The supposed 'savings' will be cancelled—and perhaps much more than cancelled—by these losses and by the ensuing fall in production and employment. The 'savers' will still have their money in the banks; but it will be in effect money filched from other people. The community as a whole will be the poorer for the unused purchasing power.

Lord Keynes has somewhat confused many students of his writings by the terminology which he has used in describing these processes. When he first drew attention to the fact that private 'saving' and investment are two quite different things, he said that there was no assurance, under the existing system, that Savings would equal Investment. Later on, he said that Savings must always be equal to Investment. The two statements do not really contradict each other; but the same terms are used in them in different senses. What Lord Keynes meant when he said that Savings might not equal Investment was that there was no assurance that the sums which people *tried* to save, and from their personal standpoints did save, out of their incomes would be balanced by the sums which business men would be willing to borrow, or to receive as share capital, for use in buying currently produced capital goods. What he meant when he said that Savings must always equal Investment was that, from the standpoint of the community, private 'savings' which did not fructify, directly or indirectly, in new capital investment could not be regarded as real savings, but would be cancelled by losses incurred elsewhere. It is unfortunate that Lord Keynes did not stick to a consistent terminology; but his argument is none the less valid for being put in a confusing way.

Lord Keynes's analysis of the effects of the instability of investment which characterizes capitalist societies leads up to the conclusion that the State and other public bodies ought to take action to keep

the total volume of investment in new capital goods reasonably steady. This, it is suggested, could be achieved if public bodies would vary their own investment inversely to the investment made by private firms, setting on foot more projects of 'public works' in bad times and fewer in good times so as to keep the total demand for capital goods in balance with the desire of the members of the community to save. The State and other public bodies would borrow the money needed for the execution of these capital works, and would thus take from the 'savers' the balance of their savings which private business men were not willing to take off their hands. This would not mean that the volume of 'public works' would have to be kept constant, irrespective of the need for them. It would have to vary, to the extent to which it was financed by borrowing, in accordance both with the amounts which the recipients of income chose to save and with the amounts which business men chose to take up in new investments. Of course, the State and other public bodies could, in addition to fulfilling this 'balancing' function, maintain regularly a policy of investment in accordance with public needs. The more industries are run by the State or by public bodies acting under its authority, the larger will be the public sector in the ordinary investment market. When the public bodies act in this way, the basic demand for investable money will be the sum of normal private and public borrowing; and the public bodies will then have to stand ready with a programme of *additional* investment projects which can be either advanced in time or deferred according to the condition of the investment market.

At the risk of appearing tedious, I must say again that the 'investment' of which I am speaking in this chapter is throughout *real* investment in newly produced capital goods, and does not include the mere purchase from a previous owner of existing capital assets. From the standpoint of the private saver, it is irrelevant whether the assets he acquires are new or old; but from the standpoint of the community the only investment is that which brings new capital assets into being. The other is a mere *transfer* of ownership, not a process of creative investment.

The view that the State and other public bodies should intervene to keep the total volume of investment at the right level is, of course, closely bound up with the view that it is the State's business to maintain 'full employment'. The State's function in this respect can be most easily fulfilled where there is a large sector of capital

development directly under public control. If the State and the local authorities regularly undertake the building, not only of roads and bridges, schools and hospitals, armaments and postal equipment, but also of houses, waterworks, electricity stations and transmission lines, ports and harbours, and other essential public utility services, their power to accelerate or decelerate investment is obviously much larger and easier to exercise than if their normal capital operations are confined within a narrower field. If the main forms of transport, and perhaps a few of the great basic industries, were added to the 'public sector' of the economy, plainly the State's task would be easier still; for the wider the range of capital-using services under public control, the easier would it be to select projects which could be advanced in time or postponed so as to serve the required 'balancing' purpose. It must not, however, be supposed that the State is necessarily confined to promoting investment in industries and services which are publicly owned and operated. The State can also proceed by way of subsidies to private enterprise. It did this, for example, in the Housing Act of 1923, which sought to stimulate investment in house-building by offering a subsidy to anyone who built a house, and not only to municipalities.

Subsidies, however, are notoriously difficult to operate without waste; for it is difficult to give them to those who need this stimulus to promote investment without giving them equally to persons who do not need them, and would be ready to act even if no subsidy were given. Therefore, though in theory there would be nothing to prevent the State from fulfilling the required function of steadying the rate of investment even if it had no industries or services under its own control, any such 'balancing' policy would be very difficult to work in practice under these conditions. This, however, is not to suggest that there is any need, in order to apply the policy, to extend public ownership over more than a small part of the whole field of industry.[1]

The 'Keynesian' school of economists, taking its stand on the view that the instability of investment is the main cause of the disastrous economic fluctuations which beset modern capitalist societies, and that this instability is at the root of the instability of credit, lay the main stress in their proposals for reform on the

[1] In my book, *The Means to Full Employment* (Gollancz, 1943), I have discussed this particular issue at length. I have no space to do more than refer to it cursorily here.

assumption by the State of the responsibility for holding total investment at a level just high enough to sustain 'full employment'. Monetary policy, they hold, plays a secondary role, and should be so adjusted as to fit in with the requirements of a right investment policy.

Plainly, the Keynesians believe that there exists, in the capitalist societies of to-day, a strong tendency for the level of investment to fall below what is needed for 'full employment'. They offer a remedy for this defect; but why, in their opinion, does the defect exist? Why should it be necessary for the State to step in to ensure a level of investment high enough to clear the market of the savings which the recipients of incomes are attempting to make?

The answer to this question is usually given, primarily, in terms of what Lord Keynes calls the 'propensity to consume' and the 'propensity to save'. In general, it is argued, those with the lower incomes have the greater 'propensity to consume' and accordingly the smaller 'propensity to save'; and at the higher income levels the propensities are reversed. Thus, a society in which the general level of wealth is increasing at all points will tend to save a higher proportion of its total income; and so will a society in which income is being re-distributed to the advantage of the wealthier classes. This generalization has in practice a good many exceptions. The wealthiest classes are not necessarily the most 'saving': in Great Britain up to 1939 probably the middle classes on the whole saved the highest proportion of their incomes. But it does hold good, broadly, that the poorer classes cannot afford to save much without enduring privations which they will not as a rule accept, and that accordingly the main bulk of savings is made by persons who are well above the 'poverty line'.

It is argued that the increased number of persons in modern communities who possess a surplus over the necessities of life has led to a growing 'propensity to save', but that this increase has not been fully or continuously balanced by the growth of the willingness of business men to undertake investment. Why should this be so? One relevant factor is that the only use of most capital goods is to facilitate the making of consumers' goods: so that the demand for investment depends in the last resort on the prospective demand for consumers' goods—that is, on the maintenance of the 'propensity to consume'. The production of new capital goods beyond what are needed to produce the goods that will satisfy

consumers' demands can result only in losses somewhere—either in a failure to use the new capital goods at a profit, or in the driving out of production of older capital goods which are not efficient enough to hold their place. Accordingly, if the 'propensity to save' is pressed too far, it will, by narrowing the market for consumers' goods, stultify itself. Doubtless, it is very right and proper that obsolescent or worn-out instruments of production should be continually in process of being driven out of the market by new and more efficient instruments; but if the process is speeded up beyond a certain point, it spreads devastation and ruin, by causing machines to be scrapped wholesale long before they have been able to pay for themselves out of the value of the products made with their help. Doubtless, it is necessary that some of the new enterprises should fail; but if failure is frequent, the result will be that few will be willing to take the risks of productive investment.

A sufficient maintenance of the 'propensity to consume' in the community as a whole is therefore indispensable for the continuance of healthy economic conditions; and where the 'propensity to save' is tending to rise unduly, action is needed to prevent depression and crisis. This action can take a variety of forms. The State can take steps, e.g. by minimum-wage legislation, to raise the incomes of the worse-paid classes; it can employ taxation as an instrument for the re-distribution of incomes, as it does in the case of social services financed out of the product of a tax system having a heavy incidence on the higher incomes; or it can develop forms of 'public works' which lead to a higher level of *collective* consumption —e.g. by the provision of free services, such as roads, parks, playing-fields, swimming-pools, municipal theatres, and so on. The first and second of these methods will directly stimulate private consumption: the third will direct a part of the investment, under public auspices, into channels which swell the volume of collective consumption of durable consumers' goods.[1]

[1] The distinction between capital goods and consumers' goods, which I have used throughout this chapter, is at certain points unsatisfactory, and for some purposes it is preferable to divide goods into three categories—production goods, immediate consumption goods, and durable consumers' goods. A house is a capital good from the standpoint of the landlord, but a consumers' good from that of the tenant, who is gradually using up its capital value by wearing it out. It is, in effect, a durable consumers' good. Some such goods, such as a house, can be and are habitually let out for money: others, such as roads, no longer are (except where turnpikes survive), but are consumed collectively and paid for out of the public purse.

This fall in the 'propensity to consume' is an explanation of the tendency for the 'propensity to save' to outrun the willingness of business men to accept money for investment. There is, however, a second explanation, not inconsistent with the first, but supplementary. Where monopoly exists, it may pay the monopolists best to keep down the volume of production in order to maintain prices at a high level and thus reap higher aggregate profits. This, where it is done, will both directly restrict the openings for investment and, by restricting employment and increasing profits, accentuate the inequality of incomes and thus lead to a further self-defeating increase in the 'propensity to save'. Monopoly and the increase in the 'propensity to save' due to a rise in the higher incomes are thus not independent factors, but work together to produce the same effects.

This falling 'propensity to consume' is, of course, only a new-fangled name for a very old idea—that of 'under-consumption'. It has been argued by many generations of heterodox economists that at the root of economic crises lies the maldistribution of incomes between rich and poor, resulting in a restricted demand for consumers' goods side by side with a growing capacity to produce. The older exponents of this view used, however, commonly to speak as if the correlative of 'under-consumption' were over-investment, leading to a glut of consumers' goods of which the makers found it impossible to dispose. They had not fully appreciated that the maldistribution of incomes in the community may in fact damp down investment as well as consumption, by making business men unwilling to create additional capital instruments and by strengthening monopolistic tendencies among the owners of the existing instruments. Where this happens, crisis will ensue just as much as it would from over-investment in capital goods; for the failure to purchase capital goods will throw the producers of such goods out of work, and the consequent loss of purchasing power will depress the demand for consumers' goods. Crisis can result from either over-investment or under-investment: the more monopoly holds the field, the likelier is it that under-investment will be what actually occurs. For it is one of the main purposes of monopoly to prevent the unregulated entry of new capital into the fields which it controls, and to keep the total investment at a level which will exclude what it regards as 'redundant capacity' and thus make it easy to restrict the level of output to what will ensure the largest aggregate of profit.

The question that necessarily arises out of the foregoing argument is this. Where the level of attempted 'saving' is too high in relation to the willingness of business men to accept funds for new investment, is the appropriate remedy (*a*) to increase investment to the point at which all 'savings' will be absorbed, or (*b*) to effect such a re-distribution of incomes as will restore the balance by increasing the 'propensity to consume'? The Keynes policy, as outlined in the *General Theory*, is mainly that of increasing the level of investment by State action. But does not the alternative policy deserve fuller consideration than it ordinarily receives?

VII

METHODS OF RE-DISTRIBUTING INCOMES

THE first and most obvious way of bringing about a re-distribution of incomes is by legislation laying down minimum rates of wages below which no employment is allowed. Such legislation can be either general or particular, or both. It can lay down certain basic minima applicable to any trade or occupation, and differentiated, as may be thought best, according to age and sex; or it can prescribe specific minimum rates or scales of wages for persons employed in particular industries or occupations; or it can combine both systems, by laying down general minimum rates which are applicable where no specific rates are fixed. In Great Britain there is no general provision for a minimum wage. Wages in a number of industries, chiefly among those in which women's employment predominates, are regulated by Boards under the Trade Boards Act; and there is special legislation prescribing minimum rates for workers in agriculture, road transport, and a few other trades. These Acts in principle prescribe only *minima*, and do not prevent any employer from paying, or any body of workers from demanding, more; but in practice the minimum wages usually become the standard wages for the great majority of the workers in the trades concerned. Some countries, notably Australia and New Zealand, have gone much further than Great Britain in prescribing minimum rates over industry as a whole, and in using wage legislation deliberately as an instrument for enforcing the recognition of a basic standard of living. In Great Britain, where only a limited range of occupations is covered, the effect of minimum wage legislation has been much more restricted. It has been used to prevent abnormal underpayment in a certain number of particular trades; but no attempt has been made to employ it as an instrument for raising the general standards of living among the working classes. Its effects on the general distribution of incomes in the community have therefore been insignificant.

The most obvious difficulty in the way of using wage legislation as a major means of re-distributing incomes is that it may affect the competitive position of the industries affected by it in the world market. It is obviously much easier to pursue in countries which are prepared to protect by import duties or other restrictions the

home markets of trades which find themselves seriously affected by foreign competition at the higher wage-levels; and the Australian legislation in particular had for its complement a high tariff on industrial imports which were competitive with home products. Such protection obviously cannot help export trades; and the difficulties of the exporting industries have been a main obstacle to the extension of minimum-wage legislation in Great Britain, as well as to the raising of wages in the trades which are covered by Trade Boards. No doubt, in some instances, the raising of wages by law will so increase the efficiency of the trades affected —both by improving the quality of the labour employed and by driving the firms to adopt more mechanized methods of production —as to increase rather than diminish their competitive capacity. But this will hold good only over a limited field, and to a limited extent; and any minimum-wage policy designed to bring about a substantial re-distribution of the national income would undoubtedly raise costs of production, at any rate in the short run, and would therefore react on the competitive capacity of the export trades, even if protection were afforded in the home market. It would be possible to offset these effects by subsidies to exporters; but such a policy would be very liable to provoke retaliation by other countries, in which the cry of 'export dumping' would be raised. Only a completely State-controlled economy, such as exists in the Soviet Union, can insulate itself from such effects. Where all foreign trade is a State monopoly, as it is in the Soviet Union, exports are determined, not by their profitability to the producers, but by considerations of public policy. It pays the State to export goods in exchange for imports which would cost more to produce at home than the exports for which they are exchanged. This, and not the prospect of profit from the sale of the exports, settles export policy; but clearly, in countries working under the system of production for profit, exports are settled in a quite different way, and the power of the State to raise wages without affecting the volume of sales and employment in the exporting industries is much more limited.

Even if we set aside the problem of exports, it is clear that any wage-policy which adds to the costs of production will tend, other things being equal, to limit sales; for the higher prices are, the less will be bought, if the incomes in the hands of the consumers remain unchanged. But will they remain unchanged? Will not a re-distribution of incomes in favour of the wage-earners increase the

'propensity to consume', and thus widen the market for consumers' goods enough to balance any rise in costs? This may happen; but a good deal will depend on the ways in which the business world reacts to the increase in wage-costs. Under normal conditions, there is a powerful tendency for such increases to lead to price-rises in the consumers' market well beyond the actual rise in costs. A good many commodities pass through many hands on their way to the consumers; and at each stage there is a tendency to add what is regarded as a 'reasonable percentage margin' to the price at the previous stage. Thus, the effect of wage-increases in manufacture is apt to be passed on with cumulative effects through the subsequent stages; and this tendency is naturally most marked when there is any sort of ring or monopoly at any stage. The higher 'propensity to consume' resulting from bigger incomes at the bottom may thus be offset by an addition to profits at subsequent stages of production and distribution, with the consequence that less may be sold at the higher price, and the effect may be to decrease employment.

The reactions on employment are indeed, under the conditions of capitalism, the main obstacle to pursuing high-wage policies far enough to produce any substantial effect on the distribution of incomes. This is no case against pursuing such policies as far as they can be pursued; but it is a reason against expecting much effect from them on the general distribution of the national income.

The second obvious way of attempting to bring about a re-distribution of incomes is by taxation levied so as to fall mainly on the richer classes, and by the use of the proceeds of this taxation to add to the incomes of the poorer. One method of doing this is by providing free of charge, or at less than cost price, goods or services either exclusively to persons of low income or to all comers—for the poor so outnumber the rich that it costs comparatively little more to extend the benefit of communal services to everybody who chooses to take advantage of them. This is the method followed in those social services which provide, not cash benefits, but goods or services—cheap milk, school meals, medical attendance under the National Insurance Acts, and so on. True, most of these services are not at present provided either free or to all comers. But they are subsidized so that the recipients pay less than the full cost; and it is proposed in the Beveridge Plan to provide free public medical services for all comers. To the same group belong the wartime subsidies designed to keep down the cost of certain

essential food supplies; and these subsidies are given to all, the rich man paying no more for his subsidized loaf or joint of meat than the poor man. Similarly, under normal conditions, the schools provided by the nation are open to all, either free, in the case of elementary and a few secondary schools, or at a subsidized rate, as in most higher forms of State-provided education. True, the rich often prefer to send their children to so-called 'public' or to private schools outside the State system. But that is their choice: they are free to use the public educational services if they wish.

A second way of re-distributing incomes through the social services is by paying out cash benefits to certain needy citizens—old age pensions, health and unemployment benefits, grants from the Assistance Board, and what used to be called Poor Relief, but is now re-named Public Assistance. Some of these payments are made subject to a 'Means Test'—e.g. non-contributory old age pensions, and Assistance Board and Public Assistance payments—while others are on a contributory basis, the State merely making a contribution which is added to those of the employed persons and of their employers to meet the cost. Clearly, the contributory part of these schemes does not represent a re-distribution of incomes between rich and poor, though it does between different sections of the poorer classes. Those who are less liable to sickness or unemployment help to pay for those who are more liable; but the only contribution levied on the richer classes is their share in the payments made by the State in aid of the finance of the various schemes. The employer's contribution cannot be regarded as levied on the richer classes; for it is paid, not out of the employer's private income, but as part of the cost of production out of business funds. It thus goes into selling prices, and the rich and the poor pay for it in proportion to the quantities of goods they buy.

As for the State's contribution, it cannot be taken as being all a transfer of income from the rich to the poor. For the poor as well as the rich pay taxes, and a very large proportion of indirect taxation especially falls on the poor. Moreover, in these days, when income tax is levied on a high proportion of the working population, the extent to which even direct taxation used to finance social services is re-distributive depends on the steepness of graduation of the taxes on incomes, and not on the mere fact that the taxation is levied directly.

These considerations explain why the great growth of the social services in recent decades has not involved anything like an equi-

valent re-distribution of incomes between rich and poor. The rise in earnings in war industries and the very steep graduation of income taxes during the war have undoubtedly produced a re-distributive effect, offset only in part by the wide extension of the income tax to the bulk of the wage-earners. But before the war the growth of the social services was being paid for largely out of contributions levied on the workers themselves, and out of indirect taxes and employers' contributions, which swelled the cost of goods largely consumed by the poor. This explains the apparent paradox that the returns showing the distribution of property at death, compiled for the purpose of collecting death duties, showed but little change in the distribution of wealth between the 'Two Nations'. There was, indeed, an appreciable tendency for the groups nearer the middle to gain at the expense of the two extremes of great wealth and dire poverty; but even this tendency was not very marked.[1]

There are, it must be admitted, difficulties under the existing economic system in carrying the re-distribution of incomes through taxation to very great lengths, though I should by no means admit that nearly all that could have been achieved in this way has been even attempted. It is not true, as is sometimes alleged, that a high level of taxation in itself acts as a deterrent to production, at any rate when the taxes are directly levied on the larger incomes. Income tax and surtax and death duties do not fall on the costs of production: they are levied on private incomes *after* profits have been distributed, and do not affect the prospective profitability of production to the *firm*. They may, no doubt, cause some owners of capital to prefer to live in countries where taxes are lower and to carry on production there. But the owner of capital cannot escape taxation by moving his business abroad unless he also moves himself: he may even run the risk of being taxed twice, both by the country in which he lives and by that in which his profits are made. The 'bogy' of the 'flight of capital' from countries which impose high direct taxation is a 'bogy', and not much more.

Nevertheless, in indirect ways, a high level of direct taxation may react unfavourably on the working of the capitalist economic system. In the last resort, the incentive to the capitalist to undertake production and employment is the *net* return which he expects to get; and if this *net* return is lowered he may be less willing to

[1] See, for a discussion of this problem, *The Condition of Britain*, by G. D. H. and Margaret Cole (Gollancz, 1937).

invest new capital. A high level of direct taxation may thus aggravate the tendency towards a gap between the attempts of income-receivers to save out of their incomes and the willingness of business men to apply these 'savings' to real investment in new productive assets. But against this effect has to be set that of the higher demand for goods and services which will arise if the State uses the money raised by steeply graduated direct taxation in such ways as will add to the consumption of the relatively poor. When goods and services are made directly available for such consumption, in such services as free education, school meals and milk, recreation-grounds and other amenities of living, or as subsidized houses or supplies of standard necessaries, the stimulus to consumption is unqualified: where money drawn by taxation from the rich is handed over to the poor the effect will be largely the same, and the 'propensity to consume' will be increased. To the extent to which monopolists are allowed to hold up prices, the effects of any given money transfer will be impaired; for an improvement in money demand will provide them with a means of charging more for their goods. On the whole, such transfers will have beneficial effects; but their value depends on the real incidence of the tax system being such that the richer classes do pay the cost and are not able to pass on their burdens to the poor.

Evidently, the more effective measures of re-distributive taxation and public expenditure seem likely to be in achieving their ostensible purpose, the more will they be opposed by the owners of property claims. Modern States have not found it easy in practice either to prevent the growth of monopolies or to place effectively high burdens of taxation on the rich. For example, the launching of a big public housing campaign after the last war was immediately followed by a sharp rise in the prices of many building materials, which were under the control of close rings and associations; and in one case after another the levying of higher taxation on rich people through the budget has been balanced by the exaction, outside the budget, of larger sums in insurance contributions falling directly or indirectly on the poorer classes. This is not to say that the thing cannot be done, but only that it will require a strong, democratic Government, with strong popular backing behind it, to get it done effectively.

What other methods are there, besides minimum-wage laws and re-distributive taxation, for securing a better distribution of incomes in the community? A third way is that of trying to reduce the gross

return on capital, instead of merely seeking to reduce the net yield by taxation after profits have been distributed. This can be attempted by operating on interest rates, so as to keep them as low as is conveniently possible. Ever since the great slump of the 'thirties it has been, on the whole, the aim of the British Government to maintain a regime of 'cheap money', in the hope of stimulating investment in new capital goods. This policy has not been aimed directly at bringing about a re-distribution of incomes; but it is evident that, to the extent to which less has to be paid for the use of capital, there will be a larger proportion of the total product available for payment to the other factors of production, of which wage-labour is by far the most important. Thus a 'cheap money' policy, if it succeeds, will not only increase consuming power to the extent of the addition to the consumption of the workers taken on in the industries producing capital goods and of the further additions to demand which will result from the transfer of the money spent in this way to other recipients (i.e. what is known as the 'multiplier'),[1] but will also tend to bring about a more favourable distribution of the product of industry by reducing the claim of capital to a share in the value created.

This, of course, is on the assumption that 'cheap money' spreads through the economic system as a whole. The 'cheap money' is, in the first instance, merely bank credit available for borrowing—that is to say, money available mainly for short loans, and not for works of long-term capital construction. If the Central Bank makes 'cash' plentiful as a basis for credit, and the commercial banks follow its lead in adopting a policy of 'cheap money', there will be reactions on long-term rates of interest, which should also tend to fall unless they are being held up artificially. But this reaction is by no means certain or automatic. It is possible for long-term rates to remain high, even when short-term rates are low; for though to a limited extent borrowers can shift from the one market to the other, they cannot do this beyond a certain point. It is easiest for the State to influence the long-term rate where there

[1] By the 'multiplier' is here meant the secondary effects on consumers' demand resulting from the increase in wage-incomes of those directly employed. The spending of these incomes stimulates demand, and thus brings more labour into employment. This in turn produces further favourable reactions of the same sort. The 'multiplier' expresses the total of all these favourable effects. Thus, if the initial employment of 100 men causes a further 100 to be employed when all the indirect reactions have taken effect, the 'multiplier' is said to be 2.

are public loans repayable at its option; for it can then offer to convert such loans to a lower rate of interest for a fresh term of years. If the lenders refuse, the State can then repay them with funds borrowed at low rates in the short-term market (e.g. Treasury Bills or short-dated Treasury Bonds), and can thus leave them with funds on their hands to re-invest under conditions which will probably force them to accept lower long-term rates. This was the position in 1932, when the Treasury was in a position to redeem a last-war loan of £2,000 millions bearing interest at 5 per cent. The conversion and repayment operations in connection with this vast loan effectually lowered long-term interest rates, and had much to do with stimulating the ensuing boom in the building industry, which is greatly affected by the level of long-term interest rates. States, however, are seldom so strongly placed as this for affecting long-term rates; and accordingly a policy of 'cheap money' may be for a long time ineffective in forcing down such rates. Where this is the case, the consequences outlined in the preceding paragraph will, of course, not follow. The 'cheap money' must spread to the long-term rates in order to produce its re-distributive effects.

Even if it does so spread, it will fail in part of its effect wherever monopoly is strong. Ordinarily, there is an interaction between interest rates on borrowed money and the expectations men entertain of the profits to be derived from using their own capital or investing it in company shares, as distinct from bonds or debentures. A person with money to invest can choose between lending it out at interest and investing it in the hope of profit. If the offered rates of interest are low, there will be a tendency for lenders to shift over to profit-seeking investment at lower expectations of profit than they would require if interest rates were high. Where, however, monopoly prevails, the monopolists may prefer not to receive fresh capital entitled to participate in profits, but to borrow what they need at low rates of interest and thus keep the profit for themselves—i.e. for the existing owners of their 'equity' capital in shares bearing a variable dividend. This will prevent the lower profit-expectation of lenders from adversely affecting the profits earned on existing capital. It is of course merely one instance of the general tendency of monopoly to shift the distribution of income in favour of the monopolists against the rest of the community.

The effectiveness of a 'cheap money' policy in bringing about a re-distribution of incomes thus depends on the monopolistic influences not being so strong as to be able seriously to distort its

working in their own favour. To the extent to which it is distorted, the consequence will be a growth of 'windfall' profits, which, so far from improving the distribution of incomes, will make it worse.

A fourth method of altering income distribution is by the remission of taxes, as distinct from the imposing of new ones, which we have considered already. Some economists have favoured a policy of tax remissions in slump periods, as a method of stimulating industrial activity. Such a policy has, however, two sides, according as the incidence of the remitted taxes is mainly on the rich or on the poor. One proposal that is often made is that, in bad times, the State should remit the taxes on company profits placed to reserve, and perhaps even refund tax paid on reserves in previous years, on condition of the reserves being spent on new capital investment. Such a policy might obviously stimulate capital investment at a time when it is at a low level; but its re-distributive effect would be that of giving more to the rich. The owners of 'equity' shares are predominantly well-to-do people (though of course the number of small shareholders in individual concerns is great); and the effect of such a remission of taxation would be to add the amount remitted to the value of the shares, and thus to make a large present of public money to the shareholding class. Similarly, if remission of taxes on incomes were so adjusted as chiefly to reduce the steepness of graduation, the effect would be that of re-distribution of incomes in favour of the wealthier classes.

This holds good even if the State does not replace the remitted taxes by others falling on the community as a whole in the same proportions as the entire tax system before the remissions. Even if the State, as is usually recommended, were to cover by borrowing the budget deficit resulting from the remissions, the effects of the re-distribution in favour of the rich would remain, unless provision were made to recover the same amount *plus* interest in later years from the same classes of taxpayers as had benefited from the remissions. The Swedish Government did carry out a policy more or less of this sort during the 'thirties; and it seems to have worked well. But a programme designed to recover in subsequent years the sums remitted, and to do so at the expense of the very classes which benefited, will obviously meet with a less enthusiastic reception in business circles than one which makes the remission virtually a gift outright.

It is far less often proposed to meet slump conditions by remitting

taxation which falls chiefly on the poorer classes. Yet this is clearly what ought to be done, if the direct purpose is to stimulate consumption rather than investment. It is one of the merits of the Beveridge Plan that it will tend to pay out in social service benefits in bad times more than is being currently taken into the Social Security Fund, whereas in good times the Fund's receipts will exceed its outgoings. It is indeed a sign of some progress in economic thought that this is now widely regarded as a merit, whereas when in 1931 the Unemployment Fund was paying out much more than it was receiving, reactionary critics loudly proclaimed this fact as a sign of impending national bankruptcy. Tax remissions to relatively poor taxpayers (or, of course, to payers of insurance contributions, which are in effect taxes) in bad times are a valuable way of maintaining the level of consumption: whether they should be recovered subsequently by higher taxation in better times merits further discussion.

Tax remissions differ in no respect from presents of purchasing power to those who benefit by them; but the benefit, of course, accrues to those on whom the remitted taxes would have fallen. In general, tax-remission policies can be more easily applied to direct than to indirect taxation in periods of slump, because the level of indirect taxation is usually governed largely by protective motives as well as by considerations of revenue, and there is strong resistance to any lowering of import duties when employment is bad. There are also political difficulties in the way of reducing insurance contributions in bad times, when insurance funds are paying out more than they are getting in. Accordingly, the taxes which are politically most open to reduction are taxes on income. These, however, are not paid by the poorest strata of the population, and, even when they have been extended to cover large bodies of wage-earners, fall, on account of their graduation, most on the larger incomes. Consequently, policies for the remission of taxation are apt to resolve themselves into measures of relief for the richer, rather than for the poorer, taxpayers; and this means that the effect of remission is smaller than it would otherwise be in increasing total consumers' demand.

There remains the proposal to improve the distribution of incomes by increasing the amount of direct money payment made to the general body of consumers, and financing this increase not out of the proceeds of taxation or out of borrowing to meet a budget deficit, but through the direct creation of additional purchasing

power. Proposals of this kind have often been linked with the view, which we have already examined, that there is an inherent tendency in the existing financial system to engender a 'deficiency of purchasing power'. This deficiency, it is alleged, can be made good only by a policy of 'social dividends', financed not out of existing incomes by taxation or borrowing, but out of 'new money' created for the purpose.

I have tried to show reasons for rejecting the view that there exists any tendency for the total quantity of purchasing power generated in the economic system to be too small to purchase the current product at a price sufficient to cover its cost, while accepting the view that there may exist temporary deficiencies (or temporary surpluses) of purchasing power, and also the view that hoarding or a deficiency of investment projects may cause the sums actually offered by purchasers for the current output to fall a long way below its cost. If these conclusions are correct, it follows that additional creation of purchasing power out of nothing would result in a surplus of spendable income above the cost of current output, and would thus tend to raise prices or, if prices were pegged at their previous level, to leave over a surplus of spendable income which could not be used in buying currently produced goods and services. It is, of course, quite true that the putting into the people's pockets of this additional spending power could, if it were done at a time when there were productive resources lying unused, stimulate additional output. But the making of this output would itself involve the creation of additional incomes in the hands of the producers; and these incomes would then be available for spending over and above the specially created supplies of purchasing power. Accordingly, there would be a tendency for prices to rise, as the total spending power available would have increased faster than the total supply of goods and services. The additional purchasing power would therefore need to be recalled as soon as it had fulfilled its purpose of stimulating the additional production, unless it were regarded as desirable or harmless to allow prices to remain at the higher level. This might be desirable if, at the time when the fresh money was introduced, prices had been artificially depressed below costs (including reasonable profits) over any wide area of industry. In that case it would be necessary only to limit the additional creation of purchasing power to the sum needed to raise prices to the level regarded as suitable, and no provision would have to be made for repaying the money thus created. If, however, more money

were created in the first instance than would suffice to sustain the desired level of prices, it would be necessary to provide means for the cancellation of the excess as soon as it had fulfilled its original purpose. It has, of course, to be borne in mind—though some monetary reformers seem strongly inclined to overlook the fact—that spending power once created does not perish when it has been expended by its first recipient, but, unless provision is made for its cancellation, goes on circulating indefinitely from hand to hand; so that each additional unit created does not replace, but is added to, the previous units. This is not the case with bankers' credits, because they do have to be repaid to the banks; but it would be the case with non-repayable grants of income financed out of specially created money paid out by the State.

It follows from what has been said that, given initial conditions of 'full employment', there can be no place for 'social dividends' created out of nothing, and not financed by the withdrawal of purchasing power either by tax or by loan from some existing possessor of it. On the other hand, where unemployment does exist and there are unused productive resources which can be brought into use, there may be a case for such a policy; but it is not possible, even so, to carry it into effect without raising prices.

There is, indeed, a special form of the policy of 'social dividends'—a form in which I have myself advocated them for many years—which is not open to the objection just raised. It would be fully practicable, under the appropriate set of social and economic institutions, instead of paying out the whole of the net revenue generated in the course of production in rent, interest, wages, salaries and profits, to deduct at source a part of this revenue and pay it out, not in rewards to the owners of the factors of production, but as 'social dividends' to all members of the community as their common birthright in the collective productive capacity of the economic system. Current productive power is, in effect, a joint result of current effort and of the social heritage of inventiveness and skill incorporated in the stage of advancement and education reached in the arts of production; and it has always appeared to me only right that all the citizens should share in the yield of this common heritage, and that only the balance of the product after this allocation should be distributed in the form of rewards for, and incentives to, current service in production.

In effect, something very like this occurs to-day in the Soviet Union, though the payments do not take the form of money

dividends. The Soviet Union raises by far the greater part of its revenue by levies on industry, which are paid to the State as prior charges before incomes can be allocated to the producers or reserves accumulated by the industrial enterprises. The sums thus levied on industry go to meet the costs of government; and in these costs are included social services which represent a far larger proportion of the real incomes of all Soviet citizens than the social services provided in other countries. The Soviet Union thus in effect pays a large 'social dividend' in kind, and finances this by means of a levy on the turnover of industrial enterprises, thus abstracting a part of the revenue from the producers as such and paying it over to the whole body of citizens. 'Social dividends' in this form, as in that described in the preceding paragraph, are thus financed out of what is in effect a form of taxation, and not out of specially created money. Of course, in saying this I am not denying that the Soviet Union may not in addition have met deficits by special creations of money. I know that it has; but the effect of its doing so has been, and must have been, to raise prices, whereas 'social dividends' fully financed out of levies on the product of industry need have had no such effect.

It is, of course, necessary, as part of the policy described, to limit the incomes paid out to the producers and the sums placed to reserve by industrial enterprises (there are, in the Soviet Union, no recipients of interest or dividends out of the product of industry) to what is left after the sums needed for public purposes have been withdrawn. If wage and other income payments are allowed to rise beyond this point, the effect must be to increase prices; and the increase can then be attributed, at choice, either to the rise in incomes or to the incidence of the turnover tax. Control of the incomes paid to the producers is the necessary correlative of the policy of 'social dividends' in the form here under discussion; and I think it follows that such a policy can be adopted only under an institutional set-up which confers upon the State the final authority to regulate incomes and prices as well as to levy taxation—in other words, under a Socialist or largely Socialist, economic system. It would no doubt be possible in theory for an economy based mainly on private enterprise to control so thoroughly both incomes and prices of all kinds throughout the productive system as to make possible a policy of 'social dividends'; but I very much doubt whether it would be possible in practice. It may be claimed that to a very great extent such controls were enforced in Nazi Germany even before the out-

break of war—though not, of course, in pursuance of a social policy even remotely resembling that of 'social dividends'. I admit that the necessary controls could be exercised under some form of complete Fascist dictatorship; but I cannot imagine a Fascist dictatorship willing to exercise them for purposes of social justice.

We can now try to sum up the general conclusions which have been reached in this chapter. There are at least six ways in which a Government which wished to improve the distribution of income in a community could set about its task. (1) It could pass minimum-wage laws, and seek through wage regulation to establish a satisfactory minimum standard of living for all its *working* citizens; (2) it could attempt to use taxation as an instrument for the redistribution of incomes, applying the yield of the taxes either to the provision of communal services, or to the making of social service payments in money to needy members of the community, or to the subsidization of necessary goods and services so as to increase the real incomes of the poor; (3) it could set out to reduce the proportion of the yield of industry accruing to owners of capital by measures designed to keep rates of interest at the lowest practicable level; (4) it could endeavour to mitigate the poverty arising in periods of depression by remitting taxes which fall heavily on the poorer classes, with or without provision for replacing the lost revenue by means of heavier taxation in prosperous times; (5) it could make direct grants of purchasing power to the poorer consumers, or to all citizens as a matter of right, and could finance these payments, not by taxation or borrowing, but by new public creation of additional purchasing power. [This proposal, we saw, is usually put forward by those who believe that the existing economic system suffers from a tendency to an endemic deficiency of purchasing power]; (6) it could adopt a policy of 'social dividends', financed not by creation of new purchasing power nor by borrowing nor by taxation in the ordinary sense of the term, but by a prior levy on all industrial turnover, with a consequent limitation of the incomes distributed as rewards for, or incentives to, production to what remained available after the share required for the 'social dividend' had been appropriated by the State.

I have tried to show both the effects of all these re-distributive policies and their limits, as well as the difficulties in the way of their adoption. They are not, of course, mutually exclusive: there is nothing to prevent a community from making use of several of them at the same time. Against the last, and to some extent against

all of them, it is urged that the distribution of any considerable part of the national income in the form, not of 'economic' rewards for work done, but of social payments based on needs or on civic rights, would react adversely on production, because it would lessen the incentives offered in the form of wages, profits and other incomes paid for the use of the factors of production. I feel sure this argument is not valid. The incentive to production depends in the main, not on the absolute magnitude of the rewards offered, but on their relation one to another. An offer of several thousands a year under one social system will provide no greater incentive than an offer of as many hundreds under another. Where great inequalities of wealth and income exist, as they do in feudal and in capitalistic societies which encourage large accumulations of property, it is necessary to offer large money incentives for the superior kinds of work. Where heavy costs of education and training fall on the entrants to certain professions, or where entry is open only to those who possess considerable capital, it is necessary to hold out the prospects of large gains. But the more nearly a community approaches to conditions of social equality, the smaller are the differences of income that will suffice to provide strong incentives to effort.

If it were decided to institute a policy of 'social dividends', payable of right to all citizens as their shares in the common heritage, quite apart from the rewards accruing to them from their individual labours, it would no doubt be necessary to begin on a small scale—with payments that would not suddenly upset the whole structure of incomes derived from the various forms of productive service. But the system, once instituted, could be extended progressively, the monetary incentives needed to elicit effort falling as the community accustomed itself to the idea of greater equality and of a right to 'dividends' as attaching not to the owners of capital, but to all the citizens as their participation in their common birthright.

To some of my readers, speculations of this order will doubtless appear Utopian, and out of place in such a book as this. But is the idea of a 'social dividend' so far away from the spirit of that part of the post-war social programme the country is now debating in which the notions of comprehensive free medical service and comprehensive free education seem to be finding ready acceptance? If the State assumes the responsibility of seeing to it that all its citizens are to be given the chance of free health service and free education up to a secondary stage—if it is to go further, and to

accept the implications of the Beveridge slogan 'Freedom from Want', what is there Utopian in suggesting that a share in the product of industry ought to accrue to every citizen as a money payment which he can spend freely, as well as in the form of certain freely provided services? It is a further step, I agree; but it is a step on a road on which we have already agreed to travel a good deal of the way.

VIII

THE DEMAND FOR CAPITAL—PUBLIC WORKS AND THE CONTROL OF INVESTMENT

THE preceding chapter dealt entirely with methods. It discussed how Governments could set about altering the distribution of incomes in the community to the advantage of the poorer classes, if that was what Governments wanted to do. Now, the desire to bring about a less unequal distribution of incomes may be based either on considerations of social justice or on the belief that the uneven distribution is a cause of economic disequilibrium and depression—or, of course, on both considerations taken together. The argument from social justice can be given an economic shape by demonstrating that on account of the 'diminishing marginal utility of money' a more equalitarian distribution is likely to achieve a greater total of 'utility' or 'value in use' than a less equal distribution. If value is something subjective, consisting in the amount of satisfaction derived from an output of goods and services, the total value created will be at its maximum if the available supply of goods and services can be distributed with as near an approach to equality as is compatible with retaining the incentives necessary to secure a satisfactory volume of output.

It is, of course, bound to be a matter of opinion, both what degree of inequality is necessary for the maintenance of the incentive to labour, and how much diminution of total output it is worth risking in order to achieve a more even distribution of the product. It may be that the highest level of total output will be promoted by a much nearer approach to economic equality than we have yet achieved; or it may not. It may be, as I believe, that the degree of inequality needed to provide adequate incentives depends on the general character of the social system, and cannot be determined apart from the character of the social institutions within which the incentives are to be offered. To the extent to which greater equality increases total output, greater equality is clearly desirable on economic grounds. To the extent to which we cannot have more approach to equality without adverse reactions on total output, there is no way in which an *economic* judgment can be reached. Society has to settle for itself, with no rule to govern its decisions, which it values the more highly—more in total output, or a more

even distribution—and how far it thinks fit to carry its preference in either direction.

The principle of the 'diminishing marginal utility of money' is easy to state. When a man has reached the point at which his income suffices to provide him and any dependants he may have with the means of tolerable living, each money unit added to his income tends to be of less value to him than the preceding units in terms of the satisfaction it affords. An additional shilling obviously means little to a millionaire, but a great deal to a poor man who has but a narrow margin above the absolute necessaries of life.

This is plain common sense; and no one in his senses will question its truth unless he is being disingenuous. It is quite true, as a number of economists have urged, that there is no way of measuring exactly *how much* more satisfaction an extra shilling gives to one person than to another, and also that different persons in the same economic position do not necessarily enjoy the same, or equal, satisfactions. Satisfaction is a psychological state, is affected by many non-economic considerations, and does not admit of exact measurement. But it is nonsense to suggest that, because we cannot measure satisfactions, we have no right to say that an extra shilling will tend to give more satisfaction to a poor man than to a rich man who is already in a position to buy all the satisfactions he is capable of enjoying. We can no doubt imagine exceptional cases—the extravagant joy which a mad miser might experience in getting possession of the last shilling in the world, or the cynical flinging of a shilling into a ditch by a man so desperately poor as to think it useless. But it is not suggested that on every occasion every poor man will get more satisfaction out of his extra shilling than any rich man can ever get. The contention is merely that in general we can act safely on the assumption that, the larger incomes people have already, the less satisfaction they will be likely to derive from each shilling or pound added to their incomes.

The argument from social justice and the principle of the 'greatest happiness of the greatest number' thus leads straight to the common-sense practical conclusion that the less economic inequality we have to tolerate in order to maintain total production at a satisfactory level, the better off we shall be. The argument leading to this conclusion is, however, quite distinct from the argument that, unless we achieve a nearer approach to equality than has been achieved in the capitalist societies of to-day, we shall find production upset by recurrent crises of under-consumption, and shall thus in

fact lose the benefit of the higher output which economic inequality is supposed to promote.

This 'under-consumption' argument takes two forms, one of which we have examined already. Stress may be laid, as it has been by Keynes, on the phenomenon of 'under-investment', or, as it has been by Hobson, directly on 'under-consumption' of consumers' goods. The two views appear at first sight to be sharply opposed; but, when they are examined, we find that they have much in common. For why does 'under-investment' occur? Clearly, because business men take an unfavourable view of the prospects of the profit to be derived from expanding output. Why do they take such a view? Clearly, because they doubt their ability to find buyers for the additional output at a remunerative price. In other words, they doubt whether consumers will be able or willing to consume as much as the productive system can put itself in a position to produce. The sole ultimate purpose of capital goods is to make consumers' goods or services, and the sole limiting factor, within the available supply of factors of production and of capital for buying them, to the demand for capital goods is the size of the market for the consumers' goods which, directly or indirectly, the capital goods can be used to produce. In other words, if business men fail to take up and spend on new capital investment as much money as would-be savers are ready to place at their disposal, the reason is that they fear the limitations of the market for consumers' goods.

'Under-investment' thus depends on 'under-consumption', or rather on the expectation of it in the minds of business men. On what, then, does 'under-consumption' itself, in the narrower sense of a deficient market for consumers' goods and services, depend? Hobson argued that it depended, not on any endemic tendency to a deficiency of total purchasing power, but on the maldistribution of incomes, which led to an attempt, over the community as a whole, to save an excessive proportion of total income. The consequence of this relative 'over-saving', he argued, was that the income applied to the purchase of consumers' goods and services tended to be too little to afford openings for the remunerative investment of all the money which the community, mainly through its richer members, was attempting to save. The investment of all this money in new productive instruments would be bound to lead to a glut of consumers' goods, with the result that many of the less efficient businesses would be driven into bankruptcy, and a

spreading crisis would develop, as the bankruptcy of some concerns led to the bankruptcy of others to which they owed money, and so on in a widening circle of chaos and unemployment.

Lord Keynes does not appear to question the fundamental part of this argument, although he states the position differently. He stresses, as we have seen, the point that a substantial part of the 'savings' which people are trying to make will not get *invested* at all in new instruments of production, and will therefore be wiped out by business losses which will necessarily arise from the withholding of a part of current income from spending either on currently produced capital goods or on consumers' goods and services. Clearly, in fact, either or both of these situations may arise. There may be either, as Hobson suggests, a glut of productive instruments in relation to the state of consumers' demand (what business men call 'redundant capacity') or a failure to invest in new capital goods, resulting in losses spread over the entire business world and in serious unemployment spreading from the capital goods industries to those producing consumers' goods.

Hobson's argument appeared to point to the conclusion that the appropriate remedy for economic depression was to be found in a better distribution of incomes, leading to the expenditure of a higher proportion of the national income on consumers' goods and services, and to a fall in the rate of saving. Lord Keynes suggested at first sight that the remedy lay rather in taking measures to expand the demand for capital goods, both by appropriate monetary measures and by the intervention of the State to increase the community's capital equipment by undertaking extended Public Works of its own, either directly or through local authorities or Public Corporations acting under State influence and control. Lord Keynes, however, also lays stress on the effect of 'full employment' in maintaining consumption, and on the effect of low interest rates in stimulating the 'propensity to consume', and opposes the notion that economic activity can be stimulated by reducing money wages.

If, as Hobson's argument suggests, the capitalist system tends, on account of the maldistribution of incomes, to 'over-saving', or, as Lord Keynes would prefer to call it, 'attempted over-saving', it seems at first sight more appropriate to adopt measures which will directly expand consumption at the expense of saving than to resort to artificial stimuli to investment in capital goods with the object of ensuring the investment of all the money people try to

save. Yet many persons are reluctant to accept this conclusion because they are unwilling to endorse the view that the community can be attempting to save too much. Thrift has been cried up so much as a virtue that any argument which throws doubt on it meets strong psychological resistances. Moreover, it seems to be plain common sense that the more capital a community can accumulate the richer it will be in a position to make its citizens. After all, the vast majority of people have still grossly inadequate incomes; and it seems evident that there *ought to be* no difficulty in disposing usefully of any increased output made possible by increased investment, no matter how large this investment may be.

Yet it is also plainly true that investment cannot be remunerative unless there is a sufficient expansion of consumers' demand to absorb the additional output as it comes on to the market. The community can, by abstaining from consumption to-day, and investing instead, make itself richer for to-morrow; but it can do this only on condition that, when to-morrow comes, it does consume the additional goods which the investment of yesterday has placed at its command. If it fails to do this, the investment is stultified. A community cannot go on indefinitely storing up jam for to-morrow: it must some time take its jam to-day.

The problem, however, is not in reality so simple as this makes it sound. Investments of different kinds take very different periods to mature. Investment in tree-planting, for example, takes a very long time to yield any consumable product. The building of a railway through potentially productive but largely uninhabited country will be remunerative only after there has been time for the new lands to be settled and opened up. The Soviet planners, in the early years of Soviet development, built power-stations of a size and capacity which they could hope to exploit fully only after they had gone a long way in expanding the industries which these stations were to serve. Investments of these types involve abstention from current consumption over long periods. On the other hand, a house can be lived in as soon as it is built; and machines for manufacturing consumers' goods can begin producing as soon as they are installed. Such investments also involve abstention from current consumption, because they take away man-power which could be used for making consumers' goods which could be more speedily available. But the period of deferment is much shorter. In any case, delivery of the goods must

be taken when they are ready, or the investment will be wasted; but delivery may come soon or late.

Does this mean that there are limits to the extent to which a community can abstain from consumption in the expectation of securing thereby an expanded supply of consumers' goods in the future? Yes, it does, where the community is self-contained. But wherever there exists a possibility of capital export on an unlimited scale, abstention from current consumption in the expectation of future benefit can be pushed very much further than it can in an economy which lives by itself, or conducts its foreign trade only on a basis of mutual exchange. If the possessors of investable capital are able to invest it abroad, and can find markets both for their capital and for the goods which will be produced abroad with its aid, they can go on investing as high a proportion as they please of their incomes, without being pulled up short by the necessity of finding in their own country consumers for the products of their capital goods.

It was, of course, this process of foreign investment that, through most of the nineteenth century, provided an outlet for all the capital British property-owners chose to save beyond what was needed for the expansion of industry to meet the demands of the home consumers. This overseas investment provided a large fraction of the employment in the industries producing capital goods, and also accounted for some of the employment in the industries producing consumers' goods; for a part of the exported capital went out in consumers' goods bought, directly or indirectly, out of the wages and other incomes paid to those engaged on overseas capital works financed with British money. No doubt, the interest and dividends on these accumulating investments were due to the British owners; but in the main the sums received in these forms were re-invested abroad, so that no net supply of consumers' goods came into Great Britain in payment for them. As long as these conditions lasted, there was no limit to the amount of saving and investment that the British economic system could engage in without any necessity of raising its standards of consumption so as to purchase the products of its investments as they were put on the market. No doubt, standards of consumption did rise in Great Britain; but this happened because of technical advances in the arts of production all over the world, and did not involve any need for home consumption to be specially expanded to meet the increasing product due to overseas investment.

In these circumstances, it is not surprising that nineteenth-century economists continued to find in thrifty saving the first of economic virtues and the key to progress, long after the period of home scarcity of capital, which characterized the earlier stages of the Industrial Revolution, was over and done with. Our grandfathers and great-grandfathers had in their minds no doubt that the man who set aside from expenditure on current consumption, and thus saved, a part of his income was a benefactor to society, or that the accumulation of capital by this method on the largest possible scale was the right way of ensuring higher standards of living for the future. It was obviously true that the individual who saved was usually able to pass on the benefit to his children; and it seemed natural to conclude that what was true of the individual must hold good for society as a whole—for what was society, except the aggregate of all the individuals who made it up? The classical economists took it for granted that under normal conditions all the sums set aside by individuals would find their way into investment in real productive assets—unless indeed they were frittered away by the State in war—and they further assumed that this process of investment would render improved technical methods of production continually practicable, and would thus lead to a continual cheapening of production and to a progressive advance in national wealth. Only their heterodox critics questioned these assumptions, laying stress on the phenomenon of 'over-production' or 'under-consumption'—which side they stressed depending on the aspect from which the occurrence of economic crises was regarded. The main current of classical economic theory swept past such criticisms, and regarded crises as abnormal occurrences, on which no general theory of economic processes could be based. After all, on the whole, societies did get wealthier, and there was no sign of the advent of that 'increasing misery' which the critics of capitalism had predicted. Standards of living did rise, with only brief interruptions, through the greater part of the nineteenth century: orthodox believers in the theory of the Wages Fund saw in the growth of capital the means of employing more labour, and, when that theory was discarded in favour of 'Productivity' theories, the highest possible rate of saving still seemed to offer, by cheapening production through more intensive applications of capital, the best assurance of rapid economic advance.

This attitude was widely acceptable because, as we have seen, the nineteenth century's appetite for additional supplies of capital

seemed insatiable. Over the century as a whole, the process of capital accumulation, interrupted though it was by recurrent crises and depressions, went on at a prodigious rate in comparison with anything the world had known before. A large part of this accumulation took the shape of investment in home industries; but a considerable, and an increasing, share went into the development of areas overseas. Investment beyond the seas formed, indeed, an important means of maintaining the demand for the products of the industries making capital goods whenever home demand for a particular kind of product fell off. For example, when the work of building the network of the British railways had been mainly done, and the demand for renewals diminished because steel was more durable than iron, the construction of railways first in the more populous foreign countries and then all over the world provided alternative employment for the resources of the great firms of railway engineers and contractors; and later in the century firms which had begun by building bridges, waterworks, gasworks, and other public utility installations in Great Britain found new outlets for their enterprise in the undertaking of similar works of construction in foreign parts—including, of course, the countries of the British Empire. Overseas investment, as the concomitant of the export of British-made capital goods and British engineering skill, more and more took precedence in the London capital market over investment in home industries, which financed themselves to a growing extent out of their own profit reserves.

We have seen that this export of British capital stimulated the demand for exports, not only of capital goods, but of consumers' goods as well. Loans made by British investors were used not only to pay for the still for the most part unrivalled products of the British steel and engineering industries, but also to pay wages and meet other charges in the borrowing countries, with the consequence that the recipients spent a substantial part of them on British textiles and other British-made consumers' goods. British investors supplied a good deal of the working as well as the fixed capital for overseas economic development; and as long as these conditions continued, the export of British capital and the export of British manufactures advanced by parallel steps. Only as other countries developed their own competing manufactures of both consumers' goods and capital goods did it cease to be true that loans of British capital overseas carried with them a practical assurance of orders for British

exports, and that foreign purchasers bought British goods not merely in exchange for their own products sold in the British market, but with British money lent to them without any formal restriction on their right to spend it where they pleased.

TABLE IV

British Overseas Investments at Long Term, 1870–1913

(Figures from Feis: *Europe, the World's Banker*)

	Annual Average £ millions		*Total Income from Foreign Investments £ millions*
1870–74	61		
1875–79	2		
1880–84	24	1883	50
1885–89	61		
1890–94	46	1891	100
1894–99	27		
1900–04	21	1903	115
1904–09	110	1907	140
1910–13	185	1913	205–210

These figures are only rough estimates.

TABLE V

Geographical Distribution of British Overseas Long-term Investment in 1913

Empire	*£ millions*	*Foreign*	*£ millions*
Canada and Newfoundland	515	U.S.A.	755
Australia and New Zealand	416	Argentina	320
South Africa	370	Brazil	148
India and Ceylon	379	Mexico	99
West Africa	37	Rest of Latin America	190
Malaya	27	Russia	110
Rest of Empire	35	Rest of Europe	109
		Japan	63
		China	44
		Egypt	45
		Turkey	24
		Rest of Foreign World	78
	1,780		1,985

Grand Total, £3,765 millions; yielding an income of from £205 to £210 millions.

This process of high capital export from Great Britain lasted right up to 1914. The First World War cost the country a substantial fraction of its overseas investments, many of which had to be sold to meet the bill for war imports. Export trade inevitably declined under war conditions; and though, when the war was over, the process of capital investment overseas was to some extent resumed, the scale was much smaller than before 1914. Nor was there the same assurance as there had been earlier that loans of money arranged in London for foreign borrowers would be spent on British-produced goods and services, and would thus give direct employment to British industries. As against this, there were at most times considerable funds belonging to foreigners left on deposit in Great Britain, and the presence of these funds, equivalent to temporary loans of capital to Great Britain, prevented the overseas loans granted in London from exerting as much pressure on the foreign exchanges as would otherwise have occurred. But making long-term loans on the strength of short-term borrowings or deposits is a precarious business; and the vulnerability of the post-1918 British system appeared in the crisis of 1931, when a flight of short-term money (both British- and foreign-owned) out of the country brought on an exchange crisis, and led to the abandonment of the gold standard and to a sharp fall in the external value of the pound sterling.

After the crisis of 1931, Great Britain was no longer a considerable exporter of capital. As long as the world depression lasted, there was little temptation to investors to risk their money in foreign ventures; and even in the period of recovery in the middle 'thirties overseas loans were on a small scale and Great Britain, instead of having a substantial balance available for investment abroad, was actually re-importing capital as old overseas loans were paid off and not replaced. All the available supply of foreign exchange was needed to pay for British imports, despite the curtailment of manufactured imports by the tariff adopted in 1931-32, and the fall in the prices of primary produce in terms of manufactured goods. Great Britain was getting imports on very favourable terms from the rest of the world; for the prices of British exports had fallen considerably less than those of British imports. But in spite of this, net overseas investment had disappeared, not through any lack of British manufacturing capacity, but because orders had fallen off.

It is difficult, in this development, to disentangle cause and effect. The fall in exports was neither the cause nor the consequence of

the decline in overseas investment. It *was* that decline, expressed in real terms. If foreign buyers had wanted to buy more British goods, their willingness to buy would have created the export of capital needed to finance the purchases; for it would not have been difficult to provide the finance for firm export orders if they had been forthcoming. No net addition to the supply of foreign exchange would have been needed; for the goods exported would themselves have provided the requisite finance. At the same time, the lack of a 'favourable' exchange balance made it more difficult to push exports by providing ahead the finance needed for buying them; and the Bank of England, acting in consultation with the Treasury, was compelled, in order to protect the value of sterling on the world market, to exercise a *de facto* embargo on foreign loans, except a limited number which were approved for special reasons. Overseas markets ceased to provide a large outlet for the products of the British industries producing capital goods; and, because of this, the point was much sooner reached in a depression when the total volume of investment fell below the sums which the recipients of incomes were attempting to save, and the gap between attempted 'savings' and real investment appeared.

The question then was whether the sums no longer embarked in investment overseas ought to be diverted to some form of home investment, or whether money savings ought to be curtailed in order to adjust their amount to the diminished investment demand. The former of these policies involved the finding of forms of real investment additional to those which would be embarked upon spontaneously by business men in search of the highest attainable profits. The advantage of 'Public Works', as an outlet for funds available for investment, was that, to a great extent, such works could be so arranged as to be non-competitive with privately owned industry, and indeed so as to provide employment for capitalist enterprise in the constructional trades. The State and the local authorities could carry out, as Public Works, projects of capital construction on which private enterprise would never have embarked, and could use on these works the services of private firms of contractors. The capital goods thus produced could be such as to enter little, or not at all, into competition with private industry in the markets to which it looked for its outlets, and could in some cases be of positive benefit to private enterprise by opening up new fields of investment and taking part of the cost of construction off the shoulders of the private entrepreneurs.

For example, when the State or the local authorities built roads, they made it cheaper and easier for private speculators to construct housing estates. Indeed, the effect of public road-building was to encourage that form of ribbon-development which was so marked a feature of speculative building enterprise between the wars. The social disadvantages were serious; but the economic inducement to the speculative builder was a plain fact. Again, the State, by promoting the construction under a Public Corporation of the electricity 'Grid', gave a very welcome stimulus to the industries producing all kinds of electrical equipment; while public housing increased the demand for builders' materials, furniture, and other sorts of supplies.

The Treasury did, no doubt, take up at first an extraordinarily obscurantist attitude towards 'public works policy', when it argued, in the notorious Treasury Memorandum of 1929, that any form of public investment was bound to be offset by an equal fall in the volume of private investment. This was the merest nonsense, directed against Labour and Liberal plans for extensive Public Works designed to combat unemployment. Such works as I have instanced—and it would be easy to instance many more—so far from reducing the amount of private investment, were bound to have precisely the opposite effect.

It is, however, true that there are kinds of Public Works which, even if they react favourably on some kinds of private investment, are unfavourable to other kinds. As long as the State confines its housebuilding activity to types of houses in which the private speculator sees no prospect of a satisfactory profit, no considerable opposition to State provision of houses is likely to arise; but as soon as it begins to build houses of types which the private speculator thinks he may want to provide himself, the contest begins. To the actual builders, it makes no difference whether the houses are publicly or privately built, unless indeed the builder is also a speculator in house-ownership; for the State and the local authorities will in the great majority of cases use private building contractors to carry out the work. But it does matter to the speculative financial agencies which depend on the development of private housing estates, as well as to the Building Societies and Insurance Companies which supply the capital for speculative building operations. Thus, in connection with post-war housing projects, these agencies are eager to confine public building to a narrow sphere—the erection of cheap working-class houses for letting by the week—and to keep

in their own hands the main field of estate development, including the provision of all houses above a quite low rent or rateable value.

I have cited this example as illustrating very clearly the desire of advocates of 'private enterprise', while not opposing all Public Works, to limit the range of State intervention in the field of capital construction to projects which will in no way compete with their own activities. It must be obvious that, if the State's field of action is thus limited, it will be very difficult for the State to find suitable projects for any really large development of 'public works policy', and that there will be a danger of the State being forced, in its endeavours to increase employment, into undertaking projects not because they are the most useful or productive among those available, but rather because they are likely to arouse the least opposition. If this is allowed to happen, the effect must be to throw discredit on 'public works policy', which will doubtless fulfil its immediate object of providing additional employment, but will fail to give the public fair value for the sums expended.

The wider the range over which the State is free to select projects for the execution of Public Works, the more satisfactory the results are likely to be, from the standpoint of improving the capital equipment of the community. Recognizing this to some extent, the upholders of private, as against public, enterprise fall back on urging that the State, wherever it desires to step across the frontier-line into the sphere which the private capitalists regard as their own, should proceed by way of subsidy rather than by direct undertaking of Public Works, i.e. it should pay private enterprise part of the cost of the job, and thus leave the finished product under private instead of public ownership. Again housing furnishes an obvious example. The Chamberlain Housing Act of 1923 offered a subsidy to anyone who undertook the building of a house, whereas the Wheatley Housing Act of 1924 confined its assistance to the local authorities, which became the owners of the houses built under its provisions.

The great difficulty about subsidies to private industry is that it is nearly impossible to pay them only to those who need them. If they are limited to stimulating investment which would not take place without them, the effect is to make unprofitable forms of enterprise more profitable than forms of enterprise which would be sufficiently profitable if no subsidy were given. This leads to allegations of unfair competition, the subsidization of the inefficient, high-cost producer to the detriment of the efficient producer, and

the disturbance of normal price-relations. Accordingly, the better-placed or more efficient producers demand to be subsidized equally with the less well placed or less efficient; and the State is usually forced to give way, and to make its subsidies available to all on equal terms. This renders a policy of subsidy exceedingly expensive, and presents large windfall profits to the better-placed producers. In effect, a large part of the money paid out by the State goes, not in stimulating additional investment and employment, but in wholly unproductive gifts to persons who do not need them.

The conclusion is that, if the State is to operate any extensive 'public works policy' with economy and efficiency, there must be at its command a wide range of projects of investment on which it can embark in such a way that the benefit accrues directly to the public. This condition can be satisfied only if the State has under its control a fairly wide range of industries which are large users of capital goods. Housing is one obvious example, and, of course, civil engineering in relation to roads, bridges, waterworks, aerodromes, and other essential public utilities is another. But, over and above these, the effective working of a large-scale 'public works policy' would be greatly helped if the whole of the electricity supply services and the essential transport services by rail, road, water, and air were brought under the control of Public Corporations on the lines of the existing Central Electricity Board.[1]

It seems probable that, for some time after the war, it will be desirable to maintain a high rate of new capital construction in order to re-build our damaged and obsolete urban areas and to bring about a thorough renovation and re-adjustment of British industries in the light of changing needs and world market conditions. When this period of reconstruction is over, we may find that we can do best with a much lower rate of capital accumulation than we have been used to in the past. Whether this will be the case or not will depend largely on what happens in the rest of the world. If there is to be a rapid and continuous industrialization of backward countries in Eastern Europe, Asia and Africa—including, of course, the colonies now attached to the various Empires—there will go with this development an active demand not merely for capital goods but for loans to enable the backward countries to buy them without depressing the current living standards of their own peoples. The Soviet Union had, in the main, to carry through its extra-

[1] The questions raised in this and the preceding paragraphs are dealt with much more fully in my recent book, *The Means to Full Employment.*

ordinary achievements in industrialization without aid from foreign capital, and had therefore to divert a large part of its resources away from the making of consumers' goods to works of capital construction. This meant, while it was going on, a terribly low standard of living for the Soviet peoples; and it was possible, on the scale on which it was done, only because the Soviet Union was lightly populated. To achieve the industrialization of Eastern Europe, India and China, with their crowded peasant populations, by similar methods would involve immense transitional sufferings, however much standards of living might be improved in the long run. Accordingly, these countries should, as far as possible, be helped to industrialize themselves by loans of foreign capital; and it is obviously desirable for Great Britain to play its part in the making of these loans.

Great Britain, however, cannot do this unless it can find means, apart from the goods exported by way of loans, of exporting enough to meet the cost of necessary imports of foodstuffs and materials—including the imported materials which will enter into the value of the goods exported on loan. This is a formidable task; for considerable exports of capital goods as well as consumers' goods from Great Britain will be needed to balance the necessary imports. It will not be possible at all unless British industry can be raised to a very high level of efficiency, and kept continuously in a condition of Full Employment. British exports of capital goods, as well as of consumers' goods, will have to hold their own in a highly competitive world market; and the backward countries will be able to afford neither high prices for the goods supplied to them, nor high rates of interest on the loans made available for financing their purchases. These conditions will call for an extensive overhauling of British industrial equipment, in order to bring it thoroughly up to date, and also for continual ingenuity in striking out on new lines of production, both to replace exports which the less advanced countries take to making for themselves and to keep British production abreast of changing demands in home and foreign markets alike. Moreover, if this process of world development sets in, the effect will be to keep the demand for capital investment high long after the period of immediate post-war reconstruction in this country has come to an end.[1]

[1] For a fuller discussion of the economic tasks facing Great Britain after the war, see my *Great Britain in the Post-War World* (Gollancz, 1942). The problem is also further discussed in Chapter XV of this book.

There may, in effect, be a large-scale resumption of the processes of overseas investment which characterized economic development during the nineteenth century. Great Britain's share in this is bound to be much smaller than in the past; but it may nevertheless play an important part in determining the structure of British industry and the level of saving and investment appropriate to the new conditions. What is clear is that, unless large-scale foreign investment revives, an increasingly important element in the investment of capital in Great Britain will be in what are called 'tertiary industries' and in the development of not directly economic services. The tendency for new investment to shift into these fields from manufacturing industry was already marked in the period between the wars; and it meant that a growing proportion of total new investment was undertaken, either by public bodies directly, or by agencies acting under State influence and subject in some degree to State control. Housing and roads absorbed between them a very high proportion of the total of new capital invested; and other major enterprises, such as the construction of the 'Grid' and the development of the London passenger transport system, were carried out under Acts of Parliament establishing Public Corporations for the purpose.

If, as seems probable, overseas investment after the war proceeds, not as it did in the past in a quite unplanned fashion, under the direction of the profit-expectations of individual entrepreneurs, but to a considerable extent in accordance with planned arrangements entered into by the Governments of the borrowing and lending countries—a method of which the Colonial Development Act may be regarded as a forerunner—State influence over investment policy will evidently be extended further still, and the determination of the socially desirable rate of capital accumulation will come to be in the main a matter for the Government and for the economic agencies acting under its auspices. Should extensive overseas investment not develop again, it seems evident that the *optimum* rate of capital accumulation in Great Britain is likely, after the period of reconstruction is over, to be considerably lower than it has been in the past, and that it will be possible to devote a larger proportion of the total productive resources to the satisfaction of current consumers' needs. This does not necessarily mean a decline in the activity of the industries producing capital goods; for such goods may be the most acceptable British exports to send out in exchange for necessary imports. The export of capital and the

export of capital goods do not coincide, though obviously export of capital does stimulate demand for exports of capital goods. A decline in the industries producing capital goods is to be expected only if exports as a whole decline—with the necessary correlative of a decline in imports. This might happen if the post-war world, instead of working out concerted arrangements both for the exchange of goods and for the development of the backward countries, were to fall back into conditions of economic nationalism. Such a possibility, disastrous as it would be for Great Britain, cannot be ruled out. It might come about as the accompaniment of political nationalism or as a consequence of the breakdown of international arrangements for the regulation of foreign trade and the monetary exchanges. To these vitally important problems I shall return in a later chapter: at present I wish only to emphasize the extreme uncertainty in which we must remain about the future level of investment in relation to current consumption until we can form a reasonably clear notion of the course which post-war international commercial and monetary policy are likely to follow.

The general conclusion to be derived from what has been said in this chapter is that the right balance between investment and consumption depends on circumstances and varies from time to time. As the purpose of all capital accumulation, or rather the only legitimate purpose of such accumulation, is to promote an increased flow of consumers' goods and services, it follows that accumulation now implies a decision to expand consumption later, when the increased supply of goods becomes available. In any one country, the increased consumption can be postponed if capital is being lent to other countries for development; but it remains true for the world as a whole that consumption must be allowed to increase *somewhere*, if the investment is not to be stultified.

It also seems clear that the rate at which private individuals decide to save out of their incomes is, as matters have stood hitherto, almost wholly unco-ordinated with the rate at which investment in new capital goods is carried on. The older economists believed that these two things would be brought into balance by the fluctuation of interest rates. But, as Lord Keynes has shown, this is clearly not the case. Financiers of industrial development in most fields are but little influenced by interest rates in determining how much real investment to undertake; and rates of interest are subject to many other influences besides those which arise in the higgling of

the capital market. The rate of investment is in effect determined by business men and by Governments, as far as the latter intervene with demands for capital, quite apart from the rate of attempted saving; and there seems to be no good reason why the rate of attempted saving should be allowed in future to settle the rate of investment rather than the other way round. Indeed, the sensible course is surely that of beginning with a programme of investment determined in the light of the prevailing need for capital extensions, and then adapting the rate of saving to this programme by less painful means than have been practised hitherto. It is a very strange way of bringing about what Lord Keynes has termed the necessary equality between 'savings' and 'investment', to allow the balance to be restored, whenever investment falls below attempted savings, by inflicting losses on the entire community at the risk of provoking a further dangerous recession in economic activity. And it is hardly less strange to insist that the right remedy is always that of raising investment to the level of attempted savings, without asking whether the community would be better served by saving less and consuming more. In the near future, this may not be a practically important point, on account of the high level of new capital expenditure that will be needed for reconstruction both at home and abroad. Later on, it may come to be of the utmost importance for the welfare of the people.

In the Soviet Union, of course, investment policy already governs the rate of attempted saving. Private savings out of income, though they exist, make only a small contribution to the total accumulation of capital, and are entirely without influence in determining its amount. The Five Years' Plan for the time in force settles how much of the national productive power is to go into the making of capital goods and consumers' goods respectively, how much into production for export, and how imports are to be distributed between capital goods and consumers' goods. These are the operative decisions which settle the amount of investment; and the provision of the necessary finance is then done, through the national budget and the banking system, as a purely derivative matter. Such a system is not fully possible where private enterprise occupies the greater part of the field of production; but an approach to it is possible, by the regulation of investment through some such body as a National Investment Board and through the management of credit supplies through a Central Bank operating in accordance with general economic and financial policies laid down for it by

the State. Such a system would still leave the rate of attempted saving unregulated; but we have seen already the ways open to the State, by effecting a re-distribution of incomes, of operating directly on the rate of saving so as to bring it into some sort of conformity with national needs.

IX

THE FINANCIAL SYSTEM AND ITS WORKING

THE British banking system, as it exists to-day, is based mainly on two sets of institutions—the *Central System*, consisting of the Bank of England and the Government Exchange Equalization Fund, and the *Commercial System*, to which belong the joint stock banks which are the chief receivers of private deposits and makers of business advances. Subsidiary to these two sets of institutions are the specialized financial houses of the City—the 'merchant bankers', as they are sometimes called, the discount houses, and the bill-brokers. 'Issuing Houses', dealing in long-term capital issues, overlap largely with the merchant bankers, but include a number of other concerns as well. In addition, there are the numerous foreign and imperial banks which have offices in London, and the British banks and banking subsidiaries operating overseas. For certain purposes, it is very necessary to take account also of the great Insurance Companies and of the various types of Investment Trusts and Finance Companies; and of late the Building Societies have also risen to a position of importance as depositories of very large capital funds. Nor can we ignore the Stock Exchange, in which in practice dealings take place in new as well as in 'second-hand' stocks and shares. Finally, we must add the Trustee Savings Banks and the Post Office Savings Bank and—a more recent recruit of substance—the National Savings Committee.

These institutions together make up a highly complex financial system. Regulation of the currency and of the volume of short-term credit available is shared between the Bank of England and the Exchange Equalization Fund, which the Treasury controls. Short-term financing of home industry and the banking business of firms and private persons of the upper and middle classes are mainly in the hands of the joint stock commercial banks, though the merchant bankers also come in to a limited extent. The financing of foreign trade is a matter for combined action by commercial banks, discount and acceptance houses, and bill-brokers, with the Bank of England coming in as a 'lender of last resort', and what is in effect a special Government bank—the Export Credits Guarantee Department. Short-term lending to the Government involves a wide range of bodies—the Bank of England, the commercial banks,

the discount houses and bill-brokers, and the London offices of the foreign and imperial banks. Longer-term financing of industry is a matter for Issuing Houses, Investment Trusts and Finance Corporations, the Stock Exchange (under the special arrangements for 'introduction' of new shares), Insurance Companies, and the special subsidiaries created by the Bank of England and the commercial banks for this purpose. There are in addition special agencies for middle-term finance, such as the United Kingdom Commercial Corporation in the realm of foreign trade and the Agricultural Mortgage Corporation. Small savings are catered for by the Trustee Savings Banks, the Post Office Savings Bank, and the National Savings Committee, and also by the Building Societies, the Co-operative Societies, and, of course, the Insurance Companies. The Investment Trusts, including the Fixed Trusts, enable the small investor to spread his risks over a number of investments of different kinds; and municipalities also offer facilities for the investment of savings in housing bonds and other local securities. Friendly Societies, as well as Insurance Companies, offer facilities for the accumulation of small savings by way of insurance; and there are numerous Pension Funds run by business firms for their employees, while some businesses still accept loan capital from their employees.

Among these financial agencies, existing for a wide variety of purposes, the key positions are held by the Bank of England, the Exchange Equalization Fund, and the commercial banks. The Bank of England holds, as the Central Bank, the pivotal position. It is at once the Government's bank, the commercial banks' bank, and the 'lender of last resort' to the other institutions which go to make up the money market for short-term funds. As the Government's bank, it both holds deposits of Government funds and is available to make short loans to the Government when they are called for. The Government does not in fact, under normal conditions, borrow much directly from the Bank. It meets its need for short-term funds mainly by the issue of Treasury Bills,[1] either to the public or by way of borrowing funds in the possession of particular departments of State. The Bank of England, however, is there to make 'ways and means advances' to the Government when they are needed. Formerly, such advances were frowned upon by the orthodox, who regarded them as having an inflationary effect. The drawing of cheques directly on the Bank by the

[1] Or, during the war, Treasury Deposit Receipts against advances made by the commercial banks. See pp. 183-4.

Government does, no doubt, serve to swell the 'cash' balances of the commercial banks at the Bank of England, and does in this way enlarge the basis of credit; whereas the issue of Treasury Bills to the public takes funds off the market. Modern opinion, however, will hardly condemn a practice merely because it enlarges the basis of credit, without inquiring whether the enlargement is needed or not. Borrowing by the Government from the Bank of England is no different in its effects on credit from open market purchases of securities by the Bank itself. Clearly the Government, if it borrows directly from the Bank, has to take account of the effects which its borrowing will have on the volume of bank credit; and the Bank, if such borrowing has occurred, will have to take account of it in determining its own open market policy. But there is no inherent wrongness in Government borrowing from the Bank of England, unless *all* measures by either the Government or the Central Bank to enlarge the basis of credit are to be condemned out of hand.

As the bankers' bank, the Bank of England holds the reserve deposits of the commercial banks, and transfers deposits from one bank to another in accordance with the results of the clearing of cheques between them. The Bank of England, unlike the Federal Reserve Banks in the United States, does not lend money to the commercial banks, which always keep credit balances in its hands. It can, however, as we have seen, affect the size of these balances by means of open market operations, and can thus determine the size of the 'cash' basis on which the commercial banks hold themselves free to erect a credit superstructure. By tradition, the joint stock commercial deposit banks have no share in the government of the Bank of England, and are not, as the merchant bankers of the City are, represented on its Court of Directors. Discussions on policy, of course, take place between the Bank of England and the commercial banks; but there is no interlocking of direction between them. It is part of the traditional principles of the English banking system that the Bank of England and the commercial banks shall stand apart, and that Central Banking policy shall not be subject to any formal influence from the commercial banks. This traditional principle is derived from the idea that the Central Bank is the guardian of the national money against inflation, to which commercial bankers were formerly supposed to be prone, because they have an interest in swelling the amount of their profit-earning assets. This was probably true in the early days of the nineteenth century; but it has hardly been true for a long time past. The commercial

banks can usually earn without difficulty quite enough profit to pay high stabilized dividends to their shareholders without embarking on any venturesome policies; and beyond such dividends they have, in modern times, no desire to go. The commercial banks are, in effect, not run nowadays for the purpose of making the largest possible profits, but rather in accordance with the notions of sound finance which those in charge of them entertain. The separation between them and the Bank of England nevertheless continues; and there is something to be said for it as based on a distinction of functions, even if the original reasons for it have largely disappeared.

As a 'lender of last resort', the Bank of England is available to re-discount bills of approved quality whenever the commercial banks suddenly withdraw funds from the discount market and thus leave the agencies which normally carry bills on borrowed money in need of alternative accommodation. As the Bank wishes to reserve itself as a 'lender of last resort', it does not normally seek bill-discounting or similar business; and the rate which it charges for re-discounting bills is usually above the market rate. Accordingly, any substantial holding of bills by the Bank of England is a sign of money market stringency; and when the regular bill-discounters are driven to the Bank for accommodation they often incur losses, by having to put up with a discount higher than they exacted when they bought the bills in question. Such losses are part of their ordinary risks; and the discount rates ordinarily charged take account of them. They are the price paid for an assurance that, even if the commercial banks restrict the supply of short-term credit on the money market, default will not follow; and of course their effect is to force up the rates of discount on new bills until the stringency disappears.

The Bank of England is thus the pivot on which the entire British banking system turns. In addition to these normal and regular functions as Government's bank, bankers' bank, and 'lender of last resort' to the money market, it has assumed in recent years certain special functions in relation to the market for long-term capital. Between the wars, there all too often arose the need for financial reconstruction of large enterprises or of whole industries which had got into difficulties. In many cases, there had been highly unwise flotations of loan capital at high rates of interest during the short-lived boom after the last war, and in many others (or indeed often in the same) there had been excessive borrowing of short-term advances from the commercial banks to replace or

supplement working capital. It often occurred that, in the course of speculative re-flotations of businesses, the new companies took over only the physical plant of the old concerns, the working capital needed to finance the turnover of goods being retained by the vendors, so that the new companies, having paid a high price for the plant, found themselves without working capital for carrying on business and had to resort to excessive borrowing from the banks. When the slump came, they were unable to repay these loans, and were in many cases under the necessity of borrowing yet more in order to remain in operation. The commercial banks, fearful of losing what they had already advanced and of starting a widening circle of bankruptcies if their debtors were forced out of business, often continued to lend, but tried to safeguard their own position by registering debentures against the firms to cover their previous loans. This meant that they ranked as prior creditors, with a first claim on the entire assets in the event of default; and the existence of such debenture claims made it impracticable for the businesses thus charged to raise fresh capital on the capital market. Anyone supplying fresh capital knew that his claims would rank after those of the debenture-holders; and no one was willing to lend money or invest in share-capital on such unfavourable terms.

This was where the Bank of England, acting usually in conjunction with the commercial banks concerned, had often to step in with an attempt to straighten matters out. Arrangements were made whereby the share-capital of firms thus affected was drastically scaled down—the shareholders thus accepting the loss of a good deal of their money.[1] At the same time the commercial banks agreed to modify their claims, so as to facilitate the financial reconstruction of the firms affected. This resulted in the banks becoming considerable owners of industrial share-capital as well as of bonds and debentures; and the commercial banks formed a special body—the Bankers' Industrial Development Company—to assist with the provision of new capital for reconstructed enterprises. Side by side with this, the Bank of England created the Securities Management Trust, as a subsidiary of its own, to co-operate in the provision

[1] Sometimes this was really a paper loss; for many bonus shares had been issued to shareholders during the boom, and sometimes the writing down meant only bringing down an inflated total of share capital to something like the sum actually invested by the shareholders. But, of course, where investors had bought the shares at inflated prices, the loss was real to them, even if their holdings had never represented equivalent real investment in capital goods.

of new capital on similar lines; and, both through this body and directly, the Bank of England began to play a substantial part in the supply of long-term capital for businesses and industries clearly in need of reconstruction in order either to set their financial houses in order or to carry through schemes of development and rationalization.

Among the bodies helped in this way were the Lancashire Cotton Corporation, formed with the purpose of buying up spinning-firms and either scrapping or reconstructing them; Shipbuilders' Security Ltd., the shipbuilders' combine formed, all too successfully, with the object of buying up and dismantling 'redundant' shipyards; Richard Thomas and Co., the great steel and tinplate firm, in connection with their purchase of the derelict steel-works at Ebbw Vale in order to build there a huge modern strip mill for the supply of steel to the tinplate trade; a number of other iron and steel concerns connected with the Iron and Steel Federation; and other bodies set up in connection with attempts at reconstruction in the metal and textile trades. In these and other ways the Bank of England, hitherto aloof from the long-term capital market for home investment, came to take to itself an additional function of acting, wholly or in part, as financial sponsor of industrial projects designed to straighten out the financial tangles in which a large section of big business had become involved.

Interest in the long-term capital market was not a new thing for the Bank of England. As the guardian of the exchanges it had for a long time past interested itself in the investment of long-term capital overseas, encouraging some loans and imposing what was practically a boycott on others, mainly in relation to the balance of payments, but also from time to time on political or semi-political grounds (e.g. in the case of Chinese loans in the period before 1914). Up to 1914, as we have seen, the great London merchant bankers, in their capacity as 'issuing houses' for long-term loans, had been concerned mainly with overseas investments; and the connections between the Bank of England and the merchant bankers have been traditionally very close, the Directors of the Bank being recruited, until quite lately, almost exclusively from the merchant banking houses. After 1918, and still more after the slump of 1921, the centre of interest shifted largely from overseas to home investment, and the merchant bankers came to play a larger part in the flotation of home issues. The Bank of England's interest also shifted; and from concerning itself with long-term capital issues mainly from

the standpoint of their direct effects on the balance of payments it came to concern itself also with home issues, particularly from the standpoint of re-building export capacity. One accompaniment of this shift in interest was a less exclusive connection of the Bank of England with the merchant bankers and the admission to its Court of Directors of persons associated primarily with home industry and commerce. In effect the Bank, in addition to its older responsibilities for the management of the currency and for the supply of funds to the money market as a 'lender of last resort', began to take on a somewhat vague responsibility for the supply of long-term capital, not to the general run of businesses, but in special cases in which the national interest seemed to be plainly involved.

This development necessarily brought the Bank of England into a new relation to the Government of the day. The Government, whatever its political complexion, was naturally anxious both to stimulate exports and to bring about a financial and technical reconstruction of industries which had got into a mess; and accordingly it was often a matter of interest to the Government whether the Bank would or would not be prepared to supply capital for schemes of business reorganization. The relations between the Bank and the Treasury had always been close, not only in matters affecting the currency, but also in respect of the timing of operations in the capital market, so as to avoid clashing demands for loans from the Government and from private issuers. But between the wars the relations became much closer as fast as the Bank began to interest itself in new capital issues at home. The Government could not, without raising howls about nationalization, itself subscribe capital for the re-organization of privately owned industries; but it could incite the Bank to do this for schemes which it—the Government—approved and desired to foster. To an extent that cannot possibly be determined, the Bank of England, in providing funds for such projects as the Lancashire Cotton Corporation and Richard Thomas's strip mill at Ebbw Vale, was acting as the independent agent of the Treasury and of the Government as a whole. The Bank, and not the Government, found the money for these schemes; but in effect the Government and the Bank were acting together, in pursuance of a mutually agreed policy. The Government could not coerce the Bank into investing where it did not want to; but the Government could influence the Bank, and the Bank the Government, in selecting projects which were to be regarded as worthy of help.

This form of Bank action, in close consultation with the Government of the day, was no doubt prompted largely by the desire to keep the Government out of business and to ensure that the reconstruction of enterprises and industries that were in difficulties should be carried through under business, and not under official, auspices. It was a way of getting what was in effect public help without submitting to the sequel of public control. True, in certain cases, for example that of Ebbw Vale, the recipients of the help found the control conferred on the Bank as irksome as control by the Government could well have been. But such instances were exceptional. In general, the Bank of England managed its control on such lines that the recipients were satisfied—the more so because they could resume independence when and if they found themselves able to pay off the Bank's loans, and the position of 'private enterprise' was thus safeguarded against forms of State control which could not, perhaps, have been so easily shaken off.

Let us turn now from the Bank of England to the Exchange Equalization Fund, which is under the Treasury, but is worked in the closest possible association with the Bank of England. The E.E.F. was established in 1932, with the purpose of guarding the foreign exchanges against influences which might lead to large short-term fluctuations in the external value of sterling, now that it was no longer pegged to gold. The basic technique is simple. The E.E.F. is financed by Government borrowing in London, in the form of Treasury Bills. It thus acquires a supply of sterling which it can use in buying either gold or foreign money. At a time when there were large inflows of foreign funds to London, including considerable imports of gold, the E.E.F. could buy up these foreign funds and thus equip itself with resources which it could use later if there should arise a demand to change sterling into foreign money beyond that which could be met out of the current supplies of such money reaching London in payment for visible or invariable exports.

A fund of this kind, having only limited resources, can influence the relative values of home and foreign monies only within limits. If, for example, there is a persistent tendency for the demand for foreign currencies to exceed the supply coming in, an exchange equalization fund cannot stand out indefinitely against such a tendency; for in the long run it must run out of gold and foreign money, and be left with only sterling in its possession. Its capacity to stand out against a reverse movement is greater; for if it runs

out of sterling it can always borrow more in the home money market, provided it is given the requisite authority. It is not, however, the purpose of such funds to resist persistent forces making for an alteration in the rates of exchange. The purposes to be served are, rather, to neutralize short-term tendencies towards exchange fluctuations which are deemed not to correspond to long-term needs. Thus, if foreigners, on account of a feeling of insecurity in their own countries, take to moving liquid funds into Great Britain, the Exchange Equalization Fund can acquire these funds and turn the whole or a part of them into gold, which it can then hold in readiness to be paid out in case the owners decide again to take their money away. In the meantime the Fund can, by sterilizing these holdings, prevent the influx of foreign money from inflating the cash basis on which the British structure of credit is raised. To do this, of course, involves the forgoing of earnings of interest on the sums thus sterilized; but this may be a small price to pay for preventing the monetary disturbance which the influx and efflux of the foreign funds might otherwise cause.

Secondly, by holding a large fund of manœuvre, those who are responsible for managing the Fund can make conditions difficult for speculators in currency. In the absence of the Fund, speculators could, by speculating on the appreciation or depreciation of a currency, largely make their own predictions come true; for if they bought in anticipation of a rise in its value, their purchases caused it to rise, and if they sold in anticipation of a fall, their sales caused it to fall. If, however, the Fund can enter the market at any moment either to buy or to sell, it can easily defeat the speculators' anticipations, and profit at their expense if they persist. It was, in fact, found possible to operate the E.E.F. at a profit, despite the loss of interest that had to be incurred when it sterilized funds for fear of undue monetary expansion.

Thirdly, the Fund can offset short-term fluctuations due to such factors as seasonal changes in the supply and demand relations between particular currencies. There used always to be a period in the autumn when the demand for dollars in London tended to exceed the supply, because large payments had to be made for American crops imported into Great Britain or other countries closely related to the 'sterling group'. With the aid of the Fund, such seasonal fluctuations can be ironed out, by letting the Fund's holdings of dollars run down for the time, and thereafter replenishing them as the conditions make this possible.

The British Exchange Equalization Fund was the first in the field, though the technique of it was largely based on the experience of Central Banks in other countries which had held an appreciable part of their reserves not in gold but in foreign exchange (e.g. sterling in the case of Empire countries). The British example was soon followed by the setting up of similar funds elsewhere; and it then became necessary for those in charge of these funds to act and consult closely together, for fear of acting one against another. The consequence was that between the group of countries operating such funds—and especially between Great Britain and the United States—their management became increasingly a matter of concerted international policy. It was necessary for the various countries to agree broadly upon the relative valuations of the various currencies which they would endeavour to support; and, to the extent to which they did act together, a new international standard, much more flexible than the gold standard, was in process of being set up. There were no fixed parities; but there was in embryo a system of international management of relative currency values which removed them out of the purely domestic sphere. A country belonging to the group could no longer alter the relative value of its currency quite at will: it had to consult the others and, though the final decision doubtless remained in its hands, it could act only in the knowledge of how its action would be received by the rest.

This half-international arrangement was gradually establishing itself during the years before the war. It was hardly more possible, however, for the group as a whole than for a single country to stand out against a really persistent tendency for the value of one currency in terms of the others either to rise or to fall, owing to real lack of balance in the supply and demand at the existing level. Exchange Equalization Funds showed themselves exceedingly powerful in reducing purely temporary fluctuations, in preventing currency speculation, and, one may add, in deterring countries from deliberately depreciating their currencies in the hope of expanding their exports. But the new device was no way of creating exchange stability in face of persistent real forces calling for a change in relative currency values.

We can turn now to the position of the joint stock commercial banks. These, as we have seen, are primarily bankers for the business world and for the private accounts of the wealthy and middle classes. As loan agencies, they provide the bulk of the short-term working capital needed by industry and internal trade over and above what

it provides directly out of long-term business capital. They are also the main suppliers of short-term funds to the money market for discounting bills and to some extent for stock exchange speculation; and they are themselves large buyers of both Treasury Bills (as well as of longer-term Government securities) and of trade bills, especially those with only a short time to run before maturity. They also perform numerous other services for their customers, including trustee business and the purchase of investments; and through special subsidiaries they conduct a considerable amount of banking business abroad.

We have seen that, in respect of loans and advances, the commercial banks are creators of credit, but that their power to create it is limited by convention to what the Central Bank allows them to create. They can thus be regarded as primarily distributors of credit up to a maximum settled by Central Bank policy. Clearly, they are in a position to influence the course of economic affairs very greatly, both by their action in lending, or not lending, up to the maximum allowed by the Central Bank—a problem which has been discussed in a previous chapter—and by their selection of the particular enterprises to which they are prepared to make loans, and the amount of credit they are ready to advance to any particular applicant.

In general, bankers will say that they do not place their loans with any desire to discriminate between applicants except in respect of their 'credit-worthiness', in the sense of their ability to meet their obligations. They will disclaim any responsibility for influencing the course of economic policy, or for interesting themselves in the affairs of the trades and industries to which they advance money. Economic policy, they will say, is ordinarily none of their business, though they cannot help interesting themselves when those to whom they have advanced money get into difficulties. As debenture-holders, they may have sometimes to put in receivers to manage particular firms on behalf of the creditors; and they may have to impose conditions when firms already deep in their debt come to them with proposals for funding their indebtedness, or with requests to borrow more money in order to carry on. But such happenings, numerous as they have been, are regarded as out of the ordinary run; and in general the bankers' view of their functions is that it is none of their business to interfere with their debtors when all is going well.

In many other countries, the position is a good deal different

from this. Either the ordinary commercial banks normally expect to have a good deal to do with the affairs of their business customers, in whose enterprises they often hold shares, or there are numerous industrial banks which specialize in various forms of industrial finance, and are to a substantial extent providers of long-term and middle-term capital, as well as of short-term credit. In this country, the agencies which carry on this sort of activity are not for the most part banks, but specialized financial institutions not engaged in deposit banking of the ordinary type. We shall come to them later; our present concern is with the joint stock commercial banks only.

Now, these banks, even if their controllers are quite sincere in disclaiming any intention of interference or of attempting to influence economic policy, cannot in fact help doing this to a very considerable extent. It is unavoidable, as matters stand, that they should greatly influence the fortunes of industries which have run into financial difficulties; for they have to choose when to give and when to refuse further accommodation to help struggling firms to carry on, and what conditions to attach to any assistance they are prepared to offer. It is often a bank, or a group of banks, that decides whether certain firms are to be forced to close down or to amalgamate, or whether a particular firm is to be forced to join, and submit itself to the discipline of, a trade association or ring which exists in its branch of production or trade. It is, again, often the banks that decide whether, and on what scale, money is to be made available for the modernization of this or that industry or business, or whether a firm or group is to be allowed to embark on a new, credit-requiring experiment of launching out on new lines, or opening up a new market.

In exercising such influence there is, again, an almost unavoidable tendency to help the big firm or combine more readily than the small business, both because the former has the more influential backers who, if displeased in one field, may retaliate to the bank's disadvantage or discomfort in another, and also because the bigger the business the likelier it is either to be able to provide good security or, if it cannot, to hold out the danger that its collapse will involve others. The big man is at a sure advantage in looking for credit, unless special agencies are provided to look after the requirements of the smaller concerns. Very often, the small man's creditworthiness rests mainly on his personal qualities of skill and enterprise, and he cannot offer collateral security; and it seems past

question that the disappearance of the old localized banks and their absorption into a nationally controlled system has diminished the readiness to go by the test of personal quality in deciding to whom to lend. True, the bankers say that they do their best to offset this tendency by placing considerable discretion in the hands of their more trusted local managers; but the extent of this discretion seems to vary a good deal from bank to bank, and, of the Big Five, only Barclays seems to have anything in the nature of a regular system of regional devolution.

It is, moreover, a fact that the small man's account is often a great deal more trouble to manage than the big man's, in respect of the amount of work falling on the bank; and this is sometimes advanced as a reason for charging the small man more in total (including other bank charges as well as interest) than the bigger borrower. Besides, though in theory the banks used to have a system of uniform loan rates, this was often departed from in the case of really large loans; and in the period between the wars even such uniformity as there had been was showing a tendency to break down.

I do not think anyone can honestly deny that the really big concerns are able to get the best terms for themselves from the banks, or that the small man is at some disadvantage. It would be most surprising if this were not the case, in an economic system mainly dominated by big business and, on the financial side, largely run by men whose interests are not limited to a single concern or line of production, but ramify through many businesses, so that the banker knows them as financiers whom he meets at every turn. It is an old saying that it is much easier to borrow a million than a hundred pounds; and in this context its truth is plain.

It must not, of course, be left out of account that businesses, both large and small, differ greatly in their demands on bank accommodation. Some businesses have, in addition to their assets locked up as fixed capital in buildings, plant, land, and other permanent equipment, large funds which are available as working capital to finance their operations—that is, to pay wages, to meet the cost of materials, and to grant trade credits to cover the period of business turnover. Such firms may, despite their possession of this capital, be large borrowers from the banks; for they may prefer to invest their capital at long-term and receive interest on it, and to borrow at short-term from the banks, if necessary depositing their securities as collateral. A quite large fraction of the National Debt is normally held in this way by business firms, which can often get on their

investments a higher return than they have to pay to the banks for overdrafts or loans—especially as their investments earn interest all the time, whereas they have to pay interest to the bank only for the actual periods for which they need the money. When, however, bank charges for interest are high, it may pay firms to sell out their securities and provide their own working capital instead of applying to the banks. When this happens, the banks find the demand for credit falling off, and are driven to invest in the securities which the business firms are selling. Bank holdings of securities rise, and loans and overdrafts fall off; firms' holdings of securities fall, and they finance more of their turnover out of their own working capital. Such changes may occur without any accompanying change in the volume of business activity.

Other firms, however, have no such reserves of working capital which they can call upon at will to finance their period of turnover. Either their capital is all locked up in their own plant and equipment, or, if they have outside investments, these are not liquid, so that they can be sold and bought back as changing relations between long-term interest rates and bankers' rates on advances make such transactions expedient. Their holdings may be in other businesses with which they desire to maintain their connections, or may be such as they can dispose of only at a loss they are not prepared to face. In such cases, or where they have no considerable outside holdings, they must rely on the banks for working capital whatever the banks' current rates of interest on advances may be. Most of the smaller businesses, and especially rising businesses which are expanding from small beginnings, are apt to be in this position, and to depend at all times on the advances they can get from the banks.

What has been said so far refers to the commercial banks as advancers of credit by way of loans and overdrafts to business firms. In the very short-term market, as we have seen, these banks are suppliers of a considerable part of the funds with which discount houses and bill-brokers carry on their operations. In this field, however, the English joint stock banks do not stand alone. A further source of such funds is found in the Dominion, colonial, and foreign banks which have offices in London. These banks have often large funds on their hands for which they need an outlet that will not lock them up for long. These funds arise out of the trade—imports and exports—of the countries in which these banks carry on their main business, as well as out of the capital operations of those countries. If, for example, Australia is selling goods to a

value beyond what is being bought for import into Australia, funds will accumulate in London to the credit of Australian firms or of Australian Governments. These funds may be needed in due course to pay dividends and interest to English owners of Australian shares and bonds; but even so there will be times of year when money is being piled up in readiness for dividend day, and in the meantime the Australian banks in London will want to earn some interest on it. They will therefore either themselves discount trade bills or Treasury Bills, or will be prepared to lend money at call or short notice to the discount market. If they have more funds than are needed for paying for imports and meeting dividend and interest charges as they fall due, there will be a wider choice open to them, and some of the money will go into longer-term securities bearing a higher rate of interest. But among all the Dominion, colonial, and foreign banks in London there will be at all times substantial amounts of money available for short-term borrowing; and this money will be lent out in pretty much the same way as similar funds are handled by the English joint stock banks.

We have seen already that this short-term money is a highly unstable factor, because a contraction in the volume of loans of this type is the first step taken by the commercial banks to meet a tightening of credit conditions. Hence, as we have seen, the importance of the Bank of England as a 'lender of last resort', ready to replace, at a higher rate, funds withdrawn by the commercial banks. The Bank of England, however, will not make advances on bills of all types; and in particular it will not handle trade bills unless they bear two recognized names and conform to certain standard conditions. There are always in existence considerable numbers of bills which are not eligible for re-discount at the Bank of England; and the discount house or bill-broker must, in face of monetary stringency, continue to hold such bills unless someone else is willing to buy them.

It is to be observed that, whereas foreign trade is commonly financed by bills, trade between firms in Great Britain is nowadays very seldom financed in this way. It used to be, before the growth of nation-wide joint stock banks; but bank loans and overdrafts have replaced bills as the method of financing internal trade. This is a curious fact, when one bears in mind that the rates of interest charged for bank advances are usually a long way above the discount rates prevailing for ordinary trade bills, so that it would appear as if firms could achieve considerable economies by borrowing in the

latter way. In fact, some do, but only a few of the largest (including a very few municipal bodies, which have found such borrowing cheaper than bank accommodation). But the practice is naturally frowned upon by the commercial banks, which would lose their most profitable outlet for credit if it were to spread; and the difficulty of re-discounting such bills either with the commercial banks or with the Bank of England stands formidably in the way of their extended use.

As for Treasury Bills, the bill market has absorbed more and more of them of late years, especially when the level of international trade has been low, and since a larger share in the financing of such trade has been taken by United States financiers. The Treasury Bill has ousted the trade bill from its former position of undisputed primacy, which was based not only on Great Britain's high volume of foreign trade but also on the financing through London of a considerable part of the trade of other countries one with another. The great increase in Treasury Bills arises not only from the fact that the National Debt has been immensely increased by wars, but also from the holding in short-term form of a very much larger proportion than would have been approved by orthodox financiers of a generation ago. A large 'floating' (i.e. short-term, unfunded) debt used to be regarded as a sure sign of unsound finance. It has, however, the manifest advantage that the nation pays much less for money borrowed at short term than for its funded, long-term obligations: so that the taxpayers' burden is lessened by the increase in Treasury Bills as against longer-term debt. Nor is there any counterbalancing disadvantage, provided that there remain in the market enough short-term funds to meet the demands of trade.

It has, of course, to be borne in mind that a large supply of short-term funds is to a considerable extent the correlative of an unwillingness to lock up money at long term, or, in other words, of a reluctance to invest in capital goods. The ease with which the State has been able to borrow at very low rates by means of Treasury Bills is, then, in part the result of an unsatisfactory level of investment and employment; and conditions of 'full employment', above all if they included a return to a high level of overseas trade, would greatly alter the position, and would compel the State to resort to other methods, either by funding more of the National Debt, or by changing its methods of short-term borrowing.

In this connection, it is interesting to notice the development, during the present war, of such an alternative method—the Treasury

Deposit Receipt—which now exists side by side with the ordinary Treasury Bill. These Treasury Deposit Receipts represent Government borrowing direct from the commercial banks, outside the regular offers for tender of Treasury Bills to the money market. They are direct creations of credit in favour of the Government by the commercial banks, at much lower interest rates than are charged to customers for ordinary loans or overdrafts. Whether such borrowing will continue after the war no one can yet say; but it seems unlikely, unless the commercial banks are made permanently subject to a high degree of Government control.

It is necessary, at this point, to add only a few words about the more specialized agencies which, with the Bank of England and the joint stock commercial banks, make up the complex of the banking system. The 'merchant bankers' are private banking houses which, while they do some ordinary deposit banking on behalf of their very select clients, are mainly engaged in the business of accepting bills, acting as agents for foreign Governments, municipalities, and big business houses, issuing and managing overseas long-term loans, and conducting highly specialized financing operations for a limited range of firms. Side by side with them are other 'issuing houses', mostly concerned with home issues, and ranging from large concerns which have been responsible for a considerable number of capital issues over a period of years, to houses which have but a single issue to their name, and appear to have been brought into existence solely to sponsor that issue. In between these extremes are houses which specialize in a particular type of loan, or are subsidiaries of a particular group of financiers. These, in turn, run into Finance Corporations which are in effect holding companies looking for outlets for business for concerns supplying capital goods, or materials, or land; and these are, at the margin, sometimes difficult to distinguish from Investment Corporations formed ostensibly for the purposes of enabling the investor the more easily to spread his risks over a number of concerns. Next in order stand Investment Trusts, definitely designed for such 'spreading', and having, when they are run on approved lines, a set principle of never distributing as dividends sums accruing from profitable sales of investments, but treating such windfalls as reserves against possible depreciation of investments. Distinct from these again are 'Fixed' and 'Unit' Trusts, in which the investment consists of a fixed bundle of mixed securities, so made up that they are not likely all to be subject to the same economic influences, and are

thus likely to yield a more regular global return than any single security bearing a variable dividend, and also to be more stable in total capital value. The difference between the ordinary Investment Trust and the Fixed Trust is that, whereas in the former the responsible directors are expected to shift the holdings so as to get the best possible results in terms of both income and capital value, in the latter the holding is fixed permanently, and when once the trust has been started there is nothing for the managing authority to do beyond distributing the dividends as they come in. Nevertheless, some of these Fixed Trusts carry high management charges; and in the ordinary Investment Trusts also it is necessary to watch carefully not only the policy of the directors in placing the investments, but also the magnitude of management charges. The well-managed Investment Trust or Fixed Trust can undoubtedly help the small investor to secure a larger return on his money than he could get elsewhere for the same degree of risk. But such agencies are open to abuse; and it is necessary for the investor to be wary in choosing those which are well and honestly managed.

One aspect of the growth of these and other types of collective investment agency, designed mainly to meet the requirements of the smaller investors, is that they provide means of bringing the pressure of criticism to bear upon companies which would otherwise be able safely to ignore the claims of their small shareholders. The small shareholder has, under the conditions of to-day, practically no control over the use made of his money by the companies to which he entrusts it. He has, in order to reduce his risks, to spread his money among a number of concerns; and, having no means of contact with other small investors and, in any case, no real knowledge of what ought to be done, he is as a rule a merely passive acceptor of such policies as the company directors choose to pursue, and is wholly without influence in choosing the directors who are supposed to represent his interests.

Investment Trusts and similar agencies are in a position, when those who administer them think that a concern is being mismanaged, to take the question up much more effectively than any small shareholder. They can insist upon, and get representatives elected to, shareholders' committees of investigation, and can make such bodies much more effective agencies of criticism than they would otherwise be. The small investor himself remains as helpless as ever in face of the scale of modern company organization; but he gets at all events more chance of there being someone to stand

TABLE VI

Joint Stock Companies in Great Britain

	Public		*Private*		*Total (U.K.)*		*Companies newly Registered*	
	Number Thousands	*Capital £ Mn.*	*Number Thousands*	*Capital £ Mn.*	*Number Thousands*	*Capital £ Mn.*	*Number Thousands*	*Capital £ Mn.*
1914	—	—	—	—	64·7	2,532	7·4 (1913)	157 (1913)
1924	—	—	—	—	92·2	4,405	8·5	124
1926	16·2	3,180	81·3	1,456	99·0	4,686	8·4	215
1929	16·9	3,698	91·5	1,502	110·1	5,250	9·2	241
1930	16·3	3,894	95·6	1,591	113·3	5,534	8·9	113
1931	15·6	3,897	98·7	1,618	115·8	5,564	8·9	65
1932	15·2	3,880	103·7	1,657	120·5	5,586	10·7	74
1933	15·0	3,871	109·3	1,692	125·9	5,610	12·0	100
1934	14·9	3,851	115·6	1,697	132·1	5,595	13·1	148
1935	14·7	3,939	122·7	1,706	139·0	5,693	13·8	144
1936	14·7	3,993	130·8	1,742	147·2	5,783	14·5	165
1937	14·7	4,067	137·5	1,829	153·9	5,940	13·4	121
1938	14·4	4,097	143·2	1,894	159·3	6,036	13·4	76
1939	13·9	4,117	146·7	1,923	—	—	11·2	59
1940	13·7	4,113	149·8	1,961	—	—	6·5	28
1941	13·6	4,105	155·0	1,948	—	—	7·4	26
1942	13·4	4,088	159·2	1,955	—	—	6·9	26

up against sheer incompetence or dishonesty in the uses to which his money is put.

The bodies discussed in the preceding paragraphs are concerned with long-term investments, and have little to do directly with banking or the markets for short-term funds. It was, however, essential to mention them in passing because they form an essential link in the chain of financial institutions, and because Fixed Trusts especially are often subsidiary to other bodies engaged in money market operations. For the same reason, this chapter would be incomplete if no reference were made to the Stock Exchange itself and to the smaller stock markets which exist in most of the larger provincial towns. The primary function of stock exchanges is to provide a ready market for second-hand securities, as distinct from new issues of capital. But in practice they also deal increasingly in securities which are new as far as the public is concerned. New companies, or existing companies desiring to raise additional capital, instead of offering their shares directly to the public, sell them in the first instance to financial agencies or syndicates which buy them in bulk with a view to re-selling them to the public at a higher price. The issuing company and the purchasers of its shares then try to arrange with the London Stock Exchange (or with a provincial stock exchange) for an 'introduction' which will entitle the shares to be dealt in, though they have not been previously offered to the public, and the agencies which have purchased them from the promoters then trade them off as opportunity allows.

This practice first arose, except in the provinces, where it provides the most convenient way of marketing shares of mainly local appeal, as a method of evading the requirements of the Companies Acts in respect of new capital issues. The normal method contemplated in these Acts of offering shares to the public is by the issue of a 'prospectus', in which the conditions and prospects are supposed to be fairly and fully set out. Stringent legal penalties are laid down against mis-statement or failure to disclose relevant facts in a prospectus appealing to the public; and the practice of issuing new shares by 'offer for sale' instead of prospectus arose largely because the offerers for sale were under no legal obligation to make full disclosure of the relevant facts. Legally, they were in the same position as any other person who offers for sale a second-hand share and has no means of knowing more than the company directors choose to tell him about the position of their concern. The Companies Act of 1928 to a considerable extent tightened up the con-

ditions in this respect, by making the intermediaries who buy new shares in bulk and then set out to re-sell them at once by means of a public 'offer for sale' subject to the same legal requirements as the issuers. But the new regulations left still untouched the alternative method of re-sale by stock exchange 'introduction', without any public 'offer for sale'. The new restrictions have by no means put an end to 'offers for sale', though they have removed many of the objections to it. Side by side with it flourishes the method of stock exchange 'introduction', safeguarded only by some tightening up of the conditions insisted on by the Stock Exchange Committee before it allows new shares to be admitted to the Stock Exchange List and officially dealt in. The Committee has undoubtedly done its best to get rid of the more obvious abuses; but the fact remains that the sale of shares by this method is still ungoverned by any legal regulations such as apply to recognized public offers of new capital holdings.

TABLE VII

	Building Societies			
	Number of Societies	*Number of Share Investors* *Thousands*	*Share and Loan Capital* *£ Millions*	*Mortgage Advances during Year* *£ Millions*
1913	1,551	617	62	9
1924	1,112	1,001	137	41
1929	1,026	1,265	297	75
1930	1,026	1,449	354	89
1931	1,013	1,578	399	90
1932	1,014	1,692	448	82
1933	1,013	1,748	477	103
1934	1,007	1,858	528	125
1935	999	1,939	571	131
1936	985	2,011	622	140
1937	977	2,083	672	137
1938	971	2,153	717	137
1939	960	2,154	711	94
1940	952	2,088	694	21
1941	947	2,040	688	10
1942	931	2,010	691	16

	Friendly Societies	Collecting Societies	Industrial Assurance
	Funds at End of Year £ Millions	*Premium Income £ Millions*	*Premium Income £ Millions*
1913	?	3	17
1924	82	8	34
1929	104	10	42
1930	108	11	44
1931	113	11	45
1932	119	12	46
1933	125	12	48
1934	130	13	50
1935	135	13	52
1936	141	14	54
1937	146	15	56
1938	152	15	58
1939	156	16	60
1940	159	16	62
1941	166	17	64
1942	—	18	68

	Life Assurance Companies		
	Total Income £ Millions	*Total Outgoings £ Millions*	*Difference £ Millions*
1913	49	38	11
1924	83	56	27
1929	112	76	36
1930	111	86	25
1931	110	92	18
1932	125	87	38
1933	127	87	40
1934	131	96	35
1935	135	99	36
1936	137	94	43
1937	139	98	41
Industrial	*Assurance only.*		
1938	74	52	22
1939	76	61	15
1940	79	65	14
1941	81	63	18
1942	86	63	23

Finally, a word must be said about the Insurance Companies and the Building Societies, which have become the largest agencies for gathering up the savings of the working and middle classes. The extraordinary increase in the volume of voluntary insurance in all its forms, from small-scale funeral insurance to the life and superannuation policies which are common to the middle and upper classes, has placed in the hands of the Insurance Companies huge funds which are available for investment. A part of these funds flows out into gilt-edged securities yielding an assured return; but the Insurance Companies have also become important sources of capital for industrial and trading enterprises, particularly in such growing branches of production as automobiles and electrical goods, and in connection with the finance of hire-purchase schemes. Meanwhile, the Building Societies have been gathering together immense funds from depositors chiefly of the middle classes, and have been applying this money to the finance of house-purchase on the instalment plan. Even before 1939 there were signs that the sums which savers were disposed to deposit with Building Societies were tending to exceed those which the Societies could place in advances for house-purchase—the more so because repayments of sums advanced earlier were mounting up rapidly and had also to be put out again in new advances. The shortage of outlets in the field of housing was beginning to drive the Building Societies into other forms of investment yielding, on the average, a lower rate of return; and during the war the Societies have lent very large sums to the Government in subscriptions to the various War Loans. Their future is highly uncertain: they have been expensive purveyors of credit to house-purchasers, and it is very doubtful whether they will be able to resume their pre-war function unless they can radically overhaul their methods so as to supply advances on very much lower terms.[1]

Building Societies cater to some extent for working-class as well as middle-class savers; and Insurance Companies, of course, draw a large proportion of their premiums from small weekly payments made by working-class households. For the working classes, the consumers' Co-operative movement offers an important outlet for small savings, both through share-capital, which is largely accumulated out of the dividends payable on purchases made in the Co-operative Stores, and through deposits in the local Societies and loan

[1] For a fuller discussion of this question, see my booklet, *Building Societies and the Housing Problem* (Dent, 1943).

investments and deposits in the federal Co-operative Wholesale Societies for England and Wales and for Scotland. Friendly Societies and Collecting Societies—the latter more analogous to Insurance Companies than to veritable Friendly Societies such as the Oddfellows and the Foresters—also accumulate considerable sums out of the weekly contributions of their members; but the size of their funds is small compared with that of the resources disposed of by the great Insurance Companies and the Building Societies.

For completeness, we must add to this list of financial agencies the Post Office Savings Bank, the National Savings Certificates which are 'sold' to the public by the propaganda of the National Savings Committee, the Trustee Savings Banks, and that *rara avis*, the Birmingham Municipal Bank. The Post Office Savings Bank collects funds from small savers (including the children of well-to-do people) and lends these funds to the Government in return for an interest payment of $2\frac{1}{2}$ per cent. The National Savings Committee and the numerous thrift clubs created under its auspices, largely in factories and offices, similarly provide funds for Government use, the interest accumulating over a period of years and being added to the cash value of the Certificates. The Trustee Savings Banks collect small savings which they re-invest in securities of a trustee type, and act as savings bankers for their depositors in the same way as the Post Office Savings Bank; while the Birmingham Municipal Bank places its deposits at the disposal of the Birmingham Corporation, which is to that extent enabled to reduce its dependence on other forms of borrowing or short-term credit.

This chapter has been mere survey. In the next, I shall proceed to consider the future of this network of institutions, which has grown up over a long period without any central plan. Will these various institutions all survive, or, if they do, will they keep their past functions and importance? Will new institutions be needed to meet the requirements of the post-war period, or will the existing institutions be adapted to serve new purposes? Will State operation, or control, of the financial system increase; and, if so, will the State need to devise new political and civil service machinery for exercising this control? To these questions we must now turn our attention.

X

SHOULD THE BANKS BE SOCIALIZED?

In considering the future of the institutions dealt with in the preceding chapter, the first question that arises is that of the general economic environment in which the financial system of the future is to be set. If we are going back to an economic order in which State intervention is to be reduced to a minimum and production and employment are to be left to find their own levels without any major attempt to influence their course by public action, we shall need one set of financial institutions: if, on the other hand, the State is to assume a general responsibility for preventing under-production and unemployment and for achieving a more equitable distribution of incomes and satisfactions among the citizens, we shall need a different set. If, as seems not improbable, we hover after the war between these two conceptions of the State's place in economic affairs, we shall also in all likelihood compromise over financial policy and adapt the institutions we have to a midway function, adding only such new ones as are imperatively needed to cover new needs.

Take, first of all, the position of the Bank of England. The Bank is a public institution, in the sense that it was set up by Act of Parliament and owes its powers to its Charters, which Parliament has from time to time amended and renewed. It is a private institution, in the sense that its capital is privately owned and earns profits for the shareholders, its Court of Directors a privately appointed body of Directors, and its lawful governing authority in the last resort a shareholders' meeting. One has, however, only to state this latter set of propositions to make it plain that the form and the substance do not fully agree. The Bank's capital is privately owned, and in theory the Directors could declare what dividends they pleased out of their profits. But in fact the Bank has paid for a long time past a stabilized dividend, which is in effect a high fixed rate of interest on its capital. Its profitability is so well assured that those in charge of it do not need to be influenced in their actions by the profit motive. Moreover, the profits of the Bank are not really determined, like the profits of ordinary businesses, by its trading operations. They depend also on intricate financial arrange-

ments with the Treasury, representing the Government. If, for example, the Bank were to make a large windfall profit through a change in the gold value of sterling, as it actually did in 1931, no one would suggest that the Directors would have a right to dispose of this profit as they pleased, without the State having the last word about its disposal. Such a profit, arising from the Bank's functions as guardian of the currency, would be regarded as the State's property, however much they might accrue in the first instance to the Bank. They did not formally accrue in 1931, because the Bank, doubtless after agreeing with the Treasury, took no step to write up its gold reserve to its enhanced sterling value.[1]

Again, though the Court of Directors is virtually a self-co-opting body as far as the general body of shareholders is concerned, there is no doubt that close consultation takes place between the Directors and the Treasury when it is a question of appointing new Directors or a new Governor. The Bank and not the State appoints; but normally the two agree about the appointment. What would happen if they were to disagree it is not easy to say. The State presumably could not override the Directors without going to Parliament for the necessary authority; but neither could the Directors flout the Treasury without considering very seriously what the consequences would be. In effect, the Bank and the Treasury have been accustomed to act so closely together that the question 'Which controls the other?' is really unanswerable.

On the score of these facts, some people conclude that the Bank of England is already in substance a nationalized institution, and that it would make no difference if it were formally taken over by the State. This, however, is surely not true. Even if the State has already great influence in the affairs of the Bank, it remains a fact that the Governor has always been chosen from circles of high City finance, that the Court of Directors is almost wholly representative of capitalist business interests, with the merchant bankers still holding a high representation, and that the whole tradition of the Bank is that of a great City institution, belonging to the world of high finance rather than to that of Government, and proud of its independence *vis-à-vis* the State. Its relations with the Government are those of treaty rather than of subordination; and it was made clear in 1931 that, when the Bank found itself confronted with a Government that it disliked, it could by no means

[1] The Bank's gold reserve has now been taken over by the Exchange Equalization Fund—that is, by the Government.

be taken for granted that the word of the Government would prevail.[1]

The Bank of England, it is argued, is already in effect a 'Public Corporation', analogous to the London Passenger Transport Board, the Central Electricity Board, and the British Broadcasting Corporation. So, in a sense, it is; but the very notion of 'Public Corporation' means different things to different people. It is generally accepted that a Public Corporation should differ from a Government department in that its administrators should be left free from day-to-day political or parliamentary interference, should not be subject to the day-to-day control of a Minister or a civil service departmental chief, and should not be under the Treasury in the same way as a regular civil service department. But most people would hold that the Board of a Public Corporation should normally be appointed by the Government, and that the singular device of Appointing Trustees employed in the case of the L.P.T.B. was a political aberration. Moreover, all who favour any real system of State economic planning must hold that Public Corporations, however much independence they may enjoy in their executive acts, should be expected to carry out general policies in accordance with the requirements of the Government's economic plans, and to accept general directives from the Minister or Ministers responsible for the operation of these plans.

Indeed, those who argue that no change is needed in the status of the Bank of England do not mean that it is already subject to Government control, but that it ought not to be. They want to preserve the Bank's independence to frame its own policy apart from the Government, and to stand out, if it thinks fit, against the Government in such a way that it can be coerced only by legislation. They want to keep banking 'outside politics': whereas those who favour economic planning and hold that the Government ought to assume the responsibility for maintaining the volume of production and employment affirm that monetary policy plays so vital a part in this as to be brought necessarily within the realm of politics as soon as such a responsibility is accepted.

What, if we assume that the State is to be responsible for a planned policy of full employment, should be the status and structure of the Bank of England in order to fit it for its new functions? The buying out of the Bank's shareholders should obviously be under-

[1] See *The Crisis*, by G. D. H. Cole and Ernest Bevin, reprinted in my *Economic Tracts for the Times*.

taken, not because the shareholders are themselves of direct importance (though in fact the Bank's shares are jealously kept in the hands of a narrow oligarchy of high finance), but because the shareholders are the persons to whom the Directors are formally responsible, and by whom they are formally appointed. The State, clearly, should replace the private shareholders as the owner of the Bank's capital, and should appoint the persons who are to take charge of the Bank's affairs.

What sort of persons should the State appoint? For the offices of Governor and Deputy-Governor, clearly it should choose the best men it can find, not as representatives of any particular interest or group, but as servants of the public. As for the Directors, there is room for difference of opinion. The Labour Party, in its proposals for the nationalization of the Bank of England, advocated a representative Court of Directors, chosen from different sectional groups —industry, commerce, finance, labour, and so on. It is, however, a moot point whether a formal scheme of balanced representation is really expedient. It would, no doubt, be desirable to have on the Court persons of experience and standing in a number of different fields; but it might be better to choose them as individuals, rather than as representatives of particular interests. The place for formal representation, if there is one, seems to be rather on some sort of Advisory Council than on the body which is actually to govern the Bank's affairs. A small, full-time Court of individuals chosen for their personal competence would probably give better service. Its members would be best appointed, for a period of years, either by the Prime Minister or by the Minister placed in charge of general development of the State's economic plans.

It is to be observed that in almost all countries except Great Britain the executive head of the Central Bank is appointed by the Government, and that in most countries the Government has also an important share in the appointment of the Directors. Practice varies a good deal from Bank to Bank, some Central Banks being in effect State Banks and others private corporations subject to a measure of public control, with all sorts of intermediate varieties. In the United States the position is complicated by the existence of twelve separate Federal Reserve Banks, co-ordinated by a central Federal Reserve Board, and by the division between the Banks and the Board of the functions ordinarily performed by a Central Bank. The United States Federal Reserve Board, which is the supreme

body, is entirely Government-appointed, and is in effect a part of the machinery of State; and the Board has an important voice in choosing the directing personnel of the Federal Reserve Banks. It appoints three out of the nine Directors of each Bank, including the Chairman, who also acts as the Board's Agent for the district. Of the remaining six Directors, three represent the commercial banks and three industry, agriculture, and commerce. The system as a whole is so designed as to ensure that the Federal Reserve Board shall be in matters of major policy the final controlling power.

Thus, even in countries which are regarded as standing pre-eminently for the system of private enterprise, the Government has usually a very large share in the direction of the Central Bank and its policy. The Government cannot effectively manage its own finances—let alone carry on a policy designed to promote full employment—unless it can be assured of the entire co-operation of the Central Bank. As long as power in Great Britain alternated merely between Liberal and Conservative Governments which did not differ greatly in their outlook on most economic questions and had no thought of assuming any responsibility for regulating the level of production and employment, no serious difficulty arose over the position of the Bank of England as a privately owned corporation, not subject to Government control; for the policies of such Governments and of the Bank were not likely to clash. The situation was different in 1931, when a Labour Government found itself faced with what amounted to an ultimatum from the Bank demanding a reduction in expenditure on unemployment; and even more serious difficulties arose in France when the Blum Socialist Government first attempted to put an advanced social policy into effect. No doubt the Bank of England would assert that it presented no ultimatum to the British Government in 1931, but only transmitted a decision of the American banking authorities not to come to the further aid of sterling unless expenditure on the unemployed were cut down. But the line of difference is fine; and it is a pertinent point that discussions with the Americans were carried on by the Bank, not as a Government agency, but as an independent body negotiating with the British Government as well, and not receiving its orders.

Advocates of a planned employment policy are likely to insist that the Bank of England ought to become definitely a Public Corporation, publicly owned, and that those who direct its affairs ought to be public servants appointed by the State, whether or not

some element of non-official representation is retained. It does not, however, at all follow that they will wish the socialized Bank to be subject to any interference beyond what is needed to ensure its compliance with the Government's general economic policy. No one will want the Bank to be subject to day-to-day control either by Parliament or by the Treasury. Indeed, it is much to be doubted whether the Treasury will be the appropriate body to exercise such control as the Government does apply. The Treasury's relation to the Bank is based on its position as the Government's bank, from which the Government from time to time seeks advances to meet deficiencies of tax revenue, or, more often, assistance in enabling the money market to meet the Government's demands and in clearing rival applicants out of the way when they inconvenience the Government's borrowing or funding operations. If, in future, the Bank is to take on the quite different function of ensuring that the supply of means of payment shall be rightly adjusted to the needs of the Government's employment plan, the logical course will be to link the Bank rather with the Government's machinery for economic planning than with the Treasury as the department responsible for attending to matters arising out of the ordinary budget. Most economists who favour a planned system of production think there ought to be two budgets—one dealing with tax revenue and current expenditure only, and the other with capital expenditure and the raising of loans for economic development and the steadying of employment at a high level. The second of these budgets, it is urged, should be the responsibility not of the Chancellor of the Exchequer or of the Treasury, but of a separate Minister of Economic Planning or Development, at the head of a department or super-department of his own. The Bank, under such an arrangement, would have to be connected with both departments; but the connection with the Minister of Economic Development might well be the closer of the two.

It would take me much too far afield to embark on any full discussion of these issues. What is clear is that planning for full employment necessarily involves very close relations between the Government's planning machinery and the Central Bank, and conformity by the latter with the essential requirements of the Government's economic plan.

Further reasons for full public control of the Bank of England can be drawn from the field of international affairs. As long as the gold standard was in operation, the value of the national currency was

fixed by decision of the State, and not of the Bank of England. As soon, however, as Great Britain left the gold standard, the determination of the value of sterling, to the extent that it was not left to the working of blind forces, rested with the authorities in control of credit policy and with such instruments as might be set up to influence the course of the exchanges by special means. We have seen that the Exchange Equalization Fund, from its establishment, was put under the Treasury and not under the Bank of England. If, thereafter, the Fund and the Bank had followed divergent policies, chaos would have been the result. The credit policy followed by the Bank and the equalization policy followed by the Fund had to be closely concerted; and the Treasury and the Bank had to work together in pursuance of a united policy. Which of the two had actually the greater influence was a matter of personalities rather than of formal regulations; but it can hardly be questioned that, if differences arose, the State's voice ought to have the final power to prevail.

This is bound to be an exceedingly important issue after the war, when new relative levels will have to be found for all the world's currencies, and the position of gold will have to be settled afresh. I shall be discussing these problems in a later chapter: here I need only assert my conviction that the regulation of credit policy and the management of the foreign exchanges will have to be integrated under a single authority, which can be only that of the State. International binding agreements will have to be made; and these will have to be agreements between Governments, and not merely between Banks. Bankers' conformity will have to be made secure—nay more, their positive co-operation with the Governments will have to be ensured. But how can it be, unless the Central Bank is made clearly subordinate to the State, and treated as an integral part of the public machinery of economic regulation in both national and international affairs?

Let us now turn to the question of the commercial banks, which are at present purely private concerns, over which the State has, in theory, no control at all. They have Boards of Directors appointed by their shareholders: they make profits, and declare dividends, in theory, just like any other joint stock company. There are, no doubt, some special provisions on the statute book relating to them; but these amount to very little, and confer no right of interference in the control of their affairs. Yet, despite formal appearances, the joint stock commercial banks are not entirely like ordinary com-

panies. They do not, as we have seen, go all out to make as much profit as they can, regardless of consequences. They pay, in the main, stabilized rates of dividend analogous to those paid by the Bank of England; and usually, like it, they find no difficulty in earning, in good and bad times alike, enough profit to pay out regularly in dividends as much as they want to pay. Their very profitableness has rendered them immune from the need to be guided by considerations of profitability: like the Bank of England, they are run, not so much to make profits for themselves as to guarantee, within their lights, that the conditions of profit-making shall be secured for others.

There is only one Bank of England; but there are a dozen or more joint stock commercial banks, not counting the Scottish and Irish banks, which work in association with them. Pre-eminent among them are the 'Big Five'—the Midland, Lloyds, Barclays, the Westminster, and the National Provincial—all the outcome of a large number of bank amalgamations by which local banks have been absorbed and national banks consolidated into bigger units. To a certain extent, these banks compete one with another for custom, and offer slightly varying facilities. But they work closely together, and follow in all major matters a policy in common. Is it desirable that any change should be made in their relations, either with one another or with the State?

Proposals for the socialization of the commercial banks meet with strong resistance in many quarters, chiefly on three grounds. There is, first, the fear that the State, if it controls the banks, will get to know too much about people's private and business affairs, and that the tax-gatherer may be equipped with a new weapon—to say nothing of the police. The privacy of bank accounts is a matter to which people attach much importance, for obvious reasons. This privacy, as far as it concerns a man's neighbours or business connections, should be fully as secure under a system of State banking as it is to-day. The servants of the State have many faults; but they are not given to blabbing. Privacy in relation to the State itself is, however, a somewhat different matter. It is a nice question whether an income-tax collector who thinks the State is being defrauded should have a right to go to a State bank manager and demand information about his client's account. Even with the banks in private ownership, nice questions arise in similar connections in respect of the law courts and the police. There is, however, nothing in public ownership of the banks that implies either that there should,

TABLE VIII

British Joint Stock Banks in 1942

	Millions							
	Paid-up Capital	*Reserves*	*Deposits*	*Cash*	*Money at Call and Short Notice*	*Discounts*	*Advances*	*Investments*
The Big Five								
Midland	15·2	12·9	758·8	113·8	25·8	235·7	159·4	244·6
Barclays	15·9	11·3	721·0	108·5	20·0	229·8	169·2	212·7
Lloyds	15·8	10·0	646·2	104·5	21·1	202·3	140·9	197·4
Westminster	9·3	9·3	501·5	81·2	22·5	145·8	109·6	157·0
National Provincial	9·5	8·5	473 7	75·6	16·5	141 3	104·8	147·0
Other Clearing Banks								
Barings	2·1	1·0	16·6	3·5	—	3·2	—	10·9
Coutts	1·0	1·0	34·4	4·8	3·0	6·1	8·7	13·4
District	3·0	3·0	146·0	22·3	4·6	47·0	24·2	52·8
Glyn, Mills	1·1	0·9	59·9	8·8	11·3	10·1	10·4	20·6
Martins	4·2	3·7	167·3	22 9	5·2	54·1	33·5	57·1
Williams Deacon's	1·9	1·0	70·4	12·5	5·9	19·6	11·3	23·0
British Mutual	0·2	0·2	1·1	0·2	—	—	0·4	0·8
Isle of Man	0·1	0·3	4·6	1 0	—	—	0 4	3 7
Scottish Banks								
Royal	4·3	4·1	89·2	13·0	8·9	9 8	25·3	47·1
Clydesdale	1·3	2·0	53·3	11·9	3·1	8 1	9·5	29·3
Bank of Scotland	2·4	2·1	60 8	13 3	6·5	8·1	8·4	36·8
Commercial	2·3	3·2	68·1	14·6	2·9	10 0	9·6	43·1
National, of Scotland	1·5	2·0	55 7	12·2	5·1	6·3	10·7	31·5
North of Scotland	1·1	1·4	35·3	11·1	1·2	1·1	6·4	22·1
Union	1·2	2·0	46 6	5·5	7·7	6·2	9·2	26·7
British Linen	1·3	2 5	44·1	8 4	5·1	5 6	7·7	27·7
Others								
National	1·5	1·2	44·5	6 0	6·5	1·4	15·7	18·5
Discount Companies								
Alexanders	2 0		49 0	0·8	—	31·7	0·2	19·8
National	2·4		63·3	1·6	—	52·9	0·6	14·8
Union	3·8		99·2	2·2	—	87·6	0·4	19·4

or that there should not, be access to information about private or business accounts for the revenue departments. The matter should be settled as a separate question: the socialization or non-socialization of the commercial banks should not be allowed to depend upon it.

The second objection that is often raised to socialization of the commercial banks is that State banking would discriminate in granting or refusing loans, and that the granting of loans to particular firms or persons would become a political question. To a certain extent, under any *planned* economic system, the distribution of credit is bound to become a matter of public concern. If there is to be a plan of production, the finance needed for the plan must be made available, whether the banks are publicly owned or not, and credit must not be so granted as to upset the plan. If the State decided to plan for full employment, on the basis of an expansion of such and such forms of production and a development in such and such depressed areas, and if the privately owned banks then refused to supply credit in accordance with the requirements of the plan, there would be a deadlock, which could be resolved only by the banks being coerced into conformity, or the plan breaking down. To this extent at any rate, a planned economic system implies public control over the commercial banks as the suppliers of short-term financial accommodation.

Discrimination between types of investment, in accordance with the needs of a general economic plan, is, however, a different matter from discrimination between individual firms. It would obviously be most undesirable to create conditions under which the head of a particular business could hope, by approaching a Member of Parliament, to get more liberal credit than he would be accorded in the absence of such an approach. State banks would have to be fully safeguarded from political interference of this sort, and from questions in Parliament designed to secure advantages for particular firms at the expense of others. It would be fully as necessary for publicly owned commercial banks as for the Central Bank to be given a wide freedom and an immunity from interference in day-to-day administration. In practice, a plan of production would necessarily involve in many cases arranging for particular businesses to carry out certain parts of the plan, just as when the State orders a battleship it has to place the order with a particular contractor. All Public Works, except those which are carried out by Direct Labour, involve such allocations of work to particular firms; and just as the banks now supply the credits required by such contracts,

the socialized banks would have to do the same. Planning for full employment would, no doubt, mean more than this, in that the State would be making itself responsible for stimulating private production as well as for extending the range of its own orders for work; and here again the banks, socialized or not, would have to provide the credits needed. Beyond this, there is no reason to suppose that the State would wish the banks to exercise any discrimination in favour of one firm rather than another, except upon very special grounds.

What is true is that State operation of banking could be used as a means of refusing credit to firms which did not comply with public requirements in such matters as the payment of fair wages and the observance of fair labour conditions. But such discrimination could not, in a country such as ours, be applied arbitrarily, or without due process. At one time the American Government attempted to enforce the law against child labour by refusing the use of federal postal facilities to firms which did not abide by it. Action of this sort in the field of credit would be possible, but only against proved offenders; and why should anyone wish to rally to their defence?

It is sometimes suggested that State-run banks would discriminate in favour of the big, and against the small, employer. This seems to me most unlikely. A similar charge is often advanced against the banks as they are, under private ownership; and we have seen that there is some substance in it, whatever the banks intend. State banking, however, is advocated chiefly by persons who believe that the great businesses ought to be brought under public control, but that small-scale production is the legitimate field for private enterprise. There is much more to be said for the view that State banks would go out to do all they could to help the small man and to provide special credit facilities for him as part of a comprehensive policy of full employment. Assuredly this is what they ought to do.

The third objection to State banking is that it would be less safe for the depositors than banking is to-day. But this is sheer nonsense. Let us agree that British banking, as it is, offers a high degree of security to its depositors, and that no big privately owned bank could be allowed to collapse without the State coming to its aid, if the other banks could not see it through without invoking the State. Surely, it is even clearer that the State could never allow a bank run under its own auspices to default. Would the depositors in American banks have been safer or less safe in 1933 if these banks

had been publicly owned? Clearly safer; for the American Government, when it came to the assistance of the privately owned banks, did not guarantee all deposits, but only deposits in certain banks and up to certain limits. If the State had owned the banks, the depositors' money in them all would have been guaranteed.

The only sense I can imagine in which State banking would be less safe than private banking is that it might result in lower bank profits. An incautiously worded phrase to this effect in a lecture I gave a dozen years ago has been made use of ever since by opponents of bank socialization, who quote it as if I had said 'less safe for the depositors', whereas the context made it plain that I meant 'less safe from the standpoint of bank profits'. A State banking system might well serve its customers more cheaply and be less cautious than the banks now are in backing progressive enterprises; but these are merits and not defects. The faults of the present banking system are over-caution and excessive margins to cover costs and risks.

But is it *necessary* to socialize the joint stock commercial banks, even if socialization would not have any of the consequences of which its leading opponents profess to be afraid? It is not *necessary*, if the requisite degree of control can be secured without, so as to ensure the conformity of the distribution of credit with the needs of the general economic plan. It may, however, be highly *desirable*, in order to facilitate the smooth working of the plan, and to ensure the cheapest practicable conditions of credit supply; and it will be absolutely *necessary*, unless the banks act as if they had been socialized, even though they have not. To a great extent they do, of course, so act in time of war; but it by no means follows that they would do as much in time of peace if most of the persons in charge of them strongly disliked the complexion and policy of the Government holding office.

What, I am sure, is neither necessary nor desirable is to amalgamate all the existing commercial banks into one grand universal National Bank, so as to leave depositors no choice and bankers no room for emulation. The 'Big Five' are quite big enough—perhaps too big: an amalgamated bank bringing together all their business would be much too unwieldy for efficient working. There is, however, nothing in the policy of public ownership or socialization that makes it necessary to amalgamate the units taken over. I should prefer to see each bank converted, by public purchase of its share-capital, into a Public Corporation, and a continuance of the separate

banks as parts of a socialized banking system centred upon a socialized Bank of England. Under such a system, it would be undesirable to preserve the tradition of isolation of the commercial banks from the Central Bank. It should be easy to transfer men from one bank to another, or from one to another branch of the public financial service. The public should keep its choice of bank, and the banks their variety of methods; and new banks—for example, special banks for agriculture or municipal banks—could be created according to need, whereas now the creation of such agencies is commonly obstructed by the vested interests of the privately owned commercial banks.

What would happen, under these conditions, to the discount houses, the bill-brokers, the merchant banks and acceptance houses, and the rest of the specialized financial institutions which make up 'the City'? Commercial banks, as well as discount houses and bill-brokers, already discount bills; and the socialized banks would presumably continue both to discount new bills and to re-discount bills on their way to maturity. The private bill-brokers are already a fast-disappearing group, and the survivors are amalgamating into larger units. These, and the older discount houses, could go on as they are, at any rate for the time being. Their knowledge is very specialized, and there is nothing much to be gained by socializing them. As for the merchant banks, they too could go on, though their sphere of action might be narrowed by the re-organization of the long-term capital market, which we have still to discuss. The State banks would still need short-term outlets for a proportion of their funds, and could join with the London offices of the overseas banks, as they do now, in placing 'money at call or short notice' at the disposal of money market borrowers. The merchant banks could carry on with their specialized acceptance business, and with their diversified work for a number of important overseas clients. The socialization of the joint stock commercial banks would not involve or imply the socialization of any of these more specialized institutions; and on the principle that the State will have enough to do, in implementing a policy of full employment, without undertaking works of supererogation, they had best be left as they are.

Much more complex issues arise in connection with the measures needed in the capital market to create a suitable framework for an investment plan designed to maintain full employment. These issues demand a separate chapter.

XI

THE INVESTMENT OF LONG-TERM CAPITAL

THE supply of long-term capital for British trades and industries comes partly through the market for new issues, through which shares and bonds are sold, directly or indirectly, to the investing public; partly from reserves built up by existing companies and invested either in their own enterprises or in those of subsidiaries or allied concerns; and partly from such special sources as the Bank of England and the commercial banks, through the subsidiary agencies which they have set up in recent years for purposes of long-term investment, including the management of shares which they have taken in connection with the re-flotation of companies which have got into financial difficulties. The organization of the market for new issues is somewhat complicated. The older Issuing Houses —in effect, the old-established firms of merchant bankers—used to specialize mainly in issues for overseas Governments and municipalities and to take little part in the raising of capital for home industry. This situation has been changing in recent years; and some of these houses—notably Lazard Bros.—have taken an active share in the handling of new capital issues for home investment. Side by side with them are other Issuing Houses, large and small, good, bad, and indifferent, which range from considerable concerns handling a substantial number of issues to nominal Issuing Houses which are in reality little more than aliases for the firms for which they set out to raise capital.

There are, as we have seen, three main ways in which an issue of capital to the general investing public can be made. The oldest, and the most respectable, of these is the method contemplated in the earlier Companies Act—the publication of a 'prospectus' giving an account of the terms of the issue and disclosing, if the law is fully complied with, all the relevant facts bearing on the value of the shares. There are legal penalties for either making false statements or suppressing relevant facts in such a prospectus; and these penalties have in the main now been extended to those who sell shares to the public by the second method—that of 'offer for sale', without the publication of any formal prospectus. The issuer of the 'offer for sale' is not the company for which the capital is being raised, but the financial agency or syndicate which has bought

its shares outright, in the expectation of being able to re-sell them at a profit. This used to exempt the 'offering' concerns from most of the requirements of the Companies Acts concerning the disclosure of relevant information—on the ground that they were in the same position as any other sellers of second-hand shares and had no necessary access to the information possessed by the company itself concerning the state of its affairs. But such serious abuses developed from the use of 'offers for sale' as a deliberate way of evading the provisions relating to prospectuses that the law was altered; and firms or syndicates which bought up new issues for immediate re-sale to the public through an 'offer for sale' were made subject to practically the same conditions as the original issuers of a prospectus.

This reform of the law failed, however, to cover the third method by which new shares can be sold to the public. Under this third method, that of 'stock exchange introduction', there is neither a published prospectus nor any published 'offer for sale'. The financial agency which has bought up the shares simply approaches the Committee of the Stock Exchange and asks its permission for the shares to be dealt in on the Stock Exchange and included in the printed Stock Exchange List. When this permission has been given, the financial agency (or of course more than one, if several have joined in the venture) proceeds to sell off the shares in parcels, managing the offers so as not to flood the market, and often arranging what are in effect fictitious deals in the shares in order to give them a good start.

Clearly, this throws a considerable burden on the Stock Exchange Committee, in deciding what new issues to admit or refuse. There is evidence that of late years the Committee has done something to stiffen up its requirements; but doubtful issues still get past the test, and there is, of course, nothing to prevent dealings in issues which the Committee has rejected from taking place anywhere outside the London Stock Exchange. The restrictions on 'share-pushing' by canvassers and by mass-circularization included in the Companies Act of 1928 have done a good deal to restrict practices which had become notorious; but the safeguards are still quite inadequate to prevent many issues of a most undesirable kind from getting made and taken up at times when the investing public is in a hopeful mood.

Purchase of the whole of a new issue outright by a financial agency, or by several agencies acting together, is an alternative to

the old-established practice of underwriting. The 'underwriters' of an issue of shares or bonds agree, in return for an underwriting commission on the whole issue, to purchase at an agreed price, or rather at the public price of issue less a specified commission, all such parts of the issue as are not taken up by the public in response to the published prospectus. Usually, the firm which undertakes the underwriting shares its responsibility with others, 'sub-underwriters', who agree to take a part of the unsold shares or bonds off its hands. No such underwriting is needed when the body which arranges for the issue buys the shares or bonds outright for purposes of re-sale. What often happens, however, is that, whereas underwriters are persons with no interest in the shares apart from the underwriting, the agencies which buy up whole issues are hardly more than aliases for the companies whose shares are being dealt in. This need not be the case, and there are entirely reputable agencies which buy shares *en bloc*; but it is not easy for the public to distinguish between an Issuing House or financial agency which is a really independent body and one which is a mere financial auxiliary of the company whose shares it is endeavouring to sell.

The reason both for underwriting and for arranging for the purchase in bulk of the whole of a new issue, at the cost of commissions which are often considerable to those who perform these services, is that, when a company decides to start business or to raise additional capital, it has presumably in mind certain definite plans, involving an expenditure which can be broadly estimated in advance. If, say, the purpose is to build and equip a factory costing £100,000, and to have a further £50,000 available for working capital and necessary expenses, it is obvious that the company cannot carry out its plans unless it gets something approaching the whole £150,000 for which it asks. If, in response to its request for capital, only £75,000 were subscribed, the projected factory could not be built, and there would be serious danger of the money being lost should the company start business with inadequate equipment and without any working funds. Underwriting, or 'placing' with a financial agency, ensures that the entire amount asked for will be forthcoming, and is therefore a necessary precaution for which it is worth while to pay a reasonable commission. There is, however, a danger, especially when the entire issue is bought up at a discount by a financial agency, that the gap between the sum paid by the public for the shares and the sum accruing to the company may be much too wide—the difference being 'raked off' in financial

operations for the benefit of persons who may have no long-run interest in the company's prosperity, because they fully intend to get out as soon as they have raked off all they can.

This sort of abuse is found much more in the case of home than of foreign issues, because most foreign issues do not stand much chance unless they are sponsored by a thoroughly reputable Issuing House. Nor, of course, is this sort of abuse found in relation to such home issues as those of local government authorities, or public corporations, or well-established big industrial concerns. The offenders are either speculative company promoters, trying to put across propositions of their own, or shady financial agents, who make a business of finding private businesses which they can convert into public companies, or struggling firms in need of additional capital, and then so arranging their affairs as to yield the largest possible 'rake-off' at the expense of those in whose hands the new shares are finally left.

Foreign issues raise certain special problems. The sending of capital overseas, unless it goes out immediately in the form of wholly British-made goods which would not otherwise have been exported, raises exchange problems. It means that the banking system—in effect, the Central Bank—has to find so much more foreign exchange; and this may raise difficulties if the state of the current balance of payments leaves no surplus available for investment abroad. Accordingly, there has to be some control, formal or informal, over the amount of capital for overseas borrowers that is allowed to be raised by appeals to British investors. For the most part, this control has been informal. The Bank of England, often in consultation with the Treasury, has for a long time past exercised an extra-legal censorship over issues of capital for overseas investment; and the old-established Issuing Houses which handle such transactions have acted in close consultation with the Bank. After the departure from the gold standard in 1931, this procedure was stiffened up, and the Treasury took a more open part in it, pronouncing an embargo on overseas loans subject to such exceptions as it agreed to make. There was, however, still a considerable loophole; for many companies registered in Great Britain carry on business partly in Great Britain and partly overseas, and there was nothing to prevent them, either from carrying overseas money raised by means of a 'home' issue of capital, or from investing abroad sums accruing to them in the course of their overseas operations. Gradually, the practice developed whereby

the larger concerns consulted the Bank or the Treasury over transactions of this sort which were calculated to involve a large transfer of funds. But there was no legal control: nor was there anything to prevent shares or bonds issued overseas from being brought to this country and re-sold here, so as to involve the export of the money needed to pay for them.

In effect, the British capital market of pre-war years was in a fairly chaotic condition, though during the 'thirties the Bank and the Treasury had been gradually tightening their control over foreign issues, and the abuses in connection with home issues had decreased, partly as a result of the new checks but much more because the total volume of issues had fallen off and there was much less prospect of speculative gains.

It should be observed at this point that such controls as do exist over the long-term capital market are almost exclusively *financial*, and have practically nothing to do with the adjustment of the supply of capital for different purposes to social or economic needs. It is nobody's business to consider how much capital is needed for this or that industry as a whole (unless the industry is fully integrated in the hands of a single great concern, such as I.C.I.), or whether capital is flowing in the quantities needed to different areas, or whether the demands for capital that are being put up in the capital market are complementary, or conflicting. It is nobody's business to consider whether the *total* demand for new capital for investment is equal to, or less than, or greater than, the supply of savings available; and it is hardly anybody's business to protect the interests even of the shareholders beyond the rudimentary precautions against fraud which I have already described.

The shareholders have, however, some further protection, whereas the general body of the public has none—no assurance, that is, that the course of investment will be in any way related to the real needs of the country. The investor's further protection comes through the special agencies described earlier—Investment Trusts, Fixed Trusts, and similar bodies—which exist primarily for the purpose of 'spreading' risks, but can be used also to a certain extent for reducing them. The Investment Trusts, or rather some of them, are considerable buyers of the more promising new issues; and as they buy to hold as well as to re-sell, they take an interest in the prospects of the companies in which they hold shares well beyond the short visions of the stock market speculators. They are in a position to take action, by threatening trouble at shareholders'

meetings or through City 'talk', to bring pressure to bear on concerns which they suspect of fraud or gross mismanagement; and their increasing importance as factors in the investment market has added greatly to their influence in recent years. They too, however, are moved purely by financial considerations: it is no part of their business to try to place their shareholders' money with any other view than the maximum profit consistent with reasonable security for the sums invested.

The question that arises is whether there ought to be some *planning* of investment, not from the purely financial standpoint only, but also from that of the right use of capital in promoting a high level of production and employment, rightly balanced between different branches of production and service, and between different areas. Clearly, the private investor cannot be expected to concern himself greatly with this; and no more can be looked for from investment agencies which are run for the purpose of securing the maximum profit, and have no interest in what is done with the money invested, beyond their interest in the profit to which it is likely to lead. It would be Utopian to expect more than a very limited number of investors to put their money into, say, model public-houses at 4 per cent., if they believed, even erroneously, that they could get 8 per cent. out of tracks for greyhound-racing. Local Authorities and Public Corporations, when they issue appeals for capital, may be presumed to make them in some relation to the real needs of the areas and services concerned; and of course those who make appeals for capital for profit-making industries expect to find a demand for the products which the capital will be used to make. If the supply and demand forces worked out with the beautiful harmony which can be attributed to them in textbooks on economics, the profit-expectations of business men would induce them to apply for just as much capital as they could employ in their several branches of production to the maximum advantage of the whole body of consumers, and there would be no need for investment to be in any way planned. But no one in his senses will contend that the forces of supply and demand do work themselves out in this socially beneficent way; or, at all events, anyone who does can be sufficiently confuted by the history of the new investments made during any boom period. It is a plain fact that a large part of the capital invested at such periods—when the majority of new capital investments are made—loses a considerable fraction of its value within a very few years. The waste of invested money

through the market for new capital issues is quite appalling;[1] and although it is, of course, to be noted that the capital goods remain for the most part in being, even if their money value falls, this is no defence, for the fall in money value is at any rate some indication that the capital has been misapplied. There is probably a good deal less misapplication of capital invested out of company reserves; for the directors of going concerns are more likely to be interested in permanent, rather than in merely speculative, values, and have a better chance of estimating correctly the possibilities of market demand. Yet experience has shown that they too can make colossal blunders, both in buying up competitive businesses at grossly inflated prices, as happened after the last war, and in putting down new plants on the unfounded expectation of a continuance of boom conditions.

No doubt, capital losses in connection with new investments would be very much smaller than they are if total demand were less unstable. If, for example, the State were to assume a responsibility for the maintenance of 'full employment', business men would be able to embark on investment in capital goods with a much better assurance of finding markets than they can have under conditions of unstable economic activity. If *total* investment were planned and held firmly at a planned level, particular processes of investment could to a much greater extent be safely left to look after themselves, outside the field of 'Public Works' and other forms of public or publicly controlled investment. But this is only to say that if a large part of the total investment were consciously planned under public auspices, much less harm would be done by leaving the uncontrolled margin unplanned. It does not follow that it would not be better for the community for a part of private investment to be planned as well, from the standpoint of the community's needs as well as from that of the investors' prospects of profit.

The proposal most often put forward for the planning of investment in Great Britain—I shall have something to say about international investment in a subsequent chapter—is that there should be created some sort of National Investment Board under the auspices of the State. This proposal has taken many different forms. At its most modest, it envisages no more than a co-ordination under the auspices of a single body of supervision over all the investment

[1] See, for example, the facts cited in *Studies in Capital and Investment* (ed. G. D. H. Cole) about the new issue boom of 1928.

done by public bodies—the State, the local authorities, and the various public and semi-public corporations and boards already subject to Government or local government control. Such investment already covered, in the decade before the war, a very substantial fraction of the total new capital applied to economic and social development. Public buildings, schools, municipally built houses, hospitals, roads, waterworks, gas and electrical construction under public bodies, publicly run transport services, docks and harbours, naval shipbuilding, postal extensions, afforestation under the Forestry Commission, and other public or publicly controlled capital works took up a large proportion of the total capital applied to home development; and if one adds to these railways and forms of industrial enterprise specially subject to the influence of Government policies (e.g. the steel industry and various branches of agricultural processing such as bacon and beet-sugar production), the proportion was, of course, much larger still. Large, however, as Government influence on capital development was, this influence was not exerted in any co-ordinated way, or in the light of any general, publicly sponsored investment plan. One object of the protagonists of the idea of a National Investment Board was to bring about a co-ordinated review of all these forms of capital expenditure, and a timing of them designed to adjust their total volume to the needs of the community, both by establishing a balanced order of priorities and by varying total expenditure in accordance with the fluctuations in private investment.

Some of the advocates of a National Investment Board went a long way beyond this, and wished the Board to have the additional function of licensing, or refusing to license, private applications for capital through the new issue market, so as both to affect the total amount and the timing of such issues and to sift proposed issues from the standpoint of their public utility. In some cases, the emphasis was put mainly on regulating the total volume of issues or on cutting out those which appeared to be unwarranted from the standpoint of social needs: in others, it was stressed that control over new issues would enable the State to prevent the piling up of new factories and extensions in already congested areas and to encourage new enterprises to settle in depressed areas in which there was a surplus of labour which the existing enterprises could not absorb. Many of the advocates of a National Investment Board argued, further, that its control should extend to investments made out of company reserves as well as to new capital issues, and that

TABLE IX—STATISTICS OF SAVINGS AGENCIES AND PUBLIC INSURANCE FUNDS

	Post Office Savings Bank Deposits (U.K.)	*Trustee Savings Bank*		*Savings Certificates Outstanding, excluding Accrued Interest* [2]	*Unemployment Insurance Fund Balance* [3] *(Debits in Brackets)*	*Health Insurance Funds Balance (U.K.)*	*Contributory Pensions Funds Balance* [3] *(U.K.)*	*Birmingham Municipal Bank Savings Bank Department* [3] *Balances due*
		Ordinary Deposits [1] *(U.K.)*	*Investment Accounts (U.K.)*					
	£ Mn.	£ Mn.	£ Mn.	£ Mn.	£ Mn.	£ Mn.	£ Mn.	£ Mn.
1913	187	54	—	—	—	—	—	(Started Sept. 1, 1919)
1924	280	82	25	369 (1924-25)	(− 8)	118	—	4
1929	285	79	45	361	(− 36)	127	43	10
1930	290	79	54	358	(− 39)	128	47	11
1931	289	78	65	372	(− 75)	129	47	13
1932	306	80	75	379	(−115)	129	41	14
1933	327	89	83	384	(−115)	129	35	15
1934	355	95	87	389	(−105)	131	29	17
1935	390	108	90	393	11	135	23	19
1936	432	120	92	391	24	138	19	21
1937	470	131	93	390	43	140	20	24
1938	509	142	96	386	42	144	22	27
1939	551	152	99	381	41	—	25	29
1940	652	176	103	431	24	—	—	—
1941	823	218	109	603	29	—	—	—
1942	1,005	269	114	831	98	—	—	—

[1] Including Eire.
[2] Accrued interest was £194 millions in March 1943. The figures are for the financial years ending in March of the year given.
[3] Figures for financial years ending in March of the year given. G.B. only.

TABLE X

CO-OPERATIVE SOCIETIES

	Retail Societies			*Wholesale Societies*	
	Members Thousands	*Funds £ Millions*	*Sales £ Millions*	*Funds £ Millions*	*Sales £ Millions*
1913	2,881	46	85	12	40
1924	4,663	99	177	43	90
1929	6,129	135	216	53	109
1930	6,367	143	216	59	104
1931	6,558	150	207	66	100
1932	6,722	155	201	69	101
1933	6,882	160	198	76	100
1934	7,152	166	206	85	110
1935	7,435	176	219	94	118
1936	7,767	185	232	102	129
1937	8,023	193	248	105	144
1938	8,339	200	262	108	154
1939	8,585	215	270	111	156
1940	8,600	214	296	108	173
1941	8,709	225	299	120	177
1942	8,872	245	315	138	193

investment control should be reinforced by a system of licensing directly applied to new industrial building and use of land under an amended Town and Country Planning Act. That is to say, the control of investment was thought of, not merely as an instrument for regulating the total flow of new capital into economic development or of bringing about a better balance between the sums directed to the various industries and services, but also as a means of achieving an improved distribution of industry and population over the country as a whole and, more particularly, of helping the depressed areas to recover their prosperity.

It was not easy, having gone so far, to stop at this point. It was argued, with some force, that, if business men were severely checked from promoting industrial investments when and where they pleased and in such branches of production as they deemed likely to offer the largest return, the effect would be to depress the total volume of private investment below its existing level, which was admittedly already too low to achieve 'full employment'. Accord-

ingly, to some it seemed necessary to advance a stage further, and to propose that the National Investment Board should not merely *control* capital development, but also promote it in a positive sense. In order to do this, the Board would clearly need to have capital of its own to invest in enterprises of which it approved. It was therefore suggested that the Board should be given power both to guarantee over a period of years the return on approved investments in new capital development and to borrow money from the public at a fixed rate of interest and re-invest such money in such capital projects as it deemed worthy of special encouragement on public grounds.

There are precedents, on a limited scale, for action along both these lines. After the last war the State, under the Trade Facilities Act, was able to guarantee the return on approved projects of capital construction; and the extensions of the London Tubes in the 'twenties were actually carried through under this arrangement, while later railway developments have been stimulated in somewhat similar ways. Moreover, the State, in attempting to cope with the special problems of the depressed areas, was led to confer on the Special Commissioners for these areas powers which enabled them to apply public money to fostering capital development. At the outset, these powers were limited to non-profit-making forms of enterprise, but later this ban was removed, after the way had been pioneered by the Nuffield Trust—a private agency set up to make advances of capital to businesses willing to locate their establishments in the depressed areas. The Trading Estates set up in South Wales, in the West of Scotland, and on the North-East Coast were similarly designed to encourage capital investment in areas in which there was a clear need for additional employment openings.

It is true that all these measures were on a small scale, and that the proposal to set up a National Investment Board, empowered to raise money from the public and to re-invest it in approved enterprises to be run for profit, goes a long way beyond anything that has been done so far. If, however, it is agreed that the State ought to assume the responsibility for maintaining 'full employment', and that 'nationalization' is unlikely to be extended in the near future beyond a limited range of key industries and services, it follows that the State will be bound to interest itself in the employment-giving capacity of a wide range of industries still remaining under private ownership and control. A National Investment Board, with power to raise money by loan and to re-invest in non-

nationalized forms of enterprise, would give the State a greatly enlarged power to influence the course of investment, from the double standpoint of ensuring its adequacy in total volume and its right distribution between industries and areas in accordance with social needs.

It would, of course, follow that the State, through the National Investment Board, would become the partner of private enterprise in many fields of business, and the part-owner of many factories run on commercial lines with a view to profit. This kind of mixed enterprise has been experimented in much more widely in other countries than in Great Britain; but it is not without precedent here. The British Dyestuffs Corporation, subsequently merged in I.C.I., was in its inception a mixed enterprise, in which the State and private capital were partners; and the Anglo-Iranian Oil Company is an existing example of public, State investment in a big capitalist enterprise. There is nothing startlingly novel, then, in the idea of such partnership: what is novel is the idea of extending it widely, to small as well as large enterprises, and of applying it where no special grounds of national 'security' can be advanced.

For my part, I have held for many years that there is very much to be said in favour of a development of this kind. Complete public ownership, of the type usually suggested for the great basic industries, and municipal ownership are both unsuitable for the general run of manufacturing industries, in which there is great diversity of products and businesses are of every sort and size. I can see no objection at all to public and private enterprise existing side by side in these fields, or to the emergence of a type of business which is neither public nor private, but mixed. Of course, such mixed enterprises could not be subjected to the traditional forms of civil service control; but who, nowadays, thinks that any industry, however completely it ought to be 'nationalized', can appropriately be run by civil service methods? Such bodies as the Central Electricity Board, the London Passenger Transport Board, and to a lesser extent the Port of London Authority, are existing experiments in the technique of running socialized services without civil service forms of administration. Why should there not be further experiments of a different kind—publicly appointed directors sitting with privately appointed directors to control the affairs of 'mixed' concerns? Such experiments have worked well in other countries —for example, in Sweden, as well as in pre-Nazi Germany. Why should they not be tried out here?

It is not suggested that the National Investment Board should enjoy any monopoly. If, as seems highly probable, the Building Societies are largely superseded by the State and the local authorities in the provision of capital for house-building after the war, why should they not divert a part of the vast resources which the public have invested with them into various forms of planned investment in industry and trade, especially in medium and small-scale enterprise?[1] Why should not insurance funds—if the Insurance Companies are brought, as they should be, under public control—be applied in a similar way? The Insurance Companies are very large investors—so large that their investment policy produces a considerable effect on the development of the industries and trades to which they direct their attention. Why should not the National Investment Board, the Investment Trusts, the Building Societies, and the Insurance Companies be brought together to serve as the instruments of a concerted plan of investment, designed to fulfil the requirements of a national policy of 'full employment'?

This is not the place in which these speculations can be followed out in their detailed application. I am here concerned with them only in their bearing on the general monetary conditions of Great Britain. Just as planning for 'full employment' implies the enforcement of a banking policy which will ensure that the supply of credit for industry shall be both adequate in amount and rightly distributed in relation to the plan of economic activity, so it also involves a planned application of long-term capital—a sufficiency of capital projects, public and private, to absorb the national 'savings', and an appropriate distribution of the outlets for capital among the different forms of economic development. The more the State can influence the course of private investment the less will it have to do in the way of Public Works designed to fill up a threatened gap between 'savings' and investment. It will be possible to settle the relative places of public and private enterprise on grounds of national expediency, instead of having to improvise Public Works for the purpose of preventing mass-unemployment.

Had I been writing this chapter a dozen years ago, I should have felt certain of being heavily fired at by dogmatic Socialists, who would have argued against me that public and private enterprise could never join hands, as well as by dogmatic anti-Socialists who would have reached the same conclusion from diametrically opposite

[1] See my booklet, *Building Societies and the Housing Problem* (J. M. Dent & Sons Ltd., 1943).

premises. Indeed, I did write something very like it as long ago as 1929, and I was fired at from both these angles.[1] I think I shall be fired at now—but much less in the spirit of absolutist dogma. There are many more non-Socialists now who admit the need for extensive State action in the economic field; and there are very few Socialists who really want, in the near future, to apply completely the formula which advocates 'the nationalization of the means of production, distribution, and exchange'. There is plenty left to differ about; but the grounds of difference have shifted, and it is now rather a question of *what* to socialize, and how, and what to leave in private hands, than a question whether we should socialize all or nothing.[2]

It is true enough that, given the definitive acceptance of 'full employment' as the objective of public economic policy, the market for both consumers' goods and capital goods would be much better assured than it has been, and that, the risks attendant on private investment being thus reduced, there would probably be much less sheer waste involved in unregulated private investment. Less waste, that is to say, from the standpoint of the investor; but there might still be grave waste and misdirection from the standpoint of the community as a whole. From the standpoint of the community, it is desirable not merely to prevent capital from being frittered unprofitably away, but also to promote its use in such ways as will achieve the maximum of social welfare, and prevent decay and destitution in some areas from coexisting with prosperity and progress in others. The right use of capital is a social, as well as a chrematistic, question: it is a matter of the happiness of the people, and not merely of the investors' profit.

[1] See *The Next Ten Years in British Social and Economic Policy* (Macmillan, 1929).

[2] See *A Word on the Future to British Socialists*, published by the Fabian Society in 1942, and also my own book, *Fabian Socialism* (Allen & Unwin, 1943), for a fuller discussion of this issue.

XII

INTERNATIONAL TRADE AND THE GOLD STANDARD

THE essential difference between home and foreign trade is that, whereas in home trade both parties to the transaction use the same sort of money, in foreign trade they use different sorts. Each seller wants to be paid in his own country's money: each buyer would usually much sooner pay, if he could, in his own country's. In fact, the buyer can only pay in the money of another country if he can get such money in exchange for his own. Foreign trade, therefore, involves arrangements for exchanging one sort of money for another; and this involves, if there is to be any security for trade, reasonable stability, at any rate over short periods, in the rates at which different sorts of money can be exchanged.

The gold standard is a method by which the value of a national currency is fixed in terms of gold, and it has therefore a practically fixed value in relation to the currencies of other gold standard countries, though not, of course, to those of countries which are not under the gold standard. Even between gold standard countries relative currency values are not quite fixed; for it costs something to transport gold from one country to another, and the exchanges can fluctuate within the limits set by the 'gold points'—that is, in either direction up to the point set by the cost of transporting gold. This cost is so small that the 'gold points' are quite close together, and no trader is likely to be much put out in his calculations by exchange fluctuations confined within these limits. The gold standard, therefore, has considerable advantages as affording a stable basis for international trade.

The gold standard, of course, involves not merely that a country shall *say* its money is worth so much gold, of a certain standard fineness, but also that its money shall actually *be* worth this amount. Accordingly, there must be some place to which anyone, or at all events anyone with payments to make in gold standard foreign money, can go and get either the money he wants at a nearly fixed rate of exchange for his own money, or actual gold. In effect, the Central Bank of the country concerned must either be prepared to pay out gold on demand at the fixed rate, or must be prepared to supply on nearly fixed terms unlimited quantities of any gold

standard foreign currency for which it is asked, at all events for any legitimate purpose. It need not, for the purposes of foreign trade, be prepared to pay gold if it is ready to supply any quantity of any gold standard foreign money that is asked for, at a rate within the 'gold points'. But its power to do this will depend on the possession of a gold reserve of its own which it can use to replenish its supplies of any gold standard currency of which it may run short.

In the terms of this definition, Nazi Germany in the 'thirties was not on the gold standard, even though the *reichsmark* was supposed to represent a fixed value in gold. Germany was working under a system of rigid 'exchange control' which denied both to German nationals and to foreigners any *right* to convert their holdings in German money into either foreign exchange or gold. Gold could not be got at all; and foreign money could be got only for purposes and in amounts approved by the State. There were, in practice, at the Reichsbank many 'blocked' accounts in *reichsmarks*, belonging to people who would have liked to change them into other currencies but were not allowed to do so—with the consequence that these 'blocked' *reichsmarks* were bought and sold for much less than their face value. Similarly, there were many German traders who would have liked to buy goods abroad for sale in Germany, but were not allowed the means of paying for them in foreign currency. There were also at the Reichsbank special accounts into which German importers had to pay in *reichsmarks* the sums they owed to foreigners, and out of which German exporters received in *reichsmarks* payment for goods sold abroad. These accounts were flanked by similar accounts in the Central Banks of other countries with which Germany had 'clearing' agreements; and no one who sent goods to Germany could get paid unless the account in the Central Bank of his own country had enough funds in it to pay him. If trade between Germany and the other country balanced, everyone concerned got paid in his own money. If not, surpluses piled up in one Central Bank, and in the other there was a deficit, so that exporters from that country had to wait for their money, unless there was a State Exports Guarantee Department, as there was in Great Britain, in which they could insure for payment of part of the sums due.

Before the war, a good many countries, instead of attempting to keep large gold reserves of their own, met the needs of their traders by holding large sums in foreign exchange—that is, either directly in the currencies of other countries or in short-dated obligations,

such as bills, which they could quickly convert into these currencies. This meant that the leading gold standard countries commonly had the use of considerable sums of money belonging to the nationals of other countries, or to their Central Banks, and might at any time have to pay out this money either in their own currencies, or in other currencies, or in gold, if the owning countries wanted it back. The advantage of this system, from the standpoint of the countries which held their reserves largely in foreign exchange, was that their money deposited in other countries usually earned them something in interest, whereas gold locked up in their vaults would have earned nothing. From the standpoint of the country which held these balances, it was supposed to be an advantage to have the use of the money; but it was necessary for their Central Banks to hold larger gold reserves than would otherwise have been needed, in order to meet demands for repayment when the depositing countries wanted, not the currency of the country in which the funds had been lying, but some other, of which its Central Bank might not have a sufficient supply. The method followed by countries which held a large part of their reserves in foreign exchange was known as the 'Gold Exchange Standard', and it was a perfectly satisfactory substitute for the gold standard proper on the assumption that the countries in which they kept their funds could be relied on to maintain the gold standard in its integrity. When Great Britain went off the gold standard in 1931, countries which had kept their reserve wholly or in part in Great Britain suffered losses in the gold value of their reserves, and were in most cases impelled to devalue their own currencies to at least the same extent as the British currency fell in value.

We have seen that the outstanding advantage of the gold standard is that it facilitates stable bargains in international trade. In any transaction made between traders in two gold standard countries, both buyer and seller know within very narrow limits what they will have to pay and to receive in their own money. Moreover, there is a tendency for countries working under the gold standard in its integrity to be enabled to undertake the financing not only of their own trade, but also of trade between other countries. Payment in a currency convertible into gold at a practically fixed rate is likely to be acceptable anywhere; and, in the old days, bills drawn on London had a world-wide currency.

There are, however, disadvantages in the gold standard, even from the standpoint of international trade. A country which is

working under the gold standard must keep its level of prices, at all events for goods which it wishes to sell abroad, and (subject to tariff barriers) for goods which its own nationals can import as substitutes for home products, at a point that will not make such goods dearer, quality for quality, than goods produced in other countries. If it fails to do this, it will lose its export trade, and will be unable to pay for the imports it needs. If no restriction is placed on imports, it will then lose its supplies of foreign exchange and of gold in paying for them, and will in the end be driven off the gold standard. It may sound quite reasonable that a country be required to keep its selling prices for exports in balance with prices in other parts of the world; but this means that, if in a particular country which is big enough to be an important factor in world trade there occurs a serious slump and prices are driven down sharply, other gold standard countries will be forced to make corresponding price-reductions, even if this leads to widespread losses and mass-unemployment. As long as all the great gold standard countries can proceed on a basis of continuous 'full employment', all is well. But as soon as there is a serious slump in one of them, it is practically bound to spread to all the others.

This is a particularly serious question for Great Britain. The United States has so vast a gold reserve and so marked a tendency for exports in record years to exceed imports as to be an exception to the rule that adhesion to the gold standard must mean internal slump and deflation for the American people should economic affairs go wrong in other parts of the world. It is difficult to imagine, for a long time ahead, a situation in which the United States, whatever its internal policy might be, would run short of the means of making foreign payments. The most that could happen even as the consequence of a serious slump in American foreign trade would be a cessation of net foreign investment and some drawing upon the vast accumulations of monetary gold at present locked up in American possession. No doubt, if the drain continued for a very long time, even America's strong creditor position could be overset; but for practical purposes such a contingency can be ruled out in considering post-war policy. The United States has so much gold that it need fear, from a monetary point of view, neither a foreign drain nor any lack of ability to finance any internal currency and credit expansion that may be needed without altering either the gold parity of the dollar or the laws regulating the supply of credit. The Americans might, no doubt, *wish* to go off gold or to change

the gold value of the dollar for some other reason, as they did in the 'thirties; but they could not be driven to any such course by lack of gold or foreign exchange.

TABLE XI

FOREIGN TRADE OF THE UNITED STATES AND OF GREAT BRITAIN, 1929-1940

	U.S.A. (*Millions of Dollars*)			*Great Britain* (*£ Millions*)		
	Imports	*Exports*	*Balance*	*Imports*	*Exports*	*Balance*
1929	4,339	5,157	+ 818	1,111	729	−382
1930	3,114	3,781	+ 667	957	571	−386
1931	2,088	2,378	+ 290	797	390	−407
1932	1,325	1,576	+ 251	651	365	−286
1933	1,433	1,647	+ 214	626	368	−258
1934	1,636	2,100	+ 464	680	396	−284
1935	2,039	2,243	+ 204	701	426	−275
1936	2,424	2,419	− 5	787	441	−346
1937	3,010	3,299	+ 289	953	521	−432
1938	1,950	3,057	+1,107	858	471	−387
1939	2,276	3,123	+ 847	840	440	−400
1940	2,541	3,934	+1,393	1,074	413	−661

With Great Britain the situation is bound to be very different; for Great Britain has now no large stock of gold, and it is plainly going to be difficult, even under favourable conditions of post-war international trade, to raise exports to the level needed to pay for imports on the scale requisite for 'full employment' at a satisfactory standard of life. Other countries adversely affected by the war are likely to find themselves in a similar difficulty, at any rate for some time to come. If Great Britain, or any country similarly circumstanced, were to be tied to the gold standard at a parity corresponding to the price-level at the end of the war—that is, broadly speaking, if the gold values of the various currencies were to be fixed in relation to their several purchasing powers—the effect would be to tie the future course of economic affairs in Great Britain, or in any other country bound in the same way, to follow the course of fluctuations in the United States, without any corresponding necessity for the United States to be influenced by events elsewhere.

This is a very serious matter; for, as we have seen, the economic system of the United States has shown itself the most unstable system in the world. Dependent to a much smaller extent than Great Britain on international trade—for a much higher proportion of American output is consumed at home—the United States suffers from an outrageous internal instability. At the depth of the depression in the 'thirties, the level of American industrial production and employment had been nearly halved, whereas the reduction in Great Britain from the pre-slump level was only about 17 per cent. If this type of violent oscillation remains characteristic of the American economy after the war, and is communicated to other countries by the fall in American demand and American foreign investment, what is to become of the 'full employment' policies on which we are proposing to build our new systems of social and economic security? In order to withstand the impact of violent fluctuations of this order any country desirous of maintaining its own level of employment must be in a position to maintain a combined programme of liberal credits through the banking system and active intervention by the State to stimulate the demand for goods and services for either consumption or investment. But no such freedom can exist in a country tied to the gold standard at a fixed parity of exchange. Between 1929 and 1932 wholesale prices in the United States fell on the average by practically one-third; and the cost of living fell by nearly a quarter between 1929 and 1933. How could other countries meet such a fall without drastic deflation, leading to mass-unemployment and widespread business ruin, if they were compelled to remain on the gold standard at an unchanged parity? For the United States, an alteration in the gold value of the dollar would have comparatively little effect: for other countries, it would make all the difference between being forced into collapse and—I will not say escaping, but very greatly reducing the impact of the American crisis upon their own economic position.

Let me be quite plain about this, even at the risk of being tedious. If the American price-level falls off sharply, and the dollar is pegged to gold at a fixed value, American goods become very much cheaper all the world over, at the same time as the Americans, through their loss of income, become able to offer much less for foreign goods. In these circumstances, other countries must reduce their prices. If they too have currencies pegged to gold, they can do this only by enforcing restrictive monetary policies, in the hope that monetary restriction will bring down costs. Costs, however, are made up of

many elements, some of which are fixed over long periods and some over shorter periods, while others are flexible almost at once. In face of the long-fixity of many capital costs, and of the large element in costs which consists of wages, no policy of deflation can succeed in bringing down costs to the required extent unless it includes drastic cuts in wages. Such cuts, however, while they may benefit the export trades, will react most seriously on home consumers' demand. If the workers, with this in mind, offer strong and successful resistance, costs will not be brought down, but employment will, because the deflated monetary structure will not make it profitable for employers to maintain production at the previous level. Thus, whether costs are brought down or not, the effect will be to depress production and employment, the incidence of the depression being different between trade and trade in the two cases, but the total effect disastrous in either.

I am not suggesting that a country which retains its freedom to alter the value of its currency can thereby escape the consequences of depression originating in the United States. Evidently, the United States holds much too important a position in the structure of world economics for such an escape to be possible under any conditions. What I am suggesting is that the disaster will be much less if such a country as Great Britain is not forced to add the calamity of internal deflation to the calamity of adverse conditions of international trade and investment.

It may be objected that there are other, and perhaps better, ways of insulating the national economic structure from the effects of crisis in America than a change in the external value of the currency. Perhaps there are; but they are equally ways that cannot be followed by a country which has pledged itself to abide by the gold standard. The external drain to which the situation we are postulating will give rise can be stopped only by altering the external value of the currency, or by restricting its export. A country may be able to achieve the required insulation by means of a thorough-going system of exchange control, while leaving the external or gold value of its currency nominally intact. It may refuse to supply gold for export, and may ration the supply of foreign exchange under a licensing system or by the adoption of various 'clearing' devices, so as to limit total outgoings to balance what is available at the fixed rate. Such devices are, as we have seen, in effect only another way of going off the gold standard: they lead, irresistibly, to a *de facto* depreciation through the appearance of 'blocked' accounts exchange-

able only at a discount. There has been, during the inter-war decades, plenty of opportunity of seeing what happens under such arrangements. The gold standard, in the form in which it existed in the 'good old days', the form in which many Americans are asking us to agree to restore it now, excludes such devices, fully as much as it excludes an alteration in the legal gold value of the currency unit.

For my part, I am convinced that, even if the leading nations were to agree, in response to requests from the United States, to return to the gold standard after the war at fixed parities of exchange, either they would find it impracticable to carry out their promises when the time came, or, if the promises were implemented, breakdown would follow within a very short space of time—in effect, as soon as the first major economic setback in the United States occurred. After the last war immense efforts were made to get the gold standard back into working order; and, one after another, countries re-defined the values of their currencies in terms of gold. Scarcely had this painful process been completed when the countries began slipping off the restored standard a great deal faster than they had gone back to it. Indeed, this is an understatement: the gold standard was already breaking down in some countries which had restored it before the process of restoration in others had been carried fully into effect.[1]

Do we want to go again through this painful and futile experience of the inter-war years? It will be obviously impracticable for most countries to return to the gold standard immediately after the war. Conditions in many areas will be much too confused; and it will be beyond the wit of man for some time to say what the appropriate parities should be. Accordingly, everyone, I think, contemplates a period of transition during which countries will be setting their monetary and economic houses in order and finding out, broadly, what their several currencies look like being worth. What is proposed is that this period should be made as short as possible, and that it should be ended by the proclamation for each country, as its affairs settle down, of a fixed currency value in terms of gold. I am prophesying that either this 'final' act will never be reached, or, if it is reached, countries will begin sliding off their fixed parities almost as soon as they are laid down.

This is not to suggest that unfixed currency values are a good

[1] For an account of this process, see Part III of *The Intelligent Man's Review of Europe To-day*, by G. D. H. and Margaret Cole (Gollancz, 1933).

thing in themselves. On the contrary, it would be much pleasanter if there could be fixed ratios at which the monies of all countries could be exchanged. It would be much pleasanter, unless the penalty of having this fixity were to be, for some countries at any rate, periodic plunges into deflation and mass-unemployment.

But, it may be argued, surely this need not happen, if the United States, which is obviously the key country in this connection, can so arrange its affairs as not to be visited by recurrent economic 'blizzards' of a blinding and devastating intensity. Surely, if the United States can arrange to follow a policy which will maintain a consistent level of 'full employment', American prosperity will boost the rest of the world into prosperity just as effectively as American depression would impel it into deflation. There is, of course, much substance in this view. There would be very much less to be said against restoring the gold standard if it were possible to feel any assurance that the United States would follow after the war a consistent policy of 'full employment'. But how can anyone feel such an assurance? The most powerful business interests in America are at present loudly proclaiming their detestation of the 'New Deal' in all its aspects, and their determination to have no more of it. Yet what was the 'New Deal' except an attempt by President Roosevelt to follow a policy of 'full employment' as far as the limits set by the American Constitution and the peculiarly resistant attitude of American business would allow? A Government cannot follow a 'full employment' policy unless it is able to interfere largely in the conduct of private business and to spend largely out of public funds in sustaining demand when it threatens to fall short. The 'New Deal' was allowed to happen because in the circumstances of 1933 the American business world lay prostrate. But no sooner was any business man back on his feet than he began loudly vilifying the hand that had raised him up. It would indeed be optimism to suppose that this mood has passed away among the Americans, that after the war American Governments are likely to be able steadily to pursue policies of 'full employment', or that American business is likely so to re-organize itself as to shed its instability and provide for a steady level of high production and high employment without Government interference.

It is, of course, easy to understand the widespread desire among Americans to give the world a strong push back in the direction of gold as a basis for national currencies. They have the stuff—far more of it than they can possibly find any use for in the United

States—and most of this gold has been taken in exchange for American exports for which they have received no other return, and is now costing good dollars to store and having to be 'sterilized' in order that it may not exert its full inflationary effects on the credit structure and the price-level. In June 1943 the American gold reserve stood at 22,388,000,000 dollars—an astronomical figure out of relation to any possible need. This gold stands at its dollar value as the capital asset held against debts owing by the American Government and its banking system to the citizens of the United States. If its value had to be written off, the taxpayers of the United States would not necessarily be any worse off than they are while they have to pay the interest on the sum immobilized in holding the gold idle; but there would be an immense book-keeping loss, in that there would no longer be any capital asset held against the debt. It is therefore very much a matter of concern to the United States Treasury that the gold stock should retain its value; and this is part of the reason why the United States has been willing for years past to go on acquiring gold which it cannot possibly use or want. A refusal on the part of the Americans to receive gold would have had a double effect. It would have meant that they could not get paid for their exports unless, by lowering or abolishing their tariff, they had allowed their debtors to pay in goods for sale in the American market; and, over and above this, it would have meant a catastrophic fall in the value of gold, because no other country could have afforded to replace America as a buyer.

It is one part of the gold standard that a country which accepts it must be prepared to receive at the price which corresponds to the gold value of its own currency any amount of gold that anyone may choose to sell to it at that price. For years before the war, the world price of gold was determined by the buying price of the American Treasury and Federal Reserve Board; and this price determined the volume of gold production throughout the world. It was a high price, in relation to the costs of mining gold; and the effect of it was that the output of gold was rapidly increased, despite the fact that nobody really wanted the gold that was being mined. Mines which had been given up as unremunerative were brought back into production, and output at mines of better productivity was increased. Huge presents of windfall profits were made to the owners of gold-mines—to be taxed away, in part, by the States in which the mines were situated—e.g. South Africa. The Soviet Union managed to pay for a substantial part of its imports with

TABLE XII

Gold Reserves of the Leading Countries in June 1939
(In Millions of U.S. Dollars)

United States[1]	16,110
France	2,570
United Kingdom	1,067
Holland	800
Belgium	668
Switzerland	599
Argentina	428
Sweden	346
India	274
South Africa	219
Canada	213
Italy	194
Japan	164
Roumania	138
Norway	107
World (except U.S.S.R.)	24,942
Gold in Exchange Equalization Funds	2,300
	27,242

Gold Production in 1939
(In Millions of U.S. Dollars)

South Africa	449
U.S.S.R. (1938)	180
Canada	178
United States	164
Japan and Korea	72
Australia	57
Philippines	35
Mexico	29
Rhodesia	28
Gold Coast	27
Columbia	20
Belgian Congo	19
India	11
Chile	11
New Zealand	10
World	1,383

newly mined gold, and was thus relieved of the necessity of exporting commodities which were badly needed for consumption at home. The purchase of gold by the Americans became a method whereby the rest of the world was enabled to keep up a relatively high level of commodity purchases from the United States. Even the gold-miners profited from better employment and from the practicability of getting higher wages as a result of the prosperity showered on their employers by the beneficent gold-buying policy of the United States.

For all this the American taxpayers had to foot the bill. But the United States could not stop buying gold without bringing disaster on its own exporters and provoking an outcry about budgetary losses from the very persons who were bearing the burden. The situation was farcically absurd; but it suited both the countries of the British Empire which are large gold-producers and the Soviet

[1] By June 1943 the United States Gold Reserve had increased to 22,388 million dollars.

Union, and it seemed to be in no one's interest to incur the risks of putting a stop to it. The production of new gold rose to fantastic heights: the less was wanted, the more was produced. Some day, the gold bubble seemed certain to burst. But when?

The necessity under which the United States was of adding continually to its stock of unwanted gold rested, of course, in the first instance, on the unbalanced condition of American import-export relations. The Americans were still trying, throughout the 'thirties, albeit with some misgiving, simultaneously to stimulate exports and to restrict imports in order to protect American industries. They were trying to sustain an economic position which could be balanced only by a steady export of capital on a large scale, or by gold imports. As the openings for foreign investment did not seem good under the prevailing conditions of world economics, only gold imports were left as a means of squaring America's international accounts.

Very naturally, the American Treasury would like to get rid of as much as possible of its huge accumulation of unusable gold. It has been doing this of late on a noticeable scale by means of gold payments to Latin America; and one Latin American country after another has been stabilizing its currency with the aid of American loans or American payments for wartime supplies. But the net effect of these outward movements of gold has been very small in relation to the magnitude of the available gold stock. At the end of 1942 the published figure for this stock was 22,726,000,000 dollars; by the end of June 1943 it had fallen only to 22,388,000,000. But in December 1939 it was but 17,643,000,000, and in December 1929 but 6,602,000,000 in terms of the present gold content of the dollar, or 3,900,000,000 at the dollar value then current, i.e. before the devaluation of the currency during the world depression.

The Americans would like, after the war, to get the business of setting up with gold reserves the depleted Central Banks of all the other belligerent countries. They would like to trade off as much as possible of their surplus gold in this way. Use it for paying for imports they cannot; for apart from any payments from this source they are certain to have a large surplus of exports over imports, even if they receive nothing on account of 'lease-lend in reverse'. The gold, if it is to go out at all, can go out only by way of loan; and if some of it does go out in this way, it is not easy to see how the recipients will be able to pay the interest on such loans except by borrowing more. The United States Treasury, however, does

not look at the matter in this light. It would like, in the interests of 'economic stability', to persuade other countries to return to the gold standard; it would like to get some return on a part of its surplus stock of gold; and it would like to be relieved of the burden of being virtually the sole buyer of newly mined gold in the future. The United States Treasury therefore starts with a strong presumption that a general return to the gold standard would be a good thing; and, as the internal credit policy of the United States is not in the least likely to be hampered in any way by the pegging of the dollar to gold, American financial opinion is liable to conclude that the same thing must be equally true of other countries.

Nor is this all. The gold standard is essentially a *laissez-faire* standard. It rules out such methods of economic management as involve restrictions on exchange transactions. The Americans are apt to regard such restrictions, from whatever cause they spring, as manifestations of the evil spirit of 'economic nationalism', which they hold laudable when it takes shape in the American protective tariff, but a sign of economic depravity when it expresses itself in any other way. The desire to return to the gold standard as a self-regulating mechanism for the international exchange of money is in part a desire to make an end of the entire system of restrictionism which was stifling international trade in the 'thirties—with the one very large exception of the American protective tariff.

The fundamental question, however, is whether other countries can possibly afford to accept the gold standard, in the sense either of incurring the cost of building up a stock of gold as a basis for their currencies, or of accepting a stable relation of these currencies to something so essentially unstable in real purchasing power as the American dollar. A gold stock is an expensive luxury, even if it is no longer to be regarded as necessary to hold a large part of it immobilized as a reserve against the internal currency, and no more is attempted than the creation of a fund adequate to stand up against any probable external drain. Gold can be accumulated only by paying for it with exports, or by borrowing it; and will countries which are hard put to it to maintain a balanced condition of their current import-export accounts be able to afford to buy gold, especially if they are in need of imports of real capital in the form of goods which will help to increase their productive power? There is something not a little absurd in attempting to force the needy debtor, who cannot pay for his current purchases, to accept an

additional loan of what he does not want. But this is in effect what is involved in an attempt to force the world back to the gold standard when the war is at an end.

It is, no doubt, true that the British Empire, as well as the United States, has an interest in keeping up the value of gold. The Union of South Africa is the world's greatest gold-producer; and Canada also has a leading position among the gold-mining countries. The profits of gold-mining in the Empire are largely brought to Great Britain as incomes of British shareholders in Empire gold-mines; and it would come as a rude shock both to the producing Dominions and to the City if these profits were to be swept away. There are accordingly powerful interests on the British side which look not without favour on projects designed to assure a profitable future for the gold-mining industry. But from the standpoint of the British people it is far less important to safeguard these interests than to ensure that Great Britain shall not be prevented, by the tying of its economy to the fortunes of the United States, from pursuing a continuous policy of 'full employment'.

Yet it would be manifestly inconvenient if the gold bubble were to burst all at once. Its bursting might easily precipitate in the United States just that economic crisis which it is in the interest of the whole world to prevent, if it can be prevented; and it is impossible to ignore the serious effects which a sudden collapse of gold-mining would have on a number of Empire countries—above all on the Union of South Africa. The Soviet Union, too, has an interest in averting a sudden loss of purchasing power in gold, especially in view of its need for large capital imports to repair war devastation. It would therefore be foolish to suggest that, because the world has already more gold than it needs, it should suddenly stop producing any further supplies. If the United States were to stop buying gold, nothing could avert a complete collapse of the gold market; but if the United States, for reasons of its own, is prepared to go on buying, so much the better for everyone else—provided that we do not expect so absurd a situation to continue for an indefinite period ahead.

Clearly, what is needed is an orderly scaling-down of the world's gold production, under an agreed scheme, and a gradual transference of the persons and the resources now employed in gold production to more useful forms of work. This could be achieved by a gradual reduction over a period of years of the American buying price for gold, involving a corresponding fall in the gold

value of the American dollar, but not necessarily any change at all in American dollar prices, which do not now depend on the amount of the American gold stock. If such a policy were agreed upon, it would allow time for the gold-producing countries to shift their activities over to other forms of production with the minimum of dislocation; and it would also give time for the Americans themselves to deal with the book-keeping loss incurred in writing down the value of their swollen stock of gold.

Such a policy as this could be adopted without any necessity for the United States to force other countries back on the gold standard. If they were forced back, it would, of course, be necessary for them to raise the gold values of their currencies in parallel steps with the changes in the gold value of the dollar. This, however, might be highly inconvenient to them, and might involve them in a continuous deflationary pressure spread over a considerable number of years.

One further factor of which it is necessary to take account in considering the expediency of a general return to the gold standard is the difference in the rate of economic progress between one country and another. If technical efficiency is advancing faster in one country than in others, and if its effects in cheapening commodities are not offset by other factors, such as a growth of monopoly or a piling up of selling costs, its goods will become cheaper than those of the countries in which technique is developing less fast. This will tend to increase its exports and to reduce its imports, at any rate in the short run, and will react unfavourably on the economic position of other countries which are tied to it by a common currency standard. No doubt, in a perfect economy of *laissez-faire*, the position would be redressed in the long run by a migration of population and resources to the country in which they could be most productively employed. But this tendency would in practice be strongly resisted, not only by the countries which stood to lose population and industry, but also in all probability by the country which stood to gain them. The theoretical restoration of equilibrium would not in fact take place, except over a very protracted period—even if it took place at all.

Now, a country which is falling behind the pace of the foremost in improving technical efficiency can to some extent check the loss of trade which it would otherwise incur by allowing the relative value of its currency to fall. Such a measure will be effective in the long run only to the extent to which internal costs and prices fail

to rise in correspondence to the changed external value of the currency. But in the short run the protection afforded may be considerable, and may be of substantial value if the time is used, not to bolster up inefficiency, but for improving the pace of technical advance and for eliminating unnecessarily high overhead costs. It will be answered that this is a dangerous line of argument, because in practice a country which resorts to this method of protecting itself against the competition of the more efficient will be more likely to remain inefficient than to re-adjust itself to an improved technical level. I do not at all dispute that this danger exists, wherever monopolist influences are allowed to exert an effect on national economic policy. But freedom to adjust currency values may be preferable to tariff manipulation, in circumstances in which a country is not prepared to accept the full consequences of a decline in its relative efficiency without some attempt at giving itself time to improve its methods of production and distribution in order to redress the balance.

XIII

EXCHANGE CONTROL

IF countries are not on a fixed gold standard, it does not follow that they must allow the external value of their currencies to fluctuate in accordance with the day-to-day conditions of supply and demand. We have seen that, in fact, in the 'thirties, when the gold standard was largely in suspense, most countries did establish some mechanism for regulating the course of their exchange rates. The methods varied from Exchange Equalization Funds, such as were operated by Great Britain, the United States, and a number of other countries, to the forms of Exchange Control and Clearing Agreement which found favour with those countries which decided to maintain the nominal gold parity of their currencies while endeavouring to insulate themselves internally from the deflationary effects of such a policy, and also with those weaker States which were driven to financial extremities by the sharp fall in the world prices of the primary products they exported.

Exchange Equalization Funds, as we have seen, cannot stand out against really persistent tendencies making for a change in relative currency values. They can only check currency speculation, iron out short-term fluctuations, and, by mutual agreement, support for a time such currencies as are attacked by such adverse forces as 'loss of confidence' or deliberate 'bear' pressure. Involving no direct interference with the course of either trade or capital movements, they can act only as the interpreters of long-term forces of supply and demand, and cannot influence these forces save to a minor extent. No doubt, if an Equalization Fund is equipped with very large resources which it can turn into gold or foreign currencies, it can operate for a proportionately long time even against a persistent tendency; but an Equalization Fund has no magic power to acquire either gold or foreign exchange in place of the national currency unless the conditions favour such acquisition. A country which has a favourable balance of payments can easily build up a large stock of gold or foreign exchange: a country with an unfavourable balance has no such power. True, conditions may arise in which a country with an unfavourable balance of *current* payments finds itself able to acquire gold or foreign exchange because of an influx of short-term capital—sometimes known as 'hot money'. But

such a situation is exceptional; and in general an Equalization Fund is an interpreter of long-term trends and not an instrument for causing the rates of exchange to be different in the long run from what they would have been in its absence.

Exchange Controls work in quite a different way; for they are, in general, instruments for altering, or artificially stabilizing, rates of exchange by influencing the volume of transactions carried on across national frontiers, both by affecting their total amount and by directing their flow into particular channels. The essence of exchange control is that the possessor of the controlled currency has no right, without special leave, to convert it into foreign currency. His right is limited to a greater or a lesser extent. There may be merely a global limit on the total amount of this or that foreign currency to be supplied, and the supply may be on the principle of 'first come, first served'; or there may be, and usually is, some rationing of foreign currencies in relation to the purposes for which they are needed. Thus, foreign currency may be demanded (*a*) to pay for imports of goods or services, (*b*) to pay interest or dividends due on capital owned abroad, (*c*) to take money out of the country for tourist or commercial travelling expenses, (*d*) to make remittances to relatives or friends abroad, (*e*) to make short-term loans abroad for financing trade or production, (*f*) to make long-term investments abroad, (*g*) to escape out of a currency in which no confidence is felt into another, (*h*) for purposes of permanent emigration from one country to another. This list is not meant to be exhaustive, and it omits Government payments; but it serves to indicate the main types of demand.

Different degrees and forms of restriction may be applied to demands for foreign exchange according to the purposes for which it is wanted. A country which is trying to reduce the demand for other currencies in exchange for its own may limit itself to a ban on capital transactions, or even on certain kinds of capital transactions, such as overseas issues in its home capital market. Or it may, if the pressure is greater than can be met by such means, set to work to limit imports by refusing to supply foreign exchange except for those purposes which are regarded as 'essential'. Imports can, of course, be restricted by other methods besides exchange control—by tariffs, for example, or by quotas, such as Great Britain applied to bacon and other foodstuffs, or by a licensing system, such as Great Britain used in the case of dyestuffs for building up the home dyestuffs industry. Exchange control may be used as an

alternative or as a supplement to such measures of direct control over international trade.

Again, a country which has to meet interest or dividend claims on foreign-owned capital can 'block' the transfer of such sums across the national frontier, either absolutely or under certain conditions. For example, the sums due may have to be paid into 'blocked' accounts at the Central Bank, to be drawn upon only for certain purposes—for current spending inside the country, or for the purchase of goods for export, or for long-term investment inside the country. Such 'blocking' may be the alternative to actual default on bonds or shares belonging to foreigners, and may of course be a temporary measure. While it lasts, sums in 'blocked' currency will obviously tend to be worth less than nominally equal sums which are freely convertible into foreign exchange. In other words, the 'blocked' money may, and usually does, go to a discount: so that there appears a second *de facto* rate of exchange different from the official rate, and maybe quite a number of such *de facto* rates, if there are a number of different kinds of 'blocked' account. In the 'thirties, the number of different kinds of German *reichsmarks*, each with its own current market value, became quite bewildering.

Yet, again, it is common for countries which have established exchange control to restrict the amount of money which anyone leaving it may take out with him. Such restrictions apply both to tourists, who are generally cut down drastically, and to commercial emissaries going abroad, who are usually better accommodated. They apply to foreigners leaving a country after a visit, and to residents who wish to leave it permanently. Wealthy persons who wished to escape from Germany under the Nazis were often allowed to take a small fraction of their fortunes out with them on surrendering the remainder to the State—or sometimes after using most of their money in greasing the appropriate palms.

With such restrictions on taking money out of a country often go requirements about bringing money in. Exporters who sell goods abroad, or capital-owners who are due to receive foreign interest or dividends, are compelled to surrender their receipts to the Central Bank or the Government, which then makes payment to them in the national currency either at the official, or sometimes at a special, rate of exchange. Attempts are sometimes made, with varying success, to prevent persons from leaving or re-investing abroad sums due to them in foreign money; but such restrictions

are peculiarly difficult to enforce with any completeness—especially against businesses which carry on operations in more than one country.

In sum, exchange control has many degrees of stringency and can be applied over a narrower or a wider field. It is naturally most stringent where a country is maintaining an official rate of exchange widely different from that which would establish itself if no control were being exercised (e.g. Nazi Germany), and least where a mild influence is enough to bring the supply and demand forces into balance at the rates of exchange which the monetary authorities are endeavouring to maintain.

The Americans have been saying a good deal of late not only about fixing the gold values of the various national currencies after the war but also about getting rid of all forms of exchange control. These two objects may, however, be fundamentally inconsistent. If countries are compelled to go back to fixed ratios of exchange for their currencies, they may be totally unable to maintain these ratios without measures of strict exchange control. Such control may be, in effect, the only alternative in such circumstances to a degree of internal deflation which it may be impossible to enforce, or politically impracticable to attempt.

The German example in the 'thirties has shown that it is possible for a country, with the aid of strict exchange control, to maintain its currency officially at a highly artificial external value, and at the same time to pursue policies of internal expansion which would be entirely ruled out if the exchanges were left free. This cannot, as we have seen, be done without the appearance of *de facto* rates of exchange different from the official rate; and it has usually the paradoxical result that the controlled currency acquires in terms of other currencies varying values which do not correspond to the relative values of these currencies in terms of dollars or sterling. Although the official rate was uniform, a *reichsmark* had in practice in the 'thirties one value in Rumania, another in the Argentine, and another in Turkey; and these values did not correspond to the values of the Rumanian, Argentinian, and Turkish currencies in other parts of the world. Such differences were the outcome of the 'clearing' arrangements which we have discussed in an earlier chapter; and the conclusion of 'clearing agreements' is a natural sequel to any far-reaching exchange control designed to preserve an artificial rate of exchange for all transactions not covered by special arrangements.

It is easy to understand the desire to get away from the tangle of exchange restrictions which almost everywhere beset foreign trade before the war. But the attempt to return to fixed gold parities, so far from furthering this object, is likely to make a continuance of drastic exchange restrictions absolutely unavoidable. If a country which is in difficulties over its balance of payments may neither allow its exchange rates to alter nor impose exchange controls, what is it to do? The *laissez-faire* purist would presumably answer that it must carry through measures of internal deflation on a sufficient scale to put its balance of payments right. But this may be a task altogether beyond the power of its Government; and an attempt to carry out such a policy after the war would be much more likely to provoke revolutions over most of the world than to result in a return of stable economic conditions.

If there is to be a return to fixed exchange parities, there will have to be exchange controls, as the only means of upholding these parities, at any rate for a long time to come. Moreover, even if, as I hope and believe likely, fixed exchange parities are not restored, I feel sure exchange controls will still be needed, though it will not be necessary for them to assume so drastic a character. Presumably, if room is left for exchange movements beyond the 'gold points', it will not be desired to leave the exchanges to fluctuate quite uncontrolled. There will be, at the least, some attempt to eliminate speculative movements and to iron out short-term fluctuations. Some countries may be able to achieve what is needed mainly by the use of Exchange Equalization Funds, without applying exchange control over any wide field; but I feel sure that most countries, including Great Britain, will have to take power to control at all events capital movements, both short and long, and I very much doubt whether most countries will be able to manage without some power, however mildly exercised, to control the supply of foreign exchange available for buying imports.

Doubtless, the need for this latter form of control will depend in part on the extent to which control over imports is made effective by more direct methods—tariffs, quotas, and licensing arrangements. The Americans, however, appear to object to quotas and licensing quite as much as to exchange control; and if only the tariff method were to be left open as a way of directly controlling imports, I feel sure most countries would have to fall back on supplementing tariffs by the indirect instrument of exchange control. The weakness of a tariff is that it is very apt to keep

out, not the less essential, but the more essential imports, and in addition to give home producers the means of raising the prices of necessary goods. Both quotas and licensing and exchange controls can be used much more easily to discriminate against unnecessary imports; and a country which is compelled by its economic situation to restrict imports can hardly give up its right to use any method except the tariff. The more quotas and licensing are used, the less exchange control will be needed, and *vice versa*; but the degree of lack of balance for some time after the war is likely to be so great as to make it quite impracticable to rule out both alternative methods of regulation.

Quotas, import licences, and foreign exchange controls are alike methods of regulating the quantity of imports. Any of these forms of control is capable of being used, not merely to limit the total quantity of imports, or to give priority to essential over non-essential supplies, but also to 'discriminate', so as to encourage trade with one country rather than another. This element of 'discrimination' enters in much more when there are 'clearing agreements', designed explicitly to foster trade between two particular countries. Now the Americans, or at any rate Mr. Cordell Hull as their spokesman, have pronounced 'discrimination' and 'bilateralism' in international economic relations to be anathema, and have declared that it is essential to return to a 'multilateral' system under which there is no need for the exchanges between any two countries to balance. Under a multilateral system, one country may sell more to another country than the latter can pay for with its exports to the former, and the difference may be settled by the second country having a surplus of exports to a third country, which in turn exports more to the first country than it imports from that country. The actual system of trading exchanges may be much more complicated than this, so as to involve a large number of countries before the balance is completed; but no difficulty will arise if in the end each country has bought from all the others taken together as much as it has sold to them—or rather so much more or less as is made desirable by its creditor or debtor situation or its import or export of capital. Thus, Great Britain has been in the habit of buying more from the United States than the United States buys from Great Britain; but Malaya has been in the habit of selling more to the United States than it buys from the United States, and of buying more from Great Britain than it sells to Great Britain, after allowance has been made for what it must send to Great Britain as pay-

ment for the use of British capital invested in Malayan tin and rubber. Therefore, a part of Malaya's exports to the United States can be used to pay for British imports from the United States; and in this way a part of the adverse British balance can be settled.

It would be obviously a great hindrance to international trade if this sort of thing could not be done, and if each country's trade with each other had to balance. The effect would be seriously to diminish the possibilities of the 'international division of labour'—that is, of each country's specialization in making on a large scale those things which it is good at making, and in which, in the language of the economists, it enjoys a 'comparative' advantage. It is indispensable, if international trade is to flourish and if the production of wealth is to be maximized over the world as a whole, to make provision for multilateral exchanges of goods and services, and not to attempt to reduce all foreign trade to a series of bilateral exchanges. So far the contention of Mr. Cordell Hull undoubtedly holds good.

It does not, however, follow from this that there ought to be *no* bilateral exchanges. If two countries can, by making a mutual arrangement to 'swop' certain goods, make possible a series of trading operations which would not otherwise occur at all, or would be on a much smaller scale, the effect will be clearly to enlarge and not to restrict the openings for international commerce. The United States has itself, in fact, entered into bilateral commodity bargains of this sort, not by way of currency clearing agreements but directly; and in the circumstances in which these exchanges were arranged—for the purpose of getting rid of otherwise unmarketable surpluses of goods—they were of advantage to both the participants, and of no disadvantage to anyone else.

The real basis of the opposition to bargains of this sort is that they involve a measure of State trading, or at the least of trading between organizations acting under the auspices of the State. American hostility to them is a part of the fight against the 'New Deal' and against everything that savours even faintly of Socialism, or of State economic activity in spheres hitherto reserved for 'private enterprise'. Bargains for the bulk exchange of goods can hardly be made except between States, or between State agencies; and any system of rationing either imports or the means of paying for them, including any sort of clearing agreement, necessarily brings in the State or, at the least, a Central Bank acting in effect with the State's authority. So, it may be said, do tariffs, to which even the most individualistic Americans are far from taking objection. But

the difference between tariffs and other means of influencing the course of international trade is that the State, having made a tariff, has nothing more to do beyond collecting the duties, whereas the working of quotas (and *a fortiori* licensing) and of exchange controls means continuous administrative intervention by a public authority. Moreover, if the trade between countries is to pass under any sort of quantitative regulation, the door is evidently set ajar to State or State-controlled arrangements for bulk purchase or bulk sale, to the creation of Import Boards and Export Boards, and to the supersession of the private merchant and the private merchant banker in certain parts of their traditional business.

Very often these reasons are not stated, and the opponents of any sort of special arrangements between States for the mutual exchange of products shelter themselves behind the arguments of the orthodox economists against bilateral and in favour of multilateral trade. There is, however, nothing in the making of collective bargains between States for bulk exchange of products that makes against multilateral trading, unless the bargains are designed to bring about an equality between the total imports and exports passing between the two countries. If Great Britain were to make a bargain to supply the Danes with certain quantities of coal and machinery in exchange for Danish bacon, this would not be in any way objectionable, or contrary to the principles of the 'international division of labour', unless it were part of the bargain that the total trade between Denmark and Great Britain should balance.

No doubt, 'clearing agreements' do involve precisely this notion of a bilateral balance of trade. They are therefore not to be welcomed, and can be defended only as expedients to which countries may be driven in periods of extreme economic dislocation. But it would be foolish to extend the objection which applies to comprehensive 'clearing agreements' to all forms of bilateral bargaining, whether by direct exchange of goods or by some form of financial control.

Let us try to apply these generalizations to a specific case. It is manifest that Great Britain after the war will be hard put to it to find means of paying for necessary imports. On the average of the three pre-war years, British net imports of food, drink, and tobacco were valued at £403 millions, of which £29 millions were spent on imported bacon, of which more than half came from Denmark. It would be possible to replace a large part of this imported bacon by home-produced bacon, with disastrous consequences for the

Danes, who have practically no outlet for their bacon except Great Britain. Great Britain might be forced by exchange difficulties to take this course; but there would be much less inducement to do this if the Danes would take payment for their bacon, which is preferred by most British consumers, in British-made goods. A bargain on these lines would enable the Danes to continue with an industry they have shown special skill in developing, would give British consumers a more favoured product, and would not involve exchange difficulties if the exports taken from Great Britain balanced the cost of the bacon, after allowing on the one side for imported materials incorporated in the exports and on the other for saving on imports of feeding-stuffs which would be needed to produce the bacon in Great Britain. This assumes, of course, that the Danes would not buy the British exports if we refused to buy their bacon; but this is a fairly safe assumption in the light of Danish import statistics in past years.

A bilateral bargain of this sort, so far from interfering with the 'international division of labour', would positively promote it. There is, however, a difficulty. Whereas it would be easy for Great Britain to purchase the Danish bacon in bulk, at an agreed price, and for Denmark to take British coal in exchange for some of it, there are few British exports except coal which could easily be sold in bulk at a fixed price to the Danish State or to any agency acting on its behalf. British exports, except coal, are mainly manufactured goods, diverse in character, and not so easily to be disposed of by bulk sales. It would therefore probably be simpler for the Danish bacon not exchanged for coal to be paid for by a credit on London, to be expended on any kinds of British goods Danish buyers happened to want. This would have to be a 'blocked' credit, spendable except by special arrangement only in purchasing British products. Objection will be taken to it on this ground; but how else is Great Britain to pay? No difficulty would arise if Great Britain could rely on selling in the world market as a whole enough exports to meet the cost of all required imports. But is this likely to be the case? If it is not, surely it is better for Great Britain to pay for the Danish bacon in the way suggested than not to be able to buy it at all?

This sort of bilateral bargain was, of course, actually tried out, up to a certain point, in the 'thirties. Great Britain did negotiate with the Scandinavian countries agreements under which they undertook to import certain quantities of British coal in exchange

for some of their exports to the British market. These agreements had, let us admit, certain disadvantages. Polish coal, which would otherwise have looked for an outlet in Scandinavia, was diverted elsewhere—to the Mediterranean in particular—and competed with British coal more intensively in these other markets. The additions to Scandinavian purchases of British coal were not net additions to total British coal exports. But I think Great Britain did as a result of the agreements export substantially more coal than could have found an outlet without them.

'Ah, yes,' it may be said, 'but this gain was at the expense of Poland.' I am not sure of that; for the maintenance of British imports from Scandinavia made possible a larger total of foreign trade than would have existed otherwise. But, to the extent to which British did displace Polish coal, is Great Britain to be blamed? The British people could not go on importing goods for which they could not afford to pay: in order to import, they had to have markets for exports. If the total world market was too small to keep the world's productive capacity adequately employed, the remedy was not for Great Britain to maintain an unbalanced position by going on paying for imports by reducing foreign investments, but for the world as a whole to take steps to achieve fuller employment by expansionist national and international policies designed to enlarge the total market.

The important thing is, not to avoid bilateral arrangements altogether, but to use them in such ways as to promote, instead of restricting, international trade. The situation imagined by economists, in which the whole world is regarded as a single economic area, within which not only goods but also human beings and capital migrate freely, moved by purely economic considerations and in entire disregard of territorial frontiers, never has existed, and is certainly not likely to exist in any near future. Men are not moved by purely economic motives in deciding where to live—when they do decide at all: nor are most men really free to move at will over the earth, in search of economic advantages, under any social system the world has known as yet. It cannot be a matter of no account to a country if, on purely economic grounds, its population ought to be moved *en masse* elsewhere, or if it must submit to a lower standard of living because total *world* wealth will be greater if industry deserts its territory. Perhaps, some day, territorial frontiers will be done away with, and a World State be born. But, even so, will it become a matter of no account to Englishmen if England

lose its prosperity? It is not so to-day with the people of Wales or of the Scottish Highlands. The throwing down of territorial frontiers between States would not make an end of national or local sentiment: nor could a World State afford to ignore the well-being of each of its parts in pursuit of a programme of maximum production over its whole territory. Countries have to think of their own well-being, as well as of the world's; and it is highly doubtful whether a world Government which ignored the lesser groups would even maximize the world production of material goods.

This is not to suggest that migration may not be beneficial. Clearly it may, especially where there is a sharply rising survival rate and a pressure of population on the land. But it is one thing to encourage voluntary migration, and quite another to expel populations from their homelands by the pressure of economic forces without an attempt to stem their current. Economic progress involves continual adaptation; but there is a limit to the pace at which countries can adapt themselves without social disaster. Nations have a right to protect themselves against world forces whose impact is too powerful to be met by reasonable measures of adaptation. This is the fundamental case for some sort of 'protectionism' in a world of change: it is the case which the *laissez-faire* dogma does not meet, but simply ignores.

Let us agree that 'protectionism' is very open to abuse, especially where there are powerful vested interests which seek it, not for the community's sake, but their own. But the admission that abuse is easy is an argument, not for giving up the thing, but for arranging it better, to serve the ends of the people. It will be necessary, if quotas, licences, bilateral arrangements, and exchange controls are to be admitted as part of the normal processes of international trade and economic relations, to ensure that what is done in these ways is done in accordance with the requirements of a clearly conceived national economic plan of production and trade, made not in isolation, but in close consultation with other countries equipped with similar plans, and made in such a way as to bring about the largest possible measure of international co-operation between the planners of the various countries.

What Great Britain cannot afford to do, in this field any more than in that of the fixing of currency values, is to give up its freedom of national policy-making, and to surrender itself to a system of world *laissez-faire*, merely on the *obiter dictum* of orthodox economists that this is the way to maximize welfare, or on the assurance

of American business interests that they will behave nicely if only other countries, and especially Great Britain, will join hands with them in making the world safe for 'private enterprise' against the threatened action of Governments in the economic sphere.

In effect, I envisage the future trade of Great Britain as resting on a foundation partly of unorganized 'free' sales and purchases between individual sellers and buyers in different countries, but also partly of organized bargains for the bulk purchase of necessary imports in exchange either directly for British exports or indirectly for more diversified exports through credits opened in Great Britain in favour of the suppliers. Such a mixed system offers great advantages. It makes possible a steadying of the market for bulk imports by means of long-term contracts which will make it feasible for the supplying countries to plan well ahead. It should steady both prices and output for the goods to which it applies; and it should give the suppliers the assurance of getting paid for their wares in goods they really want, at prices which they will have a share in fixing. I do not want this system to extend over more than a fraction of total import and export trade; for an unplanned margin is essential to the successful working of a system of planned bulk imports and planned sale of bulk exports in exchange. Over how large a part of the total field such arrangements should extend, or to how many countries they should be applied, I do not profess to say. What I am urging is that Great Britain should enter into no binding international trade or monetary bargains that would make such experiments impossible without breach of international undertakings.

I do not want to repeat here at length the arguments I have advanced elsewhere to show how great the difficulties of Great Britain are likely to be after the war in paying for the imports which will be needed to provide for a fully employed population at a satisfactory standard of life. I need only recapitulate very briefly.[1] On the average of the years 1936-38, British *net* imports were valued at £866 millions, and British net exports at £478 millions. The visible adverse balance was £388 millions. Interest and dividends on overseas investments reduced this deficit by about £203 millions, and shipping and financial services by another £145 millions, leaving a net deficit of about £40 millions to be met by borrowing or repatriation of overseas capital assets. These imports

[1] For the full argument, see *Great Britain in the Post-war World* (Gollancz, 1942).

consisted mainly of foodstuffs and of materials and intermediate products needed for industry, finished manufactures making up only quite a small proportion. After the war, a large part of the revenue from overseas investments will have disappeared; and a very great increase in exports will be needed if Great Britain is to go on importing at the same rate. Moreover, at pre-war prices imports were cheap in relation to exports (that is, in technical phrase, the 'terms of trade' were favourable). It is to be hoped that after the war the world's primary producers will get better prices; but this will mean that still more British exports will be needed to pay for imports of the pre-war volume. The increased exports will require more imported materials; for from a third to a half of the value of most exports, except coal, is made up of the things imported for making them, and not of the value added in the course of manufacture in this country. Add to this that 'full employment' and social security will mean both an additional demand for materials for use in industry, and more consumption of foodstuffs and other commodities. It is by no means an exaggeration to suggest that Great Britain will need after the war, without any provision for the export of capital on loan, to raise net exports from £478 millions to £1,000 millions at 1938 prices.

Can this be done on a basis of ordinary competitive multilateral trading? Perhaps it can, if over the world as a whole most countries are actively following policies of 'full employment' on a basis, not of economic nationalism, but of a ready willingness to collaborate with other countries in raising the level of international trade, and if, further, British industries maintain themselves at a high level of efficiency and shake themselves free of restrictive monopolies designed to hold up prices. But who can rely on all these conditions being fulfilled? They are, in my view, capable of being fulfilled only if in each country the State takes an active part in national economic planning; and I cannot see States doing this without at the same time entering into mutual relations for international planning—that is, for assured bulk exchanges of goods and services one with another. An element of what is called 'bilateralism' is, in fact, inherent in planning as soon as it transcends the purely national. It would be a sorry outcome if national planning were to be forced on to lines of *autarkie* because it had to exist in a world framework which excluded all agreements between nation and nation, in the name of an illusory world-wide freedom of exchange.

The argument becomes even stronger, from the British standpoint,

if Great Britain is to be expected after the war to play some part in the export of capital for the economic development of the more backward countries. How can Great Britain export capital until British imports have been fully paid for with exports? The export of capital implies a surplus of exports over imports; but Great Britain can hope for such a surplus only after the formidable task of more than doubling pre-war exports has been successfully tackled. Great Britain cannot export, as capital loans, goods which the purchasers would buy and find means of paying for if the loan were not granted from British sources. Great Britain must get paid for what is exported up to the point necessary for balancing the account. Of course, if foreign capital can be lent to Great Britain for re-lending as exported capital elsewhere, this objection does not apply; but how far are Americans, the only large source from which such loans could come, likely to favour making loans to be spent on British goods? Perhaps they will: if so, well and good. But we should be unwise to rely on this in framing our policies for the post-war period.

It all comes to this. Bilateralism is not, up to a point, a bad or a restrictive thing, as some of the economists have tried to make it out. It can be used to expand trade, as well as to restrict it; and in the difficult times which will follow the war, it is likely to have considerable merits as an instrument of expansion. It would be exceedingly foolish on the part of British statesmen to tie themselves down in such a way that they could not make use of it. It is easy enough for the Americans to denounce as 'discrimination' practices which the state of their own balance of payments gives them no inducement to pursue. But often the real motive is not the avoidance of 'discrimination', but the putting of barriers in the way of State trading, or of active State intervention in regulating the course of international trade. Governments which purpose to pursue policies making for 'full employment' cannot afford to divest themselves of the power to plan internationally, as well as on a purely national basis; for their plans must cover imports and exports, as well as home production for home use. Let us by all means keep on our guard against restrictive forms of bilateralism, and against the making of bargains to suit vested interests rather than the common people; but let us not fall into the trap of accepting, in the cause of 'multilateralism', a set of rules which will make it impossible for us to maintain our imports at the level needed to secure our standard of living, or to plan for 'full employment' on the basis of a satisfactory division of labour.

XIV

THE KEYNES AND WHITE PLANS

ACTIVE discussion is going on as I write between British and American financial experts in an endeavour to arrive at an agreed scheme for some sort of international monetary regulation after the war. The situation that has to be faced is complex; and it is all too easy to concentrate attention mainly on one aspect of it at the expense of others. Let us begin by trying to summarize as clearly as possible the main issues which arise.

1. If the old 'self-regulating' gold standard has broken down, is it possible or desirable either to restore it in a somewhat altered form, or to find a substitute which will serve the same purpose of stability in the exchange rates between the currencies of the leading countries?
2. In view of the difficult situation as between 'creditor' and 'debtor' countries which existed before the war, and is certain to re-appear in greatly aggravated form after the war, is it possible to find means of preventing the lack of balance between such countries from paralysing international trade and resulting in expedients of exchange control, bilateral commercial agreements, and the like, which will reproduce the evils of pre-war 'economic nationalism' on a greatly increased scale?
3. Is it possible to check the practice of accumulating unspent short-term capital in the world's monetary centres, and of shifting this capital ('hot money') from one centre to another with highly disconcerting effects on monetary stability?
4. Is it possible to re-build the system of long-term foreign investment, which had largely collapsed in the 'thirties, without imposing on the borrowing countries intolerable conditions or burdens which they cannot hope to liquidate?
5. Is it possible or desirable to apply the principles of banking and bank credit, which have been applied internally in every developed country, on an international scale?
6. Should there be a new kind of international money, either to replace or to supplement gold as an instrument for the settlement of international balances?
7. Should some action be taken after the war to start each

country off with a supply of internationally spendable purchasing power, additional to such resources in gold or foreign exchange as it may then possess?

8. Should any action be taken to induce or compel countries which export more than they import (after allowing for existing long-term capital items) to convert their 'surplus' either into additional imports or into long-term foreign investments, or even to confiscate such balances if they remain unspent in either of these ways?
9. Should any action be taken to induce or compel countries which import more than they export (again after allowing for existing long-term capital items and also for new long-term imports of capital) to reduce their 'debits'; and can any such action be taken without a deflationary effect on the world as a whole?
10. Can the treatment of the finance of current economic transactions between countries, apart from capital transactions, be separated from the treatment of the finance of capital transactions, or must the two be handled together in any scheme of post-war monetary regulation?
11. To what extent should any international agreement on monetary questions be linked with, or made contingent upon, parallel agreement about international policies in the field of foreign trade, such as agreement to abandon or modify quota schemes, bilateral trading agreements, and so on?
12. Should any proposed international monetary authority or union be open equally to all countries, including (*a*) small or backward countries, (*b*) enemy countries; and to what extent, if at all, should narrower monetary unions or agreements between particular States be ruled out or restricted?

These twelve questions do not cover the whole of the ground at present under debate; but I think they serve to bring out most of the important points. Their range is wide, as it is bound to be; and one thing is so tied up with another that it is difficult to discuss them separately. The two principal Plans which have been published so far—the 'Keynes Plan' issued by the British Treasury and the parallel 'White Plan' issued in the United States—alike attempt to deal with the more specifically monetary problems without more than incidental reference either to the problems of international long-term investment or to those of international commercial

policy. This, as we shall see, gives rise to certain difficulties; but it seems best to begin by outlining and commenting upon these two Plans, as they provide the only clear indication of what is in the minds of the responsible financial advisers of the British and American Governments.

It should be made clear at the outset that both the Keynes and the White Plans were issued to the accompaniment of disclaimers that the Governments responsible for giving them to the public were in any way committed to them, either in detail or in principle. They were published for purposes of discussion and clearing the air, not as official pronouncements of the intentions of the Governments concerned. They did, however, evidently represent hopes, if not intentions; and in their differences and similarities they can be taken as indicating the lines which discussion between the two Governments may be expected to follow. There is, it should be noted, no sign that the Soviet Government has so far been in any way consulted: nor has Moscow given any indication of its line of thought. It is quite possible that before this volume appears both the Keynes Plan and the White Plan may have been superseded by further declarations, or even by some announced agreement between the British and American delegations which have been at work for some months in the United States. Whether the Soviet Government, or the Governments of other nations, will have been brought into these negotiations, and will be parties to any agreement that may emerge, I have no means of knowing; nor can I know whether, even if the negotiators agree, the Parliament of Great Britain and the Congress of the United States will be ready to fall in with their recommendations. The issues at stake are of supreme importance to the world as a whole; and I hope it has been made plain in earlier chapters of this book that there are matters involved on which Great Britain in particular will need to reflect carefully before entering into binding engagements that might unduly subject the British economy to influences emanating from America or restrict the freedom of the British Government to adopt the measures requisite for the successful pursuance of a policy of 'full employment'.

The Keynes and White Plans both propose the establishment of a new kind of international money of account, called *Bancor* in the former and *Unitas* in the latter. This international money is, in both Plans, to represent a certain weight in gold and is, under certain conditions, to be exchangeable for gold. In the White Plan the gold

equivalent of *Unitas* is specifically fixed: it is to be "137½ grains of fine gold (equivalent to 10 dollars of the United States)". In the Keynes Plan the gold value to be given to *Bancor* is not stated, and it is said explicitly that this value need not be fixed once and for all; but it is difficult to believe that, once fixed, it would in practice be easy to alter in such a way as to lessen the value of gold, because any such alteration would involve a book-keeping loss to the International Clearing Union which it is proposed to set up. In effect, both *Bancor* and *Unitas* are intended to represent definite weights of gold, and to be in principle based on gold as a standard.

Neither *Bancor* nor *Unitas* is meant to be money in the sense in which ordinary people commonly use the word. No private citizen is meant ever to possess any, even in a bank account—much less to use a *Bancor* or *Unitas* note to settle a debt. *Bancor* and *Unitas* alike are meant to be 'monies of account', to be owned and used exclusively by Governments or Central Banks for the settlement of international debts—and not of all international debts, but only of those which remain to be settled after the existing means have been used. They are essentially intended as means of settling such international balances as have in the past been settled either by moving or earmarking gold or by the holding of funds in one country on behalf of another. The clients of the proposed International Clearing Union or 'United Nations Stabilization Fund'—the American name for the new institution proposed—are to be Governments or Central Banks, not private persons or companies: except that the Keynes Plan also contemplates that the Clearing Union should act for such international agencies as may be set up for Relief and Rehabilitation, or for the development of projects of international investment as a part of plans for long-term reconstruction.

What, then, is the purpose of the new 'money of account', which is never to be used in ordinary private or commercial transactions? It is to provide the standard to which the various national currencies are to be related. Under the White Plan, not only *Unitas* but also each national currency is to represent a fixed weight of gold, and is therefore to have a fixed value in *Unitas* as well as in gold. This amounts to a proposal to return to the gold standard in its most essential feature—that of a fixed gold value for each currency, and therewith a practically fixed ratio between the values of the different currencies. Indeed, it appears as if relative currency values would be fixed even more rigidly than under the old gold standard, as presumably balances would normally be settled by transfers in the

books of the new international institution, rather than by transferring gold, so that the movement of exchange rates between the 'gold points' would tend to disappear. The Keynes Plan also contemplates the establishment of a value for each national currency in terms of *Bancor*; but it proposes to leave room for the alteration of these values in order to correct valuations which cease to correspond to internal conditions in the countries concerned. The Keynes Plan is in this respect far the more flexible of the two: it proposes to relate the value of *Bancor* to gold (though not unalterably, at least in theory) and also to relate each national currency to *Bancor*; but it is clearly contemplated that from time to time the *Bancor* values of the national currencies may need to be changed. It aims in effect rather at short-term stability of exchange rates, and at preventing changes except for good cause, than at permanent stabilization under a new gold standard.

Actually, the Keynes Plan proposes to leave it to each State, in agreement with the others, to fix the initial value of its own currency in terms of *Bancor*. It is not said what is to happen if States fail to agree about these initial values; but it is to be presumed that, if any one country insisted on a value unacceptable to the others, the alternatives would be either to accept this value, or to refuse the State concerned entry to the proposed International Clearing Union. When the *Bancor* values of the various currencies had once been fixed, they would be alterable only under certain conditions. A State which had been for a period of two years in a condition of substantial deficit on its balance of payments would be entitled to decrease the *Bancor* value of its currency by not more than 5 per cent.; but this could be done only once, and all other changes would need the consent of the Governing Board of the Clearing Union. The Board itself could agree to any change in the *Bancor* value of a currency asked for by the State of issue, and would have a limited power to require a reduction from a country in serious and persistent deficit. Moreover, there is a provision that, during the first five years of the working of the Plan, "the Governing Board shall give special consideration to appeals for an adjustment in the exchange value of a national currency unit on the ground of unforeseen circumstances". In other words, the Keynes Plan contemplates an initial period during which national currencies would gradually settle down to stable relative values, and thereafter a system under which these values would be altered only rarely, and on special grounds.

This goes a long way towards reinstating the gold standard; but it does at least leave the door open to alterations in exchange rates for the purpose of meeting a situation which could otherwise be met only by drastic internal deflation. The White Plan, on the other hand, bangs the door. It obliges each State which joins the Stabilization Fund "to maintain by appropriate action the exchange rates established by the Fund on the currencies of other countries". What this means is nowhere explicitly stated; but what can it mean except that the country in question is to resort to deflation in the old-fashioned, gold standard way? It is to contract credit, to throw resources out of employment, to institute artificial depression, until its internal prices have been brought down to the level required for bringing its exchange rate back to the appointed ratio. Will any country pledge itself to this, in the knowledge that it means, whenever the United States has a slump, spreading that slump far and wide through other countries, and forbidding those countries to resort to the monetary methods which are needed for maintaining 'full employment'? There is, no doubt, one other thing the draftsmen of the White Plan might be taken to mean by their "appropriate measures". They might mean that the country in question is to resort to drastic exchange control, bilateral trading agreements, quotas, and all the other devices whereby the foreign exchange position can be affected without resort to internal deflation. But it is clear that they do not mean this; for they explicitly prohibit most of these alternative measures. The White Plan, in effect, proposes to put back the gold standard in all its rigidity, and to return to the old, discredited measures of deflation for the means of correcting an unbalanced exchange position.

It is, of course, easy to understand why the Americans, in any scheme which they put forward, should have at heart the maintenance of the value and of the sanctity of gold. After all, they own most of it, and they do not want to have to write off the value of their immense gold stock. But is that a sufficient reason for other countries to accept a plan which would condemn them to follow every downward movement of the American economy? Is it a sufficient reason for Great Britain, even though South Africa and Canada are also keenly interested in maintaining the value of gold? The position of gold can be safeguarded quite fully enough without recourse to such drastic measures. Under the Keynes Plan, for example, it is to be always open to Governments or Central Banks which are owners of gold to convert their gold into *Bancor* at the

fixed rate of exchange. True, this rate can be altered; but we have seen already that it will be very difficult to alter it, because the gold acquired by the Clearing Union will stand at a certain value in the books, and any reduction in this value will involve a loss, in precisely the same way as a fall in the dollar value of gold would now affect the American Government. The Keynes Plan goes a very long way to meet the American case: I do not see how the Americans can expect other countries to go further.

Indeed, my own feeling is that the Keynes Plan, though infinitely superior to the White Plan in this respect, goes much too far towards putting gold back on its pedestal. I agree that it is necessary to have safeguards against unilateral action by a country to decrease the exchange value of its currency for the purpose of expanding its exports to the detriment of others. I agree that a country which adheres to the proposed Clearing Union ought not to be allowed deliberately to alter the exchange value of its currency without prior notice and consultation. But beyond this I am not prepared to go: I think a country must be left free in the last resort to settle the gold or *Bancor* value of its own money, as a necessary condition of its freedom to follow a policy of 'full employment'. The only alternative to this freedom would be to leave entire liberty to institute any sort of exchange control, accompanied by any sort of bilateral trading and clearing arrangements, quotas, licences, and other forms of 'discrimination', that might be needed to maintain the currency nominally at its fixed value; and surely this is much the worse alternative. Let the provisions about notice and prior consultation be as exacting as you please; but leave it to each country (or group of countries, where several act together in such matters) to determine in the last resort what the gold or international value of its own money is to be.

I have begun with the 'gold standard' aspects of the Keynes and White Plans because they raise the most fundamental objections. Far better have no plan at all than one which will take us back to the old days of enforced deflation. But, of course, neither the Keynes nor the White Plan is deflationary *in intention*—quite the reverse. Both Plans are meant to provide a basis for the post-war expansion of international trade, and to deal with a situation in which, in the absence of special measures, a good many countries are likely to find themselves almost entirely devoid of the means of purchasing abroad even the most indispensable supplies. In both Plans the most important positive feature is a device for

placing at the disposal of *all* countries an initial supply of international purchasing power to tide them over the difficulties of the post-war period. In both Plans it is proposed to achieve this by placing at the disposal of each country what amounts to an overdraft facility up to a fixed maximum in the books of the new international banking institution. Just as banks within each country now create credit, this institution is to create, in effect out of nothing, a new supply of international purchasing power; and each country is to be given a quota of this purchasing power, on which it can draw in order to meet its need for foreign exchange. All the countries which take part in the Plan—either Plan—are to agree to accept this new international money as the equivalent of gold at the value fixed for it; and a transfer of credit in the books of the new international institution is to be accepted as a settlement of debts between countries or Central Banks.

The American Plan is indeed much more hesitant than the British in recognizing overtly that what it proposes is in effect a new creation of international money out of nothing, analogous to credit creation within a single country. It proposes that the Stabilization Fund shall be started off with compulsory subscriptions, payable partly in gold and partly in national currency and securities, from the member States: so that the new money appears to represent these deposits and not to be newly created. To the extent to which the White Plan requires deposits to be made in gold, and reduces the credits which countries can themselves create by the amount of these gold deposits, there is no new creation of money. But for the rest the White Plan, despite its conservative phraseology, does in truth postulate a new creation of international money not different in principle from what is openly advocated in the Keynes Plan.

This notion of a new creation of international money is entirely sound. Why should we not have an 'International Bank', which will create credit for international, as Central Banks can now authorize its creation for national, purposes? Of course, any such creation of credit will add to the world supply of means of payment. It would be 'inflationary', if without it the world had enough effective purchasing power to finance 'full employment' in all countries and a high level of trade between them. But plainly the world is not in this position, or likely to be in it after the war. Even if the stock of gold were big enough to serve this purpose, it would not serve; for most of the gold belongs to the United States, and is so locked up as not to be available for financing the world's pro-

duction and trade. If the United States were prepared to *give away* all its gold, sharing it out among all nations in proportion to their needs, it might be unnecessary to resort to a new creation of purchasing power. But clearly the United States will not do this; and a mere willingness to *lend* gold to other countries is of no use, because, being already in debt or threatened with being in debt to the United States, they cannot afford to borrow it. Accordingly, if the countries of the world are to be put in a position to buy one another's goods at fair prices, they must be started off with credits on a large scale—above all, those countries which have been seriously devastated or dislocated by war, and must live partly on credit until they have been allowed time to restore their productive capacity and bring their available resources into better use than will be possible in the early years of reconstruction.

The proposal to create a new kind of international purchasing power, based essentially on the world's capacity to produce under conditions of 'full employment', is therefore absolutely right. But as soon as we look at the methods proposed in the two Plans for achieving this we see how big the differences are. The Keynes Plan proposes to base the credit quotas which are to be made available to each country on the pre-war value of each country's foreign trade (imports *plus* exports), subject to such adjustments as may be necessary to meet exceptional cases. The quotas proposed at the start are 75 per cent. of the average value of each country's foreign trade over the three years before the war, with subsequent revisions in accordance with the actual post-war trade of the countries concerned. This formula would yield a total of initial quotas roughly two-thirds the size of total pre-war gold reserves, but of course very much more evenly distributed than these reserves were.[1] The White Plan does not state the formula according to which quotas should be allocated to the various countries; but the total fund for which it provides is on a very small scale in comparison with what is proposed in the Keynes Plan, and the effective amount of credit available under it is further reduced by a number of complicated provisions both limiting the amount that can be made use of by any single country and requiring large deposits of gold by all the countries which enter into the scheme. The only conceivable purpose of these gold deposits, which will in themselves have a deflationary effect where they are drawn from the reserves of

[1] For details, see the Oxford Institute of Statistics pamphlet, *New Plans for International Trade*, p. 10 (Basil Blackwell, August 1943).

countries likely to need credits, seems to be to help the United States to sell off a part of its surplus gold to countries which cannot afford to buy it.

I wish I could state more precisely the amount of credit that would be made available under the White Plan. But there are too many conditions and restrictions for any clear statement to be possible. One can say only that, in comparison with the Keynes Plan, it would be a bagatelle. It is sometimes suggested that no great significance ought to be given to this point, and that the United States, if the general terms of the Plan were accepted, would readily agree to an increase in the amount. I do not know about this; but I feel sure the amount could not be made adequate without great changes in the conditions.

The granting of these credit quotas to all countries is the one really valuable feature of both Plans. It would enable world trade to get started, at a time when otherwise most countries will be in the greatest difficulty in financing even their most urgent import needs. It is, however, important to realize that the quota is only an initial credit, and not an inexhaustible store of purchasing power. The assumption underlying both Plans is that, given a few years for setting their post-war houses in order, countries will be able to return to a condition of 'equilibrium' in which what they have to pay abroad will balance what they receive from abroad, so that each country's account in the books of the Clearing Union or Stabilization Fund will tend to balance.

Where there is no international agency, and each country acts as a separate financial unit, balance, in a sense, must always exist. International payments are made up of three separate streams—payments arising out of current transactions, payments arising out of long-term capital transactions, and short-term capital payments. The first include, besides the finance of current trade and insurance, payments of interest and dividends on existing investments: the second are made up of payments in respect of *new* long-term investment: the third include gold movements, short loans made from one monetary centre to another, and sums due but not withdrawn from, or placed in long-term investment in, the country in which the funds are left. The sum of all these transactions into and out of a country must always balance; for every exchange of one currency for another implies a two-way transaction. But balance in the aggregate does not imply balance in the separate elements. A country which imports more than it can pay for with exports

plus returns on shipping and insurance services and on overseas investments may be meeting the difference by exporting gold or, alternatively, either out of imports of long-term capital (e.g. where foreigners are buying up shares in its industries) or out of imports of short-term capital, which may mean only that sums due from it to other countries are not being withdrawn, or that foreigners are depositing short-term funds in its money market.

If, now, an International Clearing Union is set up, the position will be somewhat altered; for there will be the additional possibility of meeting a current deficit not by the import of short-term capital in the sense just described, but by drawing on the credit available on the books of the Union. The country which does this will then be in debit to the Union instead of owing the sum in question to particular countries or to the citizens of particular countries. Consequently, its payments will only balance in total if its debt to the Clearing Union is taken into account.

This point becomes important when we consider the proposals made for dealing with countries which remain persistently in debt to the Clearing Union. If a country goes on drawing on its credit balance with the Union in order to meet its foreign commitments, it will eventually exhaust its quota, and be unable to draw out any more. In other words, the Union will not enable any country to go on buying more than it can afford to pay for, beyond the period for which its quota lasts out. Indeed, long before its quota is exhausted, both Plans propose that corrective measures shall be brought into play. Under the Keynes Plan, no State may increase its debit balance by more than a quarter of its quota within a year without the permission of the Governing Board. If over two years its average debit balance exceeds a quarter of its quota, it may, as we have seen, devalue its currency by no more than 5 per cent. If its debit balance reaches half its quota it may be required to deposit collateral security. It may not exceed half its quota without complying with certain requirements of the Governing Board, which may include further devaluation, control of capital movements, surrender of part of its own reserves of gold and foreign exchange—all at the discretion of the Board, which can in addition "recommend to the Government of the member State any internal measures affecting its domestic economy which may appear to be appropriate to restore the equilibrium of its international balance". If a country's debit balance exceeds three-quarters of its quota over the average of a year, the Governing Board can take further

measures, and can, if it thinks fit, refuse the country any further credit.

Clearly, even under the Keynes Plan, the proposed credit facilities are hedged round with plenty of conditions, the plain purpose of which is to make countries regard their credit quotas, not as sums on which they can go on drawing freely until they are used up, but rather as advances granted in order to allow reasonable time for each country to get itself back into a satisfactory state of balance.

Now, a satisfactory state of balance must be regarded as one in which a country can meet its external obligations out of the sums accruing to it from its exports, including 'invisible exports', *plus* any net amount which foreigners are investing in it at *long-term*, but *not* including *short-term* foreign lending as defined above. If all transactions across national frontiers passed through the books of the Clearing Union, the Union would have knowledge of all the relevant factors, and would be in a position to say how far a debit in its books indicated a real deficit on the part of the country concerned. But this is not proposed. Neither the Clearing Union nor the Stabilization Fund is to handle all international financial transactions. Neither is apparently meant to deal with long-term capital movements, or to have any monopoly of dealing with short-term transactions. Accordingly, a debit balance in its books may be due, not to a country buying more than it can really afford to pay for, but to the use of part of the sum that could go to pay its current debts for quite other purposes, such as a 'flight of capital' from it, either by way of long-term investment abroad, or by the movement of short-term funds to evade a threat of devaluation or for any other reason.

It is indispensable for any International Clearing Union or similar body, in order to exercise intelligently such control as is placed in its hands, to have knowledge of what is happening over the whole field of international financial transactions, and not merely of those which pass through its hands. And it is indispensable, if countries are to avoid having their deficits on current account aggravated by 'flights of capital', for capital movements to be controlled. We have seen already that control of outward capital movements is one of the measures proposed in the Keynes Plan for dealing with countries which fall seriously into debit in the international clearing accounts; but it is not made clear whether this control is to cover movements of short-term as well as of long-term funds. It must, if it is to be effective; and there seem to be very good reasons for

establishing such controls, not merely as exceptional measures designed to deal with debits when they have been incurred, but as a normal part of each country's mechanism of international financial regulation.

I have so far spoken of the International Clearing Union and of the United Nations Stabilization Fund without entering into their proposed structure. Under the Keynes Plan, the Union will be administered by a Governing Board of from 12 to 15 members, the States with the larger quotas having each one representative and the other States being grouped for purposes of representation. Voting would be by quotas and not by counting of heads; and each State, whether represented on the Board or not, would be entitled to maintain an agent who would attend the Board when his country's affairs were under discussion. The Union would have two centres, in London and Washington, and meetings would be held alternately in these two places. The White Plan is less explicit on some of these points; but it proposes to vest power in a Board of Directors, on which each country would be directly represented, voting to be based roughly on quotas, subject to the provision that no one country shall have more than one-quarter of the total votes. This would mean a large Board, and the White Plan proposes the election from it of an executive committee, with which in practice a great deal of the power would reside. The provisions of the White Plan are so drawn that in effect the United States would hold an effective veto on any substantial modification of its very rigid conditions.

The foregoing pages are not meant to give anything like a complete summary of either Plan, but merely to select for attention a few salient points.[1] We can now return to the series of questions with which this chapter opened, and see what answers we are in a position to give to them in the light of the available information about British and American projects. The reader is requested to turn back to the questions which were set out on pages 249-250.

1. It is certainly not desirable to go back to the old gold standard in the form in which such a return is involved in the White Plan. The Keynes Plan is less rigid, in that it does allow for changes in the international or gold value of currencies after the fixing of the initial parities. But even the Keynes Plan

[1] For a much fuller discussion, see *New Plans for International Trade*, already mentioned.

may make it difficult for countries to follow policies of 'full employment' when depression exists in the United States, without resort to strong exchange controls and probably bilateral trade and payments agreements.

2. The best way of getting international trade re-started after the war, when many countries will be practically devoid of external purchasing power, is to create a new kind of international 'money', and to assign to each country a credit in this money, on which it can draw for the making of external payments. This is involved in both Plans; but the Keynes Plan proposes both much more liberal credits and much less stringent conditions. It is on this ground greatly to be preferred, and much more likely to reduce to a minimum the need for bilateral arrangements, which the authors of both Plans wish to prevent. It seems unlikely, however, that either Plan could, in fact, work without the imposition of exchange control at least in all countries threatened with deficits on their current balances of payments.
3. The operation of an international plan would to some extent check the accumulation of short-term balances in the world's leading monetary centres, by causing a part of such balances to be transferred into credit balances held in *Bancor* or *Unitas* in the books of the international agency, corresponding to debit balances owing by the deficit countries. But the accumulation of short-term balances abroad would not be prevented altogether, as it is not proposed that the new agency should have any monopoly of international financial transactions. It would therefore be necessary for the individual countries to establish their own machinery for the control of short-term capital movements.
4. This question has not yet been answered, as neither of the two Plans sets out to deal with questions of long-term investment. It will be discussed in the next chapter.
5. It is both possible and desirable to apply the principle of bank credit on an international scale; and this can best be done through a Clearing Union of the type proposed, with overdraft facilities up to certain quotas for all countries participating.
6. There will have to be an international 'money of account', in which the books of the new industrial agency will be kept. It will probably be necessary to give this new money a defined

gold value, and to accept gold in exchange for it. It will thus supplement and not replace gold as international money; but it will not be used for any other purpose than the settlement of international balances between Governments and Central Banks, unless some extension of its use is needed in connection with the financing of post-war international projects of economic development.

7. This has already been answered under 2 and 5.
8. The answer to this question is deferred to the next chapter.
9. Both Plans propose action designed to induce or compel deficit countries to reduce their debits in the books of the international agency. The American proposals under this head seem to be definitely and dangerously deflationary. The British proposals are less rigid; but they too embody potentially deflationary forces. This may be unavoidable; for beyond certain limits a persistent deficit may be a sign of inflation in the country concerned. What is essential is that any deflationary influence should come into force only against proven inflation, and not in such a way as to spread deflation to other countries.
10. To a considerable extent, current and capital transactions must be handled together; and both the British and the American proposals are difficult to judge in the absence of parallel proposals for dealing with capital movements, both long and short.
11. A purely financial agreement which tied countries down not to pursue bilateral commercial policies would be certain to break down unless it were accompanied by a parallel agreement or agreements dealing satisfactorily with the main issues arising in the field of international commerce.
12. It is easiest to leave over any attempt to answer this question until capital movements, as well as financial questions in the narrower sense, have been discussed.

XV

FOREIGN INVESTMENT AND THE DEVELOPMENT OF BACKWARD COUNTRIES

THE Keynes and White Plans, as we have seen, do not deal directly with the problems of long-term investment, to which we must now turn our attention. When capital is lent at long term from one country to another, the effect is to transfer purchasing power from the lending to the borrowing country. The loan may be made in the currency of either country, or even, occasionally, in that of a third country. If it is lent in the currency of the lender, and if the money is spent on buying goods in the lending country, no monetary problems arise, except that of paying for imported materials incorporated in the goods and for the services of foreign transport agencies, if they are used in moving the goods. Apart from these items, the loan goes out in goods, and no money, apart from the goods, leaves the lending country. This, however, hardly ever happens in full. The borrowers of the capital are pretty sure to want to spend at least part of it in buying goods and services in their own country, and probably another part in buying goods from other countries. They will therefore wish to turn some of the loan into their own currency and some into the currencies of other States. If the loan is raised in the currency of the borrowing country, there arises at once the 'transfer' problem of turning the lenders' into the borrowers' money, though some of it may be turned back again if part of the loan is spent on goods made in the lending country.

Thus, the export of capital involves a pressure on the exchanges of the borrowing country, to the full extent to which loans are not spent in buying goods made within it or services rendered by its nationals at home. It follows that a country can afford to export long-term capital only to the extent to which it either (*a*) has already a surplus of exports over imports, including the 'invisible' items on current account, or (*b*) can so arrange the loan that it is supplied in the form of goods and services from the lending country, or (*c*) can borrow the capital from some other country, and then re-export it.

What sometimes happens is that a country makes long-term loans out of short-term funds belonging to foreigners which have been deposited in its money market. It is then said to be 'borrowing

short and lending long'—a dangerous practice, because the short loans may be recalled long before it is possible to get back the capital lent at long term. Great Britain was caught in this way in 1931, not so much because British financiers had been deliberately re-lending short-term funds at long term as because loans which had been supposed to be revocable at short notice (e.g. loans to Germany) turned out not to be revocable on account of the slump. Indeed, the Germans had been re-lending at long term part of the short loans they had got from Great Britain and America; and when Germany blocked re-payment of these sums, the original short-term lenders found themselves converted against their will into lenders at long term.

Long-term foreign loans ought, then, to be made out of capital which the lenders are free to lock up over a considerable period. It does not, however, follow, because the individual or company that makes a long-term loan or investment feels able to lock the money up, that the country to which these would-be investors belong can afford to let them invest in foreign long-term capital. That is where foreign differs from home investment. In foreign investment, the State or the Central Bank has to assume the burden of providing, in exchange for home currency, such foreign money as the investment requires. If a country is short of foreign exchange, it may not be in a position to do this; and accordingly, as we have seen, countries resort to various methods of checking or controlling foreign investment by their nationals.

This problem is likely to give rise to special difficulties after the war. The only country with a large surplus of foreign exchange arising out of current transactions, and therefore available for investment overseas, will probably be the United States. But there will be other countries which have supplied large quantities of goods to the belligerents, without being able to get equivalent imports in return; and these countries—India, Australia, Canada, and some of the South American States, for example—will have credits in London or New York which they may want to turn into goods while goods are still scarce, and perhaps to remove from the country where they are now deposited to some other country which is better placed for supplying what they want. It may seriously aggravate post-war exchange difficulties if the countries which have credits in London try to use them for buying goods in the United States at a time when Great Britain will in any case be seriously short of dollars.

This, it may be said, is a problem not of investment, but of the migration of short-term funds. True; but it may be possible to divert some of these funds into long-term investment in capital goods to be produced by the countries in which the funds are deposited, in such a way as to minimize the exchange difficulties involved in their transfer. Such a policy could help greatly in the economic development of India and of certain of the colonies attached to the British Empire, as well as of the Dominions. But will it be practicable unless Great Britain is in a position to make arrangements for liquidating these obligations in kind, and is protected against demands for freedom to transfer these funds to purchase goods anywhere in the world, irrespective of the British shortage of foreign exchange?

Much larger issues arise in connection with the more general problem of long-term investment in the backward countries. If these countries are to get rid of their difficulties of agrarian overpopulation and are to have a chance of raising their economic efficiency to a reasonably high level, they will need very large quantities of capital goods for which they cannot possibly pay with current exports until time has been allowed for their productivity to be greatly increased. Accordingly, they will need large foreign loans of long-term capital. Whence are these loans to come?

The obvious source for a large part of the capital needed for this purpose is the United States, which is the great 'surplus' country. The United States, as the chief creditor nation and as a great exporter, is in a position to buy from the rest of the world a much larger quantity of imports than it has hitherto shown any willingness to buy; and this disparity is likely to be still greater in the post-war period. American unwillingness to increase imports up to the level of external purchasing power is due partly to the large native resources of most materials needed for American industry and partly to the American tariff, which is defended both by powerful business interests and on the plea that it is necessary to protect the 'American standard of life' against the competition of low-wage products made in other countries. It seems most unlikely that the Americans will consent to lower their tariff to the extent that would be necessary to absorb the 'surplus' in increased imports; and I even doubt whether, under post-war conditions, the entire abolition of the tariff would at all speedily achieve this result. The more the Americans are prepared to lower tariff duties, the better for the

world as a whole; but that is their affair, about which no one can dictate to them.

As long as the 'surplus' remains,[1] the Americans can dispose of it in only three ways. They can import gold, as they have in fact been doing on an enormous scale; or they can invest it at long term, by buying up holdings in the long-term securities of other countries; or they can lend it 'short', for the most part by leaving it uninvested in the countries where it arises. In the 1920's the Americans in the main 'lent long': that is to say, they acquired a considerable ownership of foreign long-term securities, especially in Germany, but to some extent in nearly all countries. In the course of the world economic crisis, long-term foreign investment was practically wiped out; nor did it recover on any substantial scale throughout the 'thirties. Consequently, when the American 'surplus' again grew large after the passing of the worst of the slump, the Americans, in addition to importing vast quantities of unwanted gold, 'lent short' on a large scale, leaving in other countries credits which they were not prepared to convert either into goods for import to the United States or into long-term foreign securities. This short lending had most unfortunate effects. The countries in which the money was deposited had no assurance of retaining it, and could not safely use it for long-term investment; and in most cases it was not needed in the short-term money market. It had to be sterilized—in Great Britain, through the Exchange Equalization Fund. The effect of this was the same as that of a deflationary banking policy in internal affairs. A substantial part of the world's purchasing power, instead of being used to buy currently produced goods and services, was being locked away idle, mainly in gold holdings either in the United States or in the various Exchange Equalization Funds.

It is one of the main features of the Keynes Plan that it brings out the point that there can be 'bad' creditors as well as 'bad' debtors. If it is an offence to the rest of the world for a country to run into debt and to be unable to meet its external obligations, so that it has in one way or another to 'bilk' its creditors, is it not also an offence for a country, by refusing to exercise a part of its international purchasing power, to inflict unemployment and deflation on the rest of the world? This is in effect what the Americans have been doing, and must continue to do as long as they refuse either to

[1] I.e. unless the Americans get rid of the surplus by deliberately reducing their exports.

increase their imports up to the point necessary to absorb their 'surplus', or to invest the 'surplus' at long term, so that it can be put to productive use. It is true that, by investing their current 'surplus', the Americans would be putting the world for the future still more in their debt, and increasing the disparity between their imports and their means of paying for them. In the long run, they would have either to give their capital away to other countries, or to agree to accept goods in payment of the interest and dividends earned by it. It may seem as though, by not investing at long term, the Americans are benefiting the rest of the world, by letting it enjoy the use of their liquid capital at a cheap rate. But the fact that the capital must be kept liquid cancels this benefit, because it prevents the money from being productively used. If it were invested, it would help to maintain demand for capital goods and also indirectly for consumers' goods in the countries in which it was employed; and the problem of transferring the interest and dividends would not become formidable for a long time, on the assumption that the investment was kept up.

Accordingly, it is one of the aims of the Keynes Plan to induce any 'surplus' country to make use of its current balance either in buying additional imports or in long-term foreign investment. Under the Plan a large part of the 'surplus', instead of lying in the short-term money markets of the world, would be converted into a credit balance in the books of the International Clearing Union, and would be exactly offset by debit balances of other countries. In effect, the credit mechanism of the Clearing Union is a device for lending the current American surplus to meet the needs of the 'deficit' countries. This, however, does not mean that all is well; for the 'deficit' countries want, as soon as they can, to cease being 'deficit' countries, either by expanding their exports to cover the cost of their imports, or by borrowing long-term capital from abroad. The Keynes Plan embodies an attempt to bring pressure to bear, not only on 'deficit' countries to reduce their debit balances, but also on 'surplus' countries to get rid of their credit balances in the Clearing Union either by accepting more imports or by investing them in long-term enterprises in the 'deficit' countries.

The only positive proposal put forward for achieving this is that the 'surplus' countries, instead of receiving interest on their credit balances in the books of the Clearing Union, should pay equally with the 'deficit' countries a charge upon them. In other words, credit balances should earn a *negative* rate of interest. This negative

rate, which begins only when the balance of the country concerned exceeds a quarter of its total 'quota' as laid down in the Plan, is put at 1 per cent. on any balance between one-quarter and one-half of the quota, and at 2 per cent. for any balance exceeding half the quota. The same rates would be payable by countries having debit balances, the price being levied in both cases in *Bancor*. That is to say, a 'deficit' country would have its debit balance increased, and a 'surplus' country would have its credit balance in *Bancor* decreased, by the amount of the 'fine' for departing from a position of international equilibrium.

It is very much to be doubted whether these 'fines' would have any considerable deterrent effect on any 'surplus' country. Nor, probably, is it desirable to make them heavier; for, even as they stand, they might be unduly deterrent to a 'deficit' country which needed time for the adjustment of its economy. It would, of course, be possible to make the 'fine' heavier in the case of the 'surplus' countries, while leaving it as it is or even reducing it in the case of the 'deficit' countries. But this is probably regarded as politically impracticable, and the equality of treatment as furnishing the only real chance of getting the proposal accepted. The vital point of the provision is, however, not so much the amount of the 'fine' as the recognition implied in it that creditors as well as debtors have responsibilities; and the psychological effect might well be much greater than that of the 'fine' itself.

The weakness of this part of the Plan is that it would be open to the 'surplus' countries to get rid of their surpluses, not by accepting more imports or by buying long-term investments, but by reducing their exports or by continuing to import gold, which would not appear as a 'credit' in the books of the Clearing Union. If gold were imported, the position would be no worse than it has been in the past; but if exports were deliberately restricted for the purpose of wiping out the 'surplus', the effects might be very serious indeed. The 'deficit' countries would be deprived of badly needed supplies; and a stimulus would be given to the forces of *autarkie* throughout the world. This potential danger is, however, probably not one against which such a body as an International Clearing Union can possibly guard. How real it would be would depend partly on the tenacity of resistance in the 'surplus' countries to accepting additional imports, and partly on the success of measures for promoting international long-term investment.

What, then, can be done with this latter purpose in view? One

great difficulty in the way is that investment of capital at long term in foreign countries is not attractive unless two conditions are simultaneously satisfied. The economic prospects of return must be reasonably good; and the political conditions must be such as to afford reasonable security for the money invested. How far is either of these conditions likely to be satisfied in the critical period after the war?

Take first the political condition of reasonable security. A lender to the Government of a particular State or to any corporation or business inside its frontiers runs the risks of political instability in the country concerned. In the extreme case, if it should have a Communist revolution, he incurs the risk of complete expropriation; and a much less thorough-going revolution may in practice result in the loss of his investment through the upset of the currency or at least in the 'blocking' of all returns upon it. Foreign bondholders are accordingly apt to have a strong vested interest in the stability of any Government under whose auspices they have lent money, either to the Government itself or to any concern subject to its jurisdiction. This may be a very serious matter in the case of small or backward States, whose Governments, however unrepresentative, may be powerfully upheld by foreign investing interests. Apart from this, the risks of political instability must, in order to attract lenders, be compensated for in the rates of interest offered on the loans. When world conditions are unstable, or are deemed so by the financiers who organize foreign loans, the rates of interest charged to borrowers are apt to be raised to a level at which many potential loans of capital become too expensive to be profitably taken up, so that the rate of investment is slowed down.

The economic risks are not wholly separable from the political risks. Manifestly, the prospect of using capital at a profit is affected by the political state of the country in which the investment is to be made, as well as by its natural eligibility for economic development. The policy followed by the Government of the borrowing country affects the level and the distribution of purchasing power within its frontiers, and therewith the prospects of profit on enterprises designed to provide for domestic consumers' demands. Many investments are attractive from the standpoint of prospective profit only if other investments are made as well. For example, a railway will be profitable if capital is invested in developing the area through which it runs, a power-station if there are to be local industries to use the current it can produce, and so on. A concerted policy of

investment in many forms of enterprise may increase the prospects of profit on each particular investment.

These considerations point to the desirability of a post-war investment policy designed to keep interest rates down to the lowest possible level, and also to promote a co-ordinated programme of economic development, with which each enterprise will help to put the others on their feet. But is there much prospect of finding private investors who will be willing, in face of the political and economic risks, to lend capital to the backward countries, except under very special circumstances, without charging rates of interest which it will for a long time be very difficult for the borrowers to pay? Investors seem for the most part to be tempted by high rates of interest, accompanied by considerable risks of loss or default, rather than by the offer of smaller, but better assured, returns on their money. If the returns actually received in the 'thirties on all the capital invested in foreign securities issued since 1929 were to be averaged, the average rate of interest received by the borrowers would probably look modest enough. The investors actually got only a low return, on the average; but they were promised a high return, and some of them got a high return, while others got nothing and lost, through a fall in the value of their holdings, a substantial fraction of the capital lent.

Would it not be infinitely better, instead of going back to a system under which each borrower of capital had to promise, and to pay if he were able, a high rate of interest, while the lenders got, on the average, a low rate of return after allowing for losses of interest actually paid and of capital value, to pool risks and as far as possible reduce them, so as to lower the rates charged to borrowers without therewith diminishing the incomes of the investors, taken as a group? If so, how could this be done?

One way would be for the loans to be made, not by private individuals to a host of separate borrowers, but through a single international institution, which would be able to pool the risks, and also to reduce them by following a rational, planned policy. If the investing public could lend their money, not to particular borrowers in the backward countries, but to some sort of International Investment Corporation or perhaps to a series of such corporations, each acting in a particular functional field, and if, further, this corporation, or these corporations, were to re-lend the money to Governments or enterprises in the backward countries in accordance with coherent and well-thought-out plans of economic development,

the capital could, without any element of subsidy, be made available at a lower rate of interest, which would both enlarge the demand for it in the areas concerned and yield the investors a more secure return and, on the average, one as high as they got in the 'thirties, or perhaps higher, after account has been taken of defaults and losses of capital value. Of course, an alternative, in many ways better, would be for the Governments of the more advanced countries themselves to take the responsibility of making the loans, using their own superior credit as a means of raising them at low interest rates from their own nationals, and passing them on, with only a small addition to cover management charges, to finance approved projects in the economically backward countries. But such a plan would probably fail to fit in with American ideas, because it would make the State the investor, and would be regarded as savouring too much of 'Socialism'.

The Americans, in common with financial groups in other advanced countries, will almost certainly wish to give the processes of international investment after the war to the fullest practicable extent a commercial rather than a 'Government' character. They will be more ready to accept a policy even of direct Government investment if it takes the form of loans of capital, not to the Governments of the backward countries but to specialized International Investment Agencies, organized, at any rate in appearance, as commercial, or quasi-commercial concerns. There might, for example, be a grandiose European Investment Corporation, or a Far Eastern Investment Corporation, which would get its money partly from the Governments of the more advanced countries and partly from bonds subscribed for by private persons in the money markets of these countries. Alternatively, the tasks appropriate to such an agency might be split up among a number of bodies, each working only in a particular economic field—that is, there might be separate International Corporations to finance investment in transport services, in plans of electrical development, in manufacturing industries, or in agriculture; and these 'functional' bodies might operate either over the whole world or in particular regions.

Some such structure as this, with a number of separate 'functional' agencies operating side by side and loosely linked together by some sort of general co-ordinating body under international control, seems in the circumstances to offer the best prospects of success in mobilizing the available capital of the more advanced countries for the development of the more backward. It must, however, be

emphasized that no machinery will be effective for this purpose unless the capital is really supplied to the borrowers at a cheap rate. The poorer countries cannot afford to be large borrowers at high rates of interest; and, if high rates are charged, all that will happen is that the enterprises selected for development will be not those which are most calculated to raise the productivity and the standards of living of the peoples of the backward areas, but those which the capitalists of the advanced countries wish to develop as sources of materials for use in their own industries. Disproportionate weight will be put on extractive industries, as against industries to produce cheap consumers' goods for the home markets of the countries concerned; and nothing will be done to open up the countryside by transport, power and irrigation services, or to develop high standards of agricultural technique. This is largely what has happened in the past. Too much of the capital invested in backward countries has been directed in the interests of foreign groups desirous of promoting a particular enterprise auxiliary to their own industries, and much too little to meeting the needs of local populations, or to fostering higher standards in native production generally.

After this war, if the Governments of the United Nations follow out the intentions which they have declared in time of war, the aim will be to arrive at better standards of nutrition and general living conditions in every part of the world, by means of a concerted international crusade against want. To proclaim such a purpose is not mere idealism; for it is at last coming to be widely realized that the possibility of employing to the full the productive capacity of the more advanced peoples depends on raising standards among the less advanced, so as to have continually expanding markets for the products of developed industrial technique. The peoples of the more advanced countries stand to gain by helping to enrich their poorer neighbours: it is entirely wrong to suppose that the economic advancement of the backward countries threatens the industrialized countries with a loss of markets. The exact opposite is the truth: for the limitation of markets in the past arose out of the primary poverty of most of the world's consumers.

No doubt, industrialization of the backward countries does involve a change in the character of the exports of the more advanced. They will tend to lose trade in those goods which can be most easily made with relatively unskilled labour, and are in large demand among the poorer classes of consumers. Such things the less advanced countries will tend in future to make for themselves,

or to exchange with other relatively poor countries, instead of importing them from countries with high living standards. But as the total market for the cheaper and more easily produced commodities expands, the market for goods of higher quality and finish will expand with it; and such goods, including the machine equipment of the industries which make cheap goods for mass-consumption, will have for the most part to be brought in from abroad. The more advanced nations which are promptest and most successful in adapting their industries to produce these types of goods for export at prices not inflated by either inefficiency or monopoly will prosper as a result of economic development in the backward countries: those which fail to achieve these adaptations will fall behind.

It will be of the greatest importance that borrowing as well as lending countries shall share in the control of any International Corporations or Agencies set up for the purposes described in recent paragraphs. Foreign investment in the past has been too often conducted on the principle that only lenders have rights. In equity, the borrower has at least an equal right with the lender. It is primarily on the people of the debtor country that the investments made will react for good or ill; and nothing would be more likely to lead to acrimonious disputes between countries than a policy of international investment carried out by and under the control of lenders on the soil of the borrowers and on the bodies of the peoples of the debtor countries. This is not the place for working out the details of the international structures that will be needed: what has to be emphasized is the necessity of making them truly international, and of guarding by all possible means against their becoming, or appearing to become, a new form of 'economic imperialism' based on a consortium of great industrial powers.

It is now possible to attempt answers to the questions which were left unanswered at the end of the preceding chapter.

To the fourth question (see page 249) we can answer that it is practicable to re-build, and indeed greatly to extend, the system of long-term foreign investment which grew up during the nineteenth century, and to do this greatly to the advantage of the world as a whole, but only upon certain conditions. One of these conditions is that the rates of interest shall be low, so as to avoid weighing down the borrowers with debt burdens which will mean, where loans are taken up at all, the exploitation of the peoples of the backward countries for the benefit of the capital-owners of the more advanced. Low interest rates involve the pooling, and therewith

the reduction, of investment risks, and the direct participation of the Governments of the lender nations to give the benefit of their credit to the affair. But private as well as Government investment will have to be invoked, in order to secure American participation, which is obviously vital; for American opinion will not stand for a purely inter-governmental scheme. It may be added that amortization rates, where they are used, will have to be low, and that it will probably be necessary to provide for the re-investment of sinking funds in the borrowing countries.

To the tenth question (see page 250) we can answer that clearly it will be necessary to set up special 'functional' agencies for purposes of international long-term investment, and for these agencies to be quite distinct from the proposed International Clearing Union and from any machinery that may be established to regulate the movement of short-term funds. There will, however, have to be very close connections between the International Clearing Union in respect of the extension of credit to the backward countries and the international investment agencies in respect of loans of long-term capital; and it seems highly appropriate that, as the Keynes Plan suggests, the Clearing Union should act as banker for the international agencies in the field of long-term investment as well as in that of international relief and short-term reconstruction.

To the twelfth question (see page 250) we can answer that the small and the great countries, the economically backward and the advanced, ought clearly all to participate in controlling both the proposed International Clearing Union and the agencies set up for the planning and execution of long-term investment projects. This question also raised the issue whether enemy countries should be admitted to full participation. Surely they should be, even if they cannot become full partners at the very outset. If, as is to be hoped and expected, the Germans are to be called upon to pay not money reparations but 'reparations in kind' in the re-building of the areas which they have devastated or despoiled, they will clearly have to play their part in the international agencies responsible for projects of capital development. The experience of the last war should have proved conclusively enough to convince all sane men that money reparations, without full provision for transfer in kind, are unworkable and disastrous. But it by no means follows that the despoilers must be allowed to escape scot-free. The difficulty of reparations after the last war was that the nations which tried to exact them refused to accept the goods in which alone they could

be transferred. After this war, it is to be hoped that this folly will not be repeated; and it seems clear that there is at any rate one great country in which no danger exists that it will. The Soviet Union has suffered vast devastation, and will be under no fear that reparation in the form of re-creating what has been destroyed will inflict unemployment on its own people or loss of profits to an employing class—for it has none. It should therefore be very ready to accept from the Germans plant and machinery to replace what they have annihilated; and other countries, if they are in fact pursuing policies of 'full employment', should be equally ready to accept such 'gifts of restitution'.[1]

If, then, the Germans are called upon to restore in kind what they have destroyed, or rather such part of it as they can restore without undue burdens on their own standards of living, German industry will become an important factor in the process of post-war international investment; and it will be indispensable for Germans to be actively associated with the planning and execution of this process. This constitutes a clear reason for bringing Germany in practically at once as a participant in the proposed 'functional' bodies for international investment; and I think the importance of getting the German currency back on to a sound basis will equally involve participation, practically from the outset, in the proposed International Clearing Union.

The second part of the twelfth question (see page 250) inquired how far, in the interests of a *general* international handling of post-war monetary problems, it would be necessary or desirable to restrain countries from making, between themselves, narrower agreements for common monetary action. We can now widen this question to include agreements for the pursuance of common policies of capital development, and also for the mutual lowering of trade barriers.

Surely it is very much to the world's advantage that neighbouring States should act in all these ways. There has been, very recently, an example of the first type of common action—the agreement between Belgium, Luxemburg, and Holland to adopt a linked currency arrangement and to follow a common monetary policy. The abortive trading agreement between these same countries in the inter-war period provides an example of the third type of common action. They proposed to conclude a pact whereby their tariffs against one another's goods would be gradually lowered until

[1] For a fuller discussion of this problem, see the *New Statesman and Nation* of November 13th, 1943, pp. 311-312.

they arrived at a complete system of mutual free trade. The Scandinavian countries made a largely similar scheme; but both were abortive because Great Britain and other States, whose commercial policies were based on the 'Most Favoured Nation Clause', insisted that, if these countries lowered duties on one another's goods, their goods also must be allowed the benefit of the reduced duties. These objections necessarily wrecked the schemes; for the objecting countries were not prepared themselves to grant equal concessions, and in any case the object was to weld together closely neighbouring countries with largely common economic interests.

It is to be hoped that, if such 'neighbourly' projects are revived after the war, they will no longer be vetoed by either Great Britain or the United States. It would be sheer advantage to reduce the number of separate economic units in both the monetary and the commercial sphere; and it is highly desirable that countries should be able to link their currencies together and to conclude, *inter se*, commercial arrangements more liberal and unifying than they are prepared to extend to the whole world.

It is no less plainly desirable that countries should have freedom, and every encouragement, to embark on common policies of capital development. Political and economic regions very often fail to coincide; and proposals for irrigation, or canal-making, or railway-building, or the development of electric power can often best be carried out so as to serve territories which fall within more than one State. Rivers have, of sheer necessity, been managed in a number of cases internationally for a long time past; and river administrations in which a number of States collaborate provide to some extent a model for forms of common action that need to be applied over a rapidly widening field. Assuredly, if in accordance with the Atlantic Charter each pre-war State is to be restored to full sovereignty, it will be vitally necessary, not to repress, but to do everything that can be done to encourage, neighbourly co-operation in the field of post-war capital investment.

XVI

AN INTERNATIONAL INVESTMENT BANK—INTERNATIONAL INVESTMENT AND THE STANDARD OF LIVING

THE foregoing chapter was written before there had been any opportunity of studying the American Plan for a United Nations Bank for Capital Development—the sequel to the White Plan for a Stabilization Fund. Reading it over after the issue of this further Plan, I see no reason to modify anything that I have written: indeed, the chapter serves as an introduction to the comments which I wish to make.

The second American Plan—unaccompanied, this time, by any rival British draft—proposes to establish an international investment bank with a capital rising from an initial 2,000 million dollars to an ultimate total of 10,000 millions. This vast sum is to be subscribed by the member countries, lenders and borrowers together, according to a system of national quotas which has still to be devised. Clearly, in practice, most of it will have to come from the United States, which alone has a really large surplus for international investment. The quotas are to be subscribed partly in gold and partly in the local currencies of the member countries, the proportion to be paid in gold being limited to one-fifth as a maximum, with smaller proportions for countries which are short of gold. But each country is in addition to be under an obligation to redeem in gold its subscription of its local currency at a rate of 2 per cent. per annum—so that it is apparently contemplated that in the end the whole of the 10,000 million dollars will be converted into gold. Nothing is said about *Unitas* or *Bancor* in this connection as a substitute for gold: there is no attempt to link up the proposed United Nations Bank with the Stabilization Fund contemplated in the earlier White Plan.

In addition to the capital subscribed by the Governments of the member countries, the Bank is to be empowered to raise further capital by borrowing in the private investment markets of the world. There is, accordingly, no limit to the amount of capital that could be provided for international investment under the scheme. It is a grandiose project, on a far more ambitious scale than the parallel currency plan issued from the United States Treasury.

There are, however, very substantial limitations on the purposes to which this vast capital fund can be applied. The memorandum

explaining it reiterates that the proposed Bank is in no wise meant to supersede or rival private international investment, and that it is to be used only for schemes which lie outside the field of private enterprise or are beyond the scope of private investment because of the vast scale on which they need to be launched. It is also stressed that the new Bank will deal only with Governments or with Government agencies—presumably including international agencies set up under the auspices of neighbouring Governments for the execution of projects involving more than one country. It will not make loans to private bodies unless they are guaranteed by the Governments of the countries concerned; and in general it will guarantee private loans made to Governments or Government agencies in preference to making such loans itself. All these provisions are evidently intended to disarm critics who may be disposed to attack the proposal as an encroachment on the field of private enterprise. They may mean in practice that the success of the Plan will depend on the willingness of private investors to place their money abroad, which may not be great, even if both principal and interest carry the guarantee both of the Bank and of the Government of the country in which the capital is to be invested.

There is a further provision that the Bank, in considering whether to make or guarantee loans, must take into account not only the soundness of any proposed investment in a commercial sense, but also the budgetary position of the Government concerned and the prospective balance of payments of the borrowing country. It is not at all clear what this means. The countries which will stand in greatest need of capital loans, as well as of short-term accommodation through a Credit Union, are likely to be those which are in the greatest difficulties over their balances of payments, and very likely over their budgets as well—for they may wish to finance 'public works' of their own with the aid of budget deficits in order to promote 'full employment'. If the provision means that help is to be refused in such cases, or that countries are to be compelled to balance their budgets as a condition of receiving capital loans, the effects may be highly deflationary, and may amount to a prohibition on 'full employment' policies in the countries concerned. We had to take note of a similar ambiguous provision in the White Currency Plan. It is true that in the Bank Plan it is laid down that the Bank will impose no conditions on the countries in which the proceeds of its loans are to be spent. But what does this mean? Presumably it means that there are to be no further conditions *after* the loans

have been granted, not that none are to be imposed *before* the loans are made.

Once again, in this Bank Plan, there appears the American desire to find means of getting rid, on favourable terms, of the vast gold stock accumulated in the United States. Hence the provision for the subscription in gold at first of a part and ultimately of the whole of the Bank's proposed capital of 10,000 million dollars—a proposal which would mean, in fact, that the United States would subscribe most of the capital of the Bank in gold. Gold, however, is not what the nations which are to receive the capital want: they want goods. If they can use the gold, or rather the credit based upon it, to get goods, all is well. But how is this to come about? The United States is a surplus country on current account: it has a surplus of exports for which the recipients cannot afford to pay. International balance can be restored, unless the United States is deliberately to reduce its exports, only if these exports are themselves converted in part into long-term loans. But the United States, if it thus subscribes capital in the form of goods, cannot subscribe it in gold as well, without a further swelling of the total amount of the debt owed by the borrowing countries. It is surely a great mistake to mix up a plan for international investment designed to convert the United States surplus on current account into long-term investment with a plan for dispersing the United States gold stock or making other countries compulsorily purchase part of the newly mined gold. It is of the greatest importance to keep the debt burdens of the borrowing countries down to the minimum that is really needed for the effective development of their resources. To add to their burdens by making them buy gold which they cannot afford and do not need is the height of folly.

These are criticisms of the form of the latest American plan, rather than of its underlying intention. It is highly desirable that there should be a large plan for international long-term investment for the purpose of developing the resources of the backward countries; and it is obviously on the United States that a large part of the financing of such a plan is bound to fall. How ought such a plan to work out in practice? Clearly, if the United States were to supply in goods the capital instruments needed by the borrowing countries, the effect would be to swell correspondingly the total of American exports, and the existing surplus of exports over imports would remain untouched. The only way of reducing this surplus is for the Americans to get paid for their surplus of current exports,

apart from any new ones arising from the plan, in the form of shares or bonds in foreign undertakings or Government debts, the money thus made available being spent *not* on American goods but on capital goods made in countries which have an adverse balance to meet in the United States. In other words, British and other European goods must be sent to the borrowing countries in payment of debts owing to the United States; and the ownership of the capital assets thus created must accrue to the United States Government or to private American citizens. This is the only way in which the American current surplus can be converted into international long-term investment.

Of course, this does not mean that *no* American capital goods are to be sent to the borrowing countries. Clearly, such a condition would be out of the question. But it must be fully understood that such American overseas investments as take the form of exports of *American-made* capital goods (or indeed consumers' goods) can do nothing to reduce the size of the American surplus. Accordingly, the Americans must, if the plan is to work, lend abroad much more capital than they send out either in goods or in gold. They must acquire ownership of capital resources either produced in the borrowing countries or imported from countries which owe money on current account to the United States.

Clear statement of this truth is sometimes deliberately avoided on the ground that the notion of financing large schemes of international investment after the war is likely to make a much greater appeal in the United States if the American people see themselves as the prospective suppliers of the capital goods which will be needed than if they realize that most of these goods will have to be produced elsewhere. There is, however, no escape from this; and it seems disingenuous not to put the point clearly. A country cannot go on exporting more than it is prepared to import unless it is prepared to accept in payment foreign capital assets, in either short-term or long-term obligations of the debtor countries. If the inconveniences of accumulating vast short-term assets abroad are recognized as intolerable, there remains open only the acquisition of foreign long-term capital holdings constructed by the labour and capital resources of the debtor countries.

The proposal to form a United Nations Bank for long-term investment has evidently to be considered in relation not only to the proposed Clearing Union or Stabilization Fund but also to the proposals for short-term relief and rehabilitation under the auspices

of the recently constituted United Nations Relief and Rehabilitation Administration (U.N.R.R.A.). Even as I write these words, a Conference is meeting at Atlantic City to work out the methods by which this body is to be financed and is to conduct its operations. U.N.R.R.A. has at present a constitution under which it is administered by a Central Committee representing the four Great Powers —the United States, Great Britain, the Soviet Union, and China— subject to the approval of a general council or assembly representing all the participating countries. It is to work mainly through subcommittees, some dealing with the organization of supplies and representing the supplying countries, and others on a regional basis, to take charge of the distribution of the relief and aid in recovery in the principal regions needing relief—Europe, the Middle East, the Far East, the Soviet Union, and perhaps others.

The preliminary accounts of what is being done at Atlantic City include a tentative estimate of the total sum to be appropriated for purposes of relief. The amount proposed is £625 millions, to be raised by means of a levy to which the participating countries would contribute in proportion to their national incomes. On the basis of a levy of 1 per cent. of the national income, the United States contribution is put tentatively at about £375 millions, and Great Britain's at about £156 millions. Countries which have been invaded or occupied would make no contributions to the fund. The American share in this total would come to a great deal less than the United States spent in relief after the last war. Indeed, the entire fund would be smaller than the amount then spent by the United States alone, despite the fact that the present war has been many times as destructive of capital values. It is stated that one reason why the fund is not to be larger is that a number of the countries which need relief have considerable reserves deposited abroad, chiefly in the United States, and will be expected to use up these funds in paying for part of the relief supplied. If this is insisted on, the effect will of course be that the countries in question will have fewer resources left to apply to other purposes, especially to projects of long-term reconstruction and development. Accordingly, they will have to depend for reconstruction, as distinct from relief, more than would otherwise be the case on loans, chiefly from the United States, and the funds of the proposed United Nations Bank for capital development will need to be proportionately enlarged.

U.N.R.R.A. is designed primarily as an agency for helping the

liberated countries, and not the enemy countries, which will presumably also stand in need of help. Similarly, there will presumably be a need to make provision for the investment of foreign capital in what are now enemy areas, as well as in the liberated territories. It would make nonsense of projects of economic development in Southern and Eastern Europe if a sharp line were to be drawn between enemy and liberated areas in such matters as the development of transport or power, or the improvement of methods of agricultural production and marketing. No one in his senses will wish to leave areas of primary poverty in peasant Europe, merely because the Governments of these areas took the wrong side in the World War.

Germany itself raises more difficult issues. The well-known Soviet economist, Professor Varga, has recently published certain astronomical calculations of the economic damage wrought in the Soviet Union by the Nazi invaders, and has arrived at a total more than twelve times as large as the amount originally claimed in reparations from Germany after the last war. I am not in any way impugning the accuracy of the total: the damage done to Soviet industry and agriculture has been enormous. The point is that Professor Varga uses his estimate as the basis for a plan for the collection of reparations in kind from Germany, in the form of a transfer of industrial equipment and materials, and of German labour to carry out work of reconstruction in the territories of the Soviet Union. If any scheme on a scale approaching that which Professor Varga envisages were to be carried through, and were to include a substantial removal of existing German plant to the Soviet Union, Germany itself would stand in need of big loans of foreign capital in order to make possible the building up of its industrial capacity on the scale necessary for supplying the needs of the German people. Indeed, such a necessity may arise, even apart from the exaction of reparations in kind, as a consequence of the devastation now being wrought by intensive bombing in Germany's main industrial centres.

It is, no doubt, unattractive to suggest at this stage that capital loans may have to be made to Germany for the re-building of an industrial capacity which many people, mindful of the misuse the Germans have made of it, would gladly see annihilated once and for all. It would, no doubt, be indispensable to ensure that Germany's industries should not be so reconstructed as to provide the opportunity for a new venture in intensive re-armament for aggres-

sive war. But industries the Germans must be allowed to have if they are not to starve; and even more obviously industries they must have if they are to be in a position to make any substantial deliveries of reparations in kind. It is likely to become indispensable to include Germany, under thorough safeguards, in international projects of capital development, as well as within the scope of more immediate measures of relief. Europe can no more afford a destitute Germany than a destitute Poland or Yugoslavia.

Finally, it is necessary, in painting the picture of post-war projects of financial and economic re-organization, to take account of the plans for a world nutrition policy outlined at the Hot Springs Conference of 1943 and of the accompanying proposals for special measures to stabilize, through commodity agreements, the prices and conditions of supply of a number of the principal foodstuffs needed for implementing a programme of improved nutrition throughout the world. To the extent to which the countries engaged mainly in primary production of foodstuffs and raw materials get, as a result of these and other agreements, better prices for their commodities in terms of manufactured goods and also an enlarged market capable of absorbing all they can produce, their balance of payments problems will be eased and their power to contribute native capital towards their own internal economic development will be enlarged. They will need less by way of foreign loans, or be able to carry out larger projects of development with a given amount of help from abroad. Thus, the plans for better nutrition and better agricultural prices work in with the rest of the plans for international action—but only on the assumption that these plans do in fact lead to an expanded market and not to a restrictive rise in prices based on a reduction of supplies. At the outset, a world policy of improved nutrition for all the peoples will be bound to impose burdens on the more advanced countries; for the worst-fed peoples can be fed better only if the better-fed peoples will consent to eat less until there has been time to raise the standards of productivity in the more backward areas. This 'eating less' means that the richer countries will have deliberately to refrain from using their superior purchasing power to divert foodstuffs from the more needy countries to themselves.

Here comes in a difficulty. The more successful measures for raising the prices of foodstuffs are, the more, at the outset, will they tend to divert supplies from the needier to the wealthier countries. It will therefore be necessary for the latter, until the world shortage

has been overcome, not merely to refrain from eating more, but to purchase supplies for distribution to the needy countries in accordance with the requirements of the policy of improved world nutrition. To some extent, this will be covered by the activities of U.N.R.R.A. in the field of post-war relief. But the present famine in Bengal serves to show that the problem of nutritional standards extends far beyond the field which U.N.R.R.A. is intended to cover, and that the better nutrition policy, if it is carried out, will demand far larger capital appropriations than appear to be in contemplation at present.

These considerations may seem to have taken us a long way from the subject of money, with which this book is directly concerned. But they cannot be left out, because they are absolutely bound up with the problems of international investment and the balance of payments between countries. The backward countries cannot improve their standards of nutrition unless they can either produce more food at home, or import more food from abroad, or export less food in payment for imports, or all three together. They cannot easily raise their standards of production without help from foreign capital; they cannot import more unless they can find means of paying for it, or can be lent the means of payment in the form of capital investment in their productive assets; and they cannot afford to export less and consume more at home unless they can be lent the means of paying for imports which they have hitherto paid for with exported food. If the relative prices of their food exports improve, this will ease their difficulties to some extent, but will not do away with them. Moreover, if their purchasing power is increased, they (or rather the members of their communities who enjoy the additional purchasing power) may prefer to spend a good deal of it, not in raising nutritional standards among the general body of the people, but in buying more manufactured goods from abroad. The effects on demand of a rise in national purchasing power depends on the distribution of this purchasing power among different sections of the public. If power and wealth in the needy countries reside in a feudal or commercial governing class rather than in the main body of the people, there may be little or no improvement in standards of nutrition even when the total national income has been substantially increased. A world policy of better nutrition can succeed only if the balance of power in the poorer countries is shifted decisively in favour of the common people.

Will such an international agency as the Americans have pro-

posed for the supervision of the process of investment in the backward countries actually work in such a way as to favour the needs of the common people? There is serious danger that it may not. Created mainly as an agency for stimulating and guaranteeing private investment rather than for making investments of its own, it will be in danger of fostering those forms of investment which appeal most to the capitalist interests in both the lending and the borrowing countries, and of becoming an instrument for exploiting the cheap labour of the latter rather than for raising their standards of living. Of course, this need not be the case if in the borrowing countries there are resolute democratic Governments determined to prevent it, or if the lending countries act resolutely in the spirit of world democracy even against the pressure of their own capitalists. But these are large 'ifs'.

In effect, it seems clear that a great deal will turn on the character and extent of the international investment that is undertaken directly by the new agency itself, and not by private investors stimulated by its guarantees. We have seen that, under the American Plan, such direct investment is to be confined to projects which are either outside the scope of private investment or prohibitive to private investment on account of their cost. This seems to envisage that the projects to be sponsored directly by the Bank will be major schemes analogous in character and range to the establishment of the Tennessee Valley Authority in the United States—i.e. huge schemes serving wide areas through the development of electric power and irrigation or land drainage, or big projects for the improvement of land or water transport. There has been talk, most of it rather vague, of a 'Danube Valley Authority' or of similar schemes involving unified development in the territories of several neighbouring States; and clearly, the more such plans, even if they have to be on a rather less extensive scale than some of the projectors suggest, can be developed across national frontiers, the more hope there will be of breaking down *autarkic* tendencies in the national States which the Governments of the United Nations have pledged themselves by the Atlantic Charter to restore.

If projects of this order and magnitude, operated through international functional agencies established *ad hoc* for each major scheme, can be given a large place in the work of the proposed United Nations Bank, there is hope that they will not be subject to the dangers of economic-imperialist exploitation which is likely to beset ventures sponsored by private investment agencies. When,

however, one bears in mind the intense hostility displayed by a large section of American business towards the Tennessee Valley Authority, it is not easy to feel confident that the Bank will be given freedom to develop its work along similar lines without being accused of invading the legitimate field of private enterprise. One can but wait and see, and in the meantime do everything possible to bring it about that in the borrowing countries power after the war goes to Governments which will use it, not to abet exploitation, but to raise the living standards of the common people.

AN ANALYSIS OF THE MONEY TRANSACTIONS INVOLVED IN THE PRODUCTION AND DISTRIBUTION OF GOODS TO A RETAIL PRICE OF £1,000.

Note.—The analysis is based on tracing back the £1,000 worth of retail goods through the successive stages of distribution and production, and then considering the final destination of financial charges on these stages. The figures used are, of course, imaginary.

	[6] [7] *Distribution*		*Production*			*Transport*		*Finance*		*Investment*		*Totals*
	I *Retail*	*II* *Wholesale*	*III* *Finishing*	*IV* *Intermediate* [2]	*V* *Primary* [3]	*VI* *Charges for Transport*	*VII* *Goods used in Transport*	*VIII* *Insurance Charges*	*IX* *Banking Charges*	*X* *Depreciation Accounts* [5] [7]	*XI* *Reserves* [6] [7]	
	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.	A. B.
a. Labour and Management .	50	25	75	75	65	30	4	4	20	30	12	390
b. Proprietors' Receipts . .	100	20	25	25	25	10	2	2	5	10	5	229
c. Creditors' Receipts for Loan Capital . . .	—	30	30	30	30	10	2	12 [4]	—	13	6	163
d. Rent to Landlords .	50	5	10	10	20	5	1	1	5	4	1	112
e. Rates and Taxes . . .	40	20	10	10	10	5	1	1	5	2	2	106
f. Transport Charges . .	—	20	20	20	20	—	—	—	—	—	—	80
g. Insurance Charges .	—	5	5	5	5	2	—	—	—	—	—	22
h. Bank Charges . . .	10	10	5	5	5	2	—	—	—	—	—	37
i. Depreciation and Obsolescence	—	10	15	15	15	4	—	—	—	—	—	59
j. Reserved Profits . . .	—	5	5	5	5	2	—	2	2	—	—	26
'B' Payments other than Goods purchased .	10	50	50	50	50	10	—	2	2	—	—	
k. Goods Purchased . . .	750 [1]	600	400	200	—	10	—	—	—	—	—	1,960
Total of A	240	100	150	150	150	60	10	20	35	59	26	1,000
Total of B	760	650	450	250	50	20	—	2	2	—	—	2,184
Total of A+B	1,000	750	600	400	200	80	10	22	37	59	26	3,184

Cumulative Total of 'A' Payments	240	340	490	640	790	850	860	880	915	974	1,000
Cumulative Total of 'B' Payments	760	1,410	1,860	2,110	2,160	2,180	2,180	2,182	2,184	2,184	2,184
Cumulative Total of 'A'+'B' Payments . . .	1,000	1,750	2,350	2,750	2,950	3,030	3,040	3,062	3,099	3,158	3,184

a. Wages and salaries.
b. Incomes received by private proprietors and dividends on equity capital.
c. Interest on Loans and Debentures, except Bank Loans.
d. Rent of land and buildings rented.
e. National Indirect Taxes and Local Rates, spendable by public authorities.
f. External payments to transport agencies.
g. Payments by transport agencies for goods supplied.
h. Payments to insurance agencies.
i. Bank charges and interest on short loans.
j. Replacements and Renewals out of Depreciation Accounts.
k. Allocations to Reserves, not included in above.

A = Payments to Final Incomes.
B = Payments to Intermediaries.
A + B = Total Transactions.

1 Including trade credits.
2 Assuming only one intermediate stage. There might, of course, be several.
3 Covering, where necessary, more than one material.
4 Including payments to insured persons.
5 On the assumption that expenditure = allocations.
6 On the assumption that reserves are spent on capital development.
7 These stages are artificially simplified. There would, in fact, be more stages, but the final result would be the same.

APPENDIX A

ON THE ALLEGED DEFICIENCY OF PURCHASING POWER

(See Table on page 288)

Is there any substance in the allegation, so often made, that under the existing economic system there is a continuous tendency towards a 'deficiency of purchasing power', in the sense that not enough purchasing power gets distributed to make it possible for all the current products of industry to be bought at prices which cover their costs of production, including reasonable returns to those who direct the process? A number of attempts have been made to demonstrate that such a tendency exists, notably by Major Douglas and his followers, but also in other quarters. This appendix is devoted to a consideration of this problem.

The question here posed must be distinguished from another, or rather from two others, with which it is often confused. It is obvious that at certain points in the trade cycle a deficiency of purchasing power does appear. When credit is restricted, or when the business world is attacked by a fit of pessimism, warranted or unwarranted, and sets to work to contract production and employment, there ensues a period during which current incomes are insufficient to buy at remunerative prices the output that is on the market, and has largely been produced during a previous period of fuller employment. That is to say, there are undoubtedly *epidemic* occurrences of deficiency of purchasing power. That is not, however, the question here under discussion: it is dealt with, I hope adequately, in the text of this book. The question now under consideration is one not of *epidemic*, but of *endemic*, deficiency.

Secondly, it is undeniable that the amount of purchasing power distributed through the economic system is not usually sufficient, even when trade is regarded as good, to purchase at a remunerative price all that *could be* produced. Purchasing power, apart from bank credit, is distributed as a sequel to production and not as a means to the full use of all the available productive capacity; and bank credit, though it involves a creation of purchasing power, is not usually carried to such a point, or so directed, as to make it remunerative to bring all the available factors of production into the fullest possible use. Perhaps purchasing power ought to be distributed with a view to ensuring 'full employment'; but no one will claim that it is so under the existing system in capitalist countries, except in time of total war. This again, however, is not the question at present under debate.

I am dealing here only with the question whether there exists under the present economic system, in times of activity and depression alike, an inherent tendency towards a deficiency of purchasing power in the sense given to the term in my opening paragraph. I am convinced that no such

tendency does exist, and that what is called 'Say's Theory' of the conditions of the market is true, though the deductions drawn from it are very often wrong. It is often assumed that, because the amount of purchasing power generated in the processes of producing and distributing goods and services tends, in conditions of static equilibrium, to amount to all the purchasing power that is needed for buying these goods and services at prices remunerative to the sellers, therefore there must be a natural tendency for all the available resources of production to be employed. This, however, does not follow at all: all that does follow is that, in the absence of disturbing factors, any given level of employment, high or low, tends to perpetuate itself. This is not very helpful, because there always in practice are disturbing factors; and accordingly it would not suffice once to raise the level of production and employment to the maximum in order to ensure that it should stay there. The self-perpetuating tendency of any level of production and employment under static conditions is, however, a matter of some importance; for it does mean that less effort will be needed to maintain a high level, once set up, against disturbing forces than would be needed if there were no such tendency.

It was a tenet of classical economic theory, known as J. B. Say's 'Market Theory' (*théorie des débouchés*), that 'over-production' could never arise because every act of production constituted at the same time a market for the goods produced. Incomes, Say pointed out, were generated in the process of production, of which they constituted the costs. Every cost was, in the final analysis, an income as well as a cost; and accordingly the income available for buying goods and services would always be equal to the cost of placing them at the consumers' disposal. There would, of course, be, when any single stage of production was looked at separately, a great many elements in cost that did not appear to be balanced by incomes paid out to the producers. The incomes accruing to the makers of finished goods would always be much less than the prices charged for their products, because a large part of the costs would consist of payments for the materials used up in producing them, and other parts would be charges for fuel, machinery, buildings, transport, and so on. This, however, Say held, did not invalidate the generalization; for if these other costs were traced back through the successive stages of production until every ingredient at every stage had been accounted for, it would be found that they would all break up finally into incomes of one sort or another, paid out at some stage to labourers by hand or brain, or to the owners of land or capital, or to the State or some other authority in taxes or rates. In effect, every payment would in the end be found to resolve itself into somebody's income—either that of an individual or that of some corporate or collective body—and to be available for spending on the goods and services of which the costs were being analysed.

The table on page 288 is an attempt to substantiate this generaliza-

tion. It is based, as any such attempt is bound to be, on a drastic simplification of what actually occurs; but I believe the simplification in no way impairs the force of the argument. I have taken an imaginary bundle of goods having a retail selling price of £1,000. The goods in question are assumed to be consumers' goods, sold to the consumer through a retail shop. If I had taken a bundle of capital goods, sold not to a consumer but to a business firm for use in further production, the headings in the table would have been different, but the general conclusion would have been the same. Similarly, if I had taken £1,000 worth of railway journeys, or of any other services, as distinct from goods, the form of the demonstration would have been somewhat different, but the argument would have been unaffected.

Of course, in actual fact, some goods pass through many more stages than others on their way from primary materials to finished products ready for sale, and some goods are made of a diversity of materials, or are joint products with others (e.g. coke and gas). In order to get a manageable simplicity, I have assumed two stages of distribution, retail and wholesale, and three stages of production, finishing, intermediate, and primary. Then I have taken separately the transport costs involved in all these five stages, and also the financial costs of insurance and bank credit. Finally, I have dealt with the 'capital' items of depreciation (including obsolescence) and the accumulation of business reserves. It would make no difference to the argument if there were more, or fewer, stages, or if there were, say, several raw materials used in making a single finished product.

It must be emphasized that the figures used are purely imaginary and, to a great extent, arbitrary in their relative magnitudes. It would be impossible to use realistic figures for an imaginary commodity. But, here again, it makes no difference what the figures are, as long as they are correctly added up and transferred from column to column. Any other set of figures can be substituted, with precisely the same result.

I begin, then, with the retailer, selling £1,000 worth of goods across his counter. I have assumed him to be a small private trader, employing only a shop-boy and renting his shop. I have also assumed that he gives little credit or none, and that he buys his goods mainly on credit from the wholesaler. He pays £750 for the goods, leaving £250 to cover his own costs and means of living. Of this, £10 goes in bank charges, which are put in column 'B' because they are paid to the bank and do not *directly* constitute anybody's spendable income. The remaining £240 all goes in such a way as to become spendable income—£50 to the shop-boy, £100 to the shopkeeper himself, £50 to his landlord, and £40 in rates and taxes. The landlord may, of course, have to spend some of his £50 on repairs; but it would only complicate the argument, without affecting the conclusion, to show how any such sum would finally convert itself into 'A' payments—that is, into directly spendable

income. Again, both the landlord and the shop-boy, as well as the shopkeeper, may have some of their incomes taken away in taxes and compulsory State insurance payments, but this also does not affect the argument. Rates and taxes are the spendable income of the State and the local authorities: they are either spent directly on goods and services, or handed over in interest payments on public debt, or in pensions, insurance and assistance payments, and so on, to individuals or groups whose spendable income they become.

The retail stage accounts, then, for £240 worth of 'A' payments, £10 of 'B' payments to the bank, and £750 of 'B' payments for goods supplied, making in all £1,000, which is the retail price of the goods.

Next comes the wholesale stage. Here we assume that £600 is paid for the goods which are re-sold to the retailer for £750. We are, of course, here dealing with only a small part of the wholesaler's total turnover. We are simply tracing back the history of the £1,000 worth of retail goods, and are not concerning ourselves with the rest of the wholesaler's business. At this stage we introduce a new factor of loan capital, on which interest is paid to the amount of £30 in respect of this particular part of the wholesaler's transactions. The £20 set down as 'Proprietors' Receipts' probably goes not to a single proprietor, but in dividends on share-capital of a trading company; but it is all the same from the standpoint of the argument. The 'A' payments which constitute directly spendable incomes amount to £100: the 'B' payments, in addition to £600 for goods supplied, come to £50. Of this £50, transport charges come to £20. (It was assumed, by the way, that the retailer's customers took their own goods home, and that the wholesaler met transport charges to the retail shop.) Insurance charges, which we neglected at the retail stage, come to £5 and bank charges to £10. Further, we have a new item for 'depreciation and obsolescence' of the wholesaler's warehouse and equipment, which he will need to replace over a period of years. (I have assumed that, whereas the retailer rents his premises, the wholesaler owns his, and pays only ground rent to a landlord.) Finally, I have assumed that the wholesale firm does not distribute all its profits in dividends, but keeps back £5, which is passed into a reserve fund and is not necessarily spent at once. We shall see what happens to that £5 later on.

Putting the two distributive stages together, we have £340 of 'A' payments—spendable income—£60 of 'B' payments other than payments for goods supplied, and £1,350 as the sum of the two sets of payments for the same goods passing through two successive stages. The goods were sold for only £1,000 at retail; but the money payments already amount to £1,750 altogether.

We come now to the manufacturer who puts the goods into their finished form. He pays £400 for the components out of which the goods are made, including fuel, oil, etc., used up in producing them, these

being treated as 'intermediate products' for the purposes of our simplified analysis. Neither 'A' nor 'B' payments at this stage exhibit any new feature, except that wage-labour begins for the first time to assume an important part. (It might, of course, have been important at the retail stage, if we had taken a multiple firm instead of a small shopkeeper.) The 'A' payments amount to £150, and the 'B' payments to £50, plus the £400 paid for goods supplied. The cumulative totals are now—'A' payments £490, 'B' payments other than goods supplied £100, and goods supplied £1,750.

The stage of intermediate manufacture is made, for purposes of simplicity, a mere replica of the stage just analysed. It presents no new features. At the stage of primary production, I have scaled up the rent to landlords, to cover royalty payments, and have reduced somewhat the share accruing to labour and management; but this is in no way essential. Taking the three stages of production together, we have total 'A' payments amounting to £450, total 'B' payments, other than payments for goods, amounting to £150, and total payments for goods amounting to £600. The item 'payment for goods purchased' disappears at the primary stage, when the materials worked on are supplied by nature and the payment for them included in the rent.

Let us now total up all the stages. We have accounted for £790 of 'A' payments, £210 of 'B' payments other than payments for goods supplied. These two together add up to £1,000, the retail price of the goods. In addition, we have a total of £1,950 paid for goods purchased at the various stages—for the same goods, at different stages in their movement from primary products to retail shop goods.

The next step is to analyse the 'B' payments of £210. We begin with transport charges. These break up, in the same way as costs at the previous stages, into 'A' and 'B' payments made by transport agencies. The 'A' payments come to £60, and the 'B' payments to £10 for goods purchased and used up in transport (e.g. coal or oil), and £10 for other 'B' charges. We proceed at once to analyse the first of these two sums of £10, and for simplicity, instead of tracing it back through a number of stages similar to those which we have analysed already, we assign it to 'A' payments of various kinds. For complete accuracy it would be necessary to insert more stages here; but it would come to exactly the same in the end.

Adding on both transport groups, we have a cumulative total of £860 'A' payments, £220 'B' payments, apart from goods purchased, and £1,960 for goods purchased. The first two items now add up to more than £1,000, because a part of the earlier 'B' payments is already being transformed into 'A' payments. If we deduct these from the previous total of 'B' payments except for goods purchased, we get £140 of 'B' payments still unresolved. This, with £860 'A' payments, adds up to £1,000.

We come next to insurance payments. Here a complication arises, because a part of such payments comes back to the insured persons in benefits. I have classed such re-payments as 'A' payments accruing to creditors. This is not quite correct, as they may pass back into the funds of the business. They could be regarded as analogous to payments for depreciation or to business reserves. If they were so regarded, the final result of the analysis would not be affected. They would merely be transferred to the 'A' column later, under these other heads, which would be proportionately larger. It seemed simplest to put them in at this stage.

Banking charges raise no new problems. They are transformed into the incomes of bank clerks and managers, rent of bank premises, bank profits, and so on.

Again, let us add up. We have now a total of £915 for 'A' payments and of £224 for 'B' payments other than goods supplied. But of these 'B' payments, the amount unaccounted for has been reduced by the 'A' payments under the headings of insurance and banking to £85.

There remain the 'capital' items. A total of £59 has been paid at the various stages into depreciation and obsolescence accounts. This is available for spending on new capital goods to replace those worn out or discarded. Again simplifying, I have treated this as composed of 'A' payments, without going through all the stages over again. It is, of course, here assumed that the sums allocated to depreciation and obsolescence accounts are actually spent on new capital goods. If they are not spent, a deficiency arises, but not a deficiency of purchasing *power*. Anyone who has money to spend can refrain from spending it, and so cause a deficiency. But such abstention from the actual use of purchasing power is not relevant to the present analysis, important as it may be in practice. It has been fully discussed in the main text of this book.

Finally, we have the £26 which, instead of being paid out in dividends, was passed into business reserves. Again we must assume that these reserves are spent somehow: for the purpose of the analysis it does not matter how. I have assumed that they are spent on capital development, and have simplified in the same way as before by treating them as 'A' payments, without going through all the stages through which they are transferred.

We have arrived now at a total for 'A' payments of £1,000—exactly enough to buy the £1,000 worth of retail goods which is the subject-matter of the entire analysis. There is no deficiency of spendable income available to buy the finished goods.

But total payments needing to be financed in the course of all the stages amount, not to £1,000, but to £3,184—which is, incidentally, a great under-estimate, because of the simplifications used, of the total volume of money transactions normally involved in getting £1,000 of finished goods into the consumers' hands. This difference has to be

financed by credit, i.e. mainly by bank advances repayable when the borrowers get paid for the goods they sell.

I hope my readers, if they have ever been puzzled by the 'inherent deficiency' theorem, will find this demonstration of its falsity convincing. There are plenty of things amiss with the existing economic system; but an *inherent* tendency to distribute too little purchasing power to buy at remunerative prices the goods actually produced is not one of them.

APPENDIX B

FIFTY PROPOSITIONS ABOUT MONEY AND PRODUCTION

INTRODUCTION

I WROTE down the Fifty Propositions which form the main part of this pamphlet in the hope of clearing my own mind. When I first wrote them, I was dissatisfied; and I let them lie for some months and then went carefully over them again. I am by no means satisfied with them even now; for I am well aware that, even where they are correct, they raise far more questions than they answer. Nor do I even hope that they are all even roughly right, being well aware that I have not yet seen nearly to the end of the road. But, for what they are worth, let them go forth and be discussed, if anyone feels like discussing them; for assuredly it is of the first importance that we should all pool our ideas about the monetary problem, in the hope of seeing straighter and further by collaboration than any one of us has been able to see hitherto.

Money, let us agree, is an exceedingly difficult subject, about which it is all too easy to talk nonsense. The world is full, on the one hand, of monetary cranks, each with a patent panacea for setting all our ills to rights, and, on the other, of orthodox economists, so alarmed at the cranks' proposals as to be wholly unwilling to make any new discoveries at all, for fear of appearing to sanction some of their notions. The 'monetary reformers' and the professional economists stand, for the most part, facing each other across an impassable gulf, ignoring or deriding one another's theories, and passionately reaffirming their own with an almost religious fanaticism. The orthodox have a faith that they are defending the traditions of economic order against the assaults of dangerous lunatics; the 'reformers' are exasperated by the refusal of the professors to admit there is anything wrong with the monetary arrangements of a world in which need is so often unarmed with effective purchasing power, although men and factories are standing idle, well equipped to produce the goods and services which would meet its case.

In common with most people who have an itch to set the world to rights, I have been troubled in mind for many years by this controversy over the monetary system. I have never been able to agree with the monetary reformers that the mismanagement of money is the main thing wrong with the world as it is, or that a change in our monetary arrangements would by itself avail to bring plenty to birth. I have been sure that there is very much wrong with our present economic system besides its mishandling of monetary matters, and that the advent of the age of plenty depends on the planned and co-ordinated production and distribution of wealth, and not merely on the methods adopted for exchanging

it. But I have also been sure that there is very much amiss with our present management of money, and that a planned system of production and distribution could not be made to work to good effect without a very different monetary mechanism.

I have therefore been more sympathetic than many of my fellow-economists, or than many of my fellow-Socialists, to projects of monetary reform; and my interest has even survived the receipt, during the past three years, of over two hundred and fifty separate schemes, each put forward by its author as the one infallible remedy for the world's monetary disorders. These schemes have come to me from nearly every economically developed country in the world and from many of the less developed—in print, in typescript, or in manuscript—with letters from their authors entreating me, with varying degrees of insistence, to criticize them, to make them known to the world, or merely to endorse the claim that they, and they alone, have penetrated to the heart of the ultimate mystery of money. I have read every one of these schemes—the plainly mad ones as well as the sane—and I have spent a good deal of time writing back to their authors my criticisms and comments. Or rather, I did this until the number of schemes which reached me was over two hundred; and then, as the stream showed no sign of slackening, I resorted to the free man's privilege. I went on strike, and refused to deal with any more, because I realized, first, that I could not afford the time from my other work, and secondly, that most of the system-makers were by no means content with a reasoned reply, but wanted me to undertake the getting of publicity for their ideas, or to find them publishers, or at the least to go on corresponding with them, and that many of them were disposed to be angry with me when I refused these offices.

My sympathy, I say, has survived this ordeal, because I am convinced that there is behind the ideas of the 'monetary reformers' a substantial element of truth, and that they, far more than the orthodox economists who busy themselves with the 'monetary theory of the trade cycle' and suchlike matters, are feeling out after conceptions which will form the very basis of the monetary systems of the new social order. I have been unable to accept any of the numerous new monetary theories which I have studied as even roughly correct as a whole, or even as a successful statement of the fundamentals of the problem. But I believe truth will be advanced far more by trying to discover what the 'monetary reformers' are 'getting at' than by lying in wait to catch them out in a mistake; and the main purpose of my *Fifty Propositions* was to set out that part of their contentions which I felt able to regard as an acceptable basis for further discussion and inquiry.

I think I should give first place among the points upon which I find myself on the unorthodox side about money to the conviction that, under the conditions of large-scale production, it is disastrous to use the same sort of money for two quite disparate purposes—the buying and selling

of finished goods and services which are not intended to pass again into exchange—save occasionally at second hand—and the financing of the intermediate processes of production and distribution. I feel sure that wherever, in an advanced economy, consumers' money and producers' credit money, designed to finance production, are interchangeable, confusion is bound to arise. In other words, a system in which bank credit, the predominant form of producers' money, is interchangeable with the money which constitutes the spendable income of the community, is inherently unstable. It is, of course, true that producers want credits for the purpose of paying them out to other people, and that a good deal of the producers' money that is issued is in fact paid out in wages and salaries and other forms of income either by the firms to whom it is originally issued or by other firms which receive it directly or indirectly from them. Producers' credits must, for this reason, be *exchangeable* into consumers' money up to the point required for making these payments; but *exchangeability* and *interchangeability* are two very different things. The one implies, and the other does not, a definite act of exchange, in the course of which the sum exchanged alters its form; and this makes a vital difference. For where a definite act of exchange is required, a proportion can be kept between the supplies of money made available in different forms; whereas, when the different monies are freely interchangeable, this proportion is inevitably destroyed.

I set out, then, from the opinion, for which I claim no originality, that consumers' money and producers' money should be of different kinds, and inconvertible without a definite act of exchange. But this is merely the first step; for the requirement of an act of exchange will be valueless unless the exchanges are in fact so proportioned as to preserve a right balance between the different kinds of money. Some writers have suggested that this balance could best be secured by allowing the rates of exchange to vary freely, according to the conditions of supply and demand. This would, indeed, be the only way of managing the matter if the proposed dualism were to be introduced into a *laissez-faire* economy of the type usually postulated by the academic theorists. But to me, who put no faith in the 'pre-established harmony' of the classical economists, this solution seems radically unsatisfying as well as very difficult to work. I can see that it might do something to make monetary conditions less unstable than they are, and perhaps to check the diversion of money from the 'industrial circulation' into the purely 'financial circulation' in periods of boom. But I am unable to see that it would help at all towards that full utilization of the available productive resources—that unloosing of the forces of plenty—which I regard as the indispensable objective of worth-while economic reformation.

I go on, then, at the second stage to suggest that the supply of both sorts of money ought to be a controlled supply—controlled, that is, as to the total of each sort which the monetary authorities should be prepared

to make available. I get a hint here from two contending schools of monetary theorists, of which one contends that the road to monetary stability is to stabilize the income of the community per head of population, while the other urges with equal insistence the stabilization of the total supply of credit. How either of these objectives can be realized without making the two kinds of money distinct I am quite unable to see. But as soon as we are equipped with two different sorts of money both these forms of stabilization become feasible.

I do not, however, necessarily want to stabilize either consumers' money income per head of population or the total supply of credit. I want to see both these amounts controlled, but not necessarily invariable from time to time. If, however, they are to vary, what principles are to govern their variations? Clearly, the amount of money of both sorts that an economy needs depends, for one thing, upon the levels of prices which it desires to maintain. Any amount of money, if only it be sufficiently divisible, will serve to buy any quantity of goods and services, provided only that the prices correspond to the supply of money. It is sometimes objected that this statement needs qualification in order to take account of the varying 'velocity' of the circulation of money; but if we say that any amount of consumers' income will serve to buy any quantity of goods and services, at corresponding prices, this complication does not arise.

The question of the 'right' amount of money is therefore closely bound up with that of the 'right' levels of prices. If all money were used exclusively for buying finished goods and services arising out of current production, any level of prices would be equally right with any other, provided only that it tallied with the supply of money. Of course, there would remain the problem of a right adjustment of relative prices of different goods and services; but we can leave this important complication aside for the moment, in order to consider another. Consumers' incomes are used, not only for buying current goods and services, but also for meeting debt charges and for making savings for spending in the future. Changes in the purchasing power of money therefore upset the current balance between production and demand either by diverting a larger or smaller part of current incomes to existing debt-charges, which are largely fixed over long periods, or by altering the part of current incomes which the recipients decide to 'save'. This constitutes a strong argument in favour of preserving as far as possible a stable level of purchasing power for money; and it is largely on this argument that the advocates of price-stabilization rest their case. But this contention is valid only on the assumption that it is desirable to leave the existing distribution of wealth as far as possible unaffected by monetary forces. In fact, the existence owing to past maladjustments of an unduly inflated debt-structure may be a powerful reason for wishing to raise prices, and so lower the purchasing power of money; and it is possible to conceive of

circumstances in which the balance of advantage would lie the other way.

If, however, we assume that it is desirable to establish, as nearly as possible, the 'neutrality' of money between incomes of different sorts, stability of the price-level does seem to be, on the whole, a good thing. But it must be recognized that this conclusion depends on the same sort of money being used to meet debts and to effect savings as is used for making current purchases of consumable goods and services. If this were not the case, the arguments in favour of a stable price-level would largely disappear, and, given the right equilibrium with the supply of incomes, any level of prices would be just as good as any other. Some people will argue that, even so, it would be best for the price-level to remain stable, because change is always to be deprecated unless there is good reason for it. But this view rests largely on taking for granted what is in fact a highly artificial notion—that of the 'general level of prices'. So much use has been made of this notion in the course of monetary arguments that most people seem to have quite forgotten how highly artificial it is. There are countless prices of different things; but there is no such thing as a 'general level of prices' except in the sense of a weighted average of them all. How much real meaning has this average? It would have a good deal if all consumers spent their money on identical mixed bundles of goods and services. But clearly they do not, and accordingly a stable 'general level of prices' does not mean that the purchasing power of money remains unchanged for every individual who possesses an income.

In the very nature of the case, the prices of particular things are under the present system constantly changing. This happens, apart from changes due to fluctuating desires for them, because the conditions of production are being constantly modified by technical change. The relative costs of producing different things alter, and this causes under normal conditions changes in prices. On the whole, the tendency of industry is towards falling *real* costs as technical efficiency improves. In other words, fewer productive resources have to be used up in order to provide a particular commodity; and this, in the absence of counteracting influences, is likely to bring about a fall in price. If, however, the 'general level of prices' is to be kept stable, every time the price of one thing is reduced because there has been a fall in the cost of producing it or for any other reason, there must be a corresponding increase in the prices of other things, even if no changes have occurred in the conditions under which they are produced. But why should there be? What special sanctity is there about the stability of a mere average? Why not let prices fall as costs fall?

As matters stand to-day, there are strong reasons against doing this; for the effect would be to raise steadily the purchasing power of fixed incomes, which accrue chiefly, though not entirely, to the richer classes. Moreover, the inflation of the debt-structure hampers production under

the existing system whereby industry is financed to a substantial extent by means of fixed interest-bearing debt. But if there existed a system of Social Dividends, such as I advocate in my *Fifty Propositions* and have worked out in greater detail in my *Principles of Economic Planning*, by far the larger mass of fixed money incomes would be received by the relatively poor, and the fall of prices, instead of transferring purchasing power on balance from the poor to the rich, would transfer it rather from the rich to the poor, and thus exert a socially advantageous influence. If, further, industrial operations were no longer financed at all by means of long-term capital bearing interest at fixed rates, the adverse reactions on borrowers, as borrowers, of a fall in the relative prices of their products would disappear.

There would, accordingly, be much to be said, under a better ordered economic system, for allowing prices to fall as technical efficiency improved, without any attempt to offset such falls by measures designed to keep the 'general level of prices' stable. Under existing conditions, however, the magnitude of the debt-structure may constitute a powerful argument against falling prices, and reinforce the contentions of those who wish to keep prices stable by means of monetary manipulation.

The weakness of this policy is that it is quite impossible for infusions of money, designed to prevent the 'general level of prices' from falling, to act evenly upon the prices of different things. Unavoidably, the infusion of new money affects some prices more than others, and thus tends to set in motion forces making for disequilibrium in the economic system as a whole. This tendency is greatly exaggerated by the unlimited interchangeability of money between different uses; for this allows money meant to steady commodity prices to escape instead out of the industrial into the financial circulation, where it is used to push up the prices of second-hand goods, especially stocks and shares and real estate, and thus makes the way easy to an unsound speculative boom. Here again we see how the interchangeability of money creates conditions which prevent the ordered operation of economic forces.

I have been discussing so far the question of balance between money incomes and the prices of the goods and services on which these incomes are to be spent. I have stressed the need for ensuring such a balance; but clearly the question is far less simple in fact than it would be if this were all that had to be done. For at present the incomes distributed to consumers are used not only in buying up the current supply of consumers' goods and services, but also in buying capital goods. In part, these capital goods are also current products of the economic system. But to a substantial extent they are not; for, whereas sales of second-hand consumers' goods form only an insignificant fraction of total sales, second-hand capital goods, including both land and stock market securities, form a large fraction of total 'capital' sales.

It is, of course, true that, when second-hand capital goods are bought

and sold, the effect is merely a transference of purchasing power from buyer to seller. The seller then has the money, minus the overhead costs of the sale, to use over again in buying something else, which may be either another capital good, or a consumers' good, if he decides to spend his receipts in that way. But this interchangeability between expenditure on capital goods, old or new, and expenditure on consumers' goods, which are chiefly new, introduces yet another factor of instability into the economic system, even apart from the fact that it is always open to anyone not to expend his income or his capital receipts at all, but to hold them idle in the form of deposits in a bank, or, for that matter, cash in an old stocking.

Leaving this last possibility aside, we are still left with the fact that the use of the same sort of money for buying old capital goods, new capital goods, and consumers' goods and services makes it possible for great variations to arise from time to time in the amount of money locked up in the trade in second-hand capital, with corresponding repercussions on the amount of money currently available for buying the goods and services which are being currently produced. The banks can and do, in times of boom, prevent the diversion of money to speculative uses from causing a positive shrinkage in the sums applied to buying currently produced goods and services; but they achieve this only by increasing the total amount of money through increased emissions of bank credit, which are then applied either directly to financing speculation, or to filling up the gap that has been caused in the industrial circulation by the withdrawal of money for speculative use.

If the trade in second-hand capital goods could be divorced entirely from the trade in new capital goods, there would be no necessary cause of disequilibrium in the use of consumers' incomes to purchase new capital goods as well as consumers' goods. But such a divorce is quite impossible, under the existing system, for at least two reasons. In the first place, second-hand securities are for the most part more suitable for purchase by the general run of investors than new ones, which are bought more extensively by professional operators for re-sale. Secondly, under a system in which a large part of the new capital applied to industry takes in the first instance the form of reserved profits accumulated by joint-stock concerns, the expenditure on the capital goods provided in this way never enters into ordinary consumers' income at all, but is made through joint-stock concerns which often treat the reserves thus accumulated as substitutes for or alternatives to credit advances from the banks, and in this way introduce a further element of confusion into a monetary situation which is already confused enough.

It is, I believe, impossible to escape from these confusions within the limits of a system which involves the use of a mixed bag of money, made up partly of consumers' incomes, partly of business reserves, and partly of bank credits, for buying a mixed bag of things consisting indiscrimin-

ately of consumers' goods and services, new capital goods, and second-hand goods chiefly of the nature of capital. I feel sure that there ought to be clearly separated markets and means of payment for these different classes of things; and that no assured balance of the economic system can exist as long as they are all mixed up together.

I have urged already that bank credit should be separated sharply from all other sorts of money, and used only for financing intermediate transactions. This involves that it should be used directly for buying neither consumers' goods and services, nor new capital goods, nor second-hand capital goods. Consumers' goods and services should be bought only out of incomes, of which there should be a planned distribution adequate to purchase the entire supply of such things that can be made available by the full use, after necessary deductions, of the community's productive resources. How, then, should the purchase of new and of second-hand capital goods be financed?

My own answer, as regards new capital goods, is that the demand for them should become almost entirely a collective demand exercised by the planning authorities of a reformed economic system by way of a prior call on the requisite supply of agents of production. By 'prior' I mean prior to the distribution of consumers' incomes. The planning authorities should first determine, by the most democratic methods that can be devised, how much of the available powers of production it is expedient to devote to the making of capital goods, with a view to maintaining and enlarging the future supplies of consumers' goods, and should themselves directly order the production of these capital goods; and thereafter the balance of productive power should be assigned, subject, of course, to the limit set to total productive power by the democratic demand for leisure, to producing consumers' goods and services; and therewith enough income should be made available for consumers to enable them to buy these consumers' goods and services—neither more nor less. There would then be no need for any money paid out in personal incomes, save in quite exceptional cases, to be applied to the purchase of new capital goods.

If, however, it were thought desirable to leave the receivers of incomes free to 'save', as well as to spend on current consumers' goods and services, it would be quite possible to arrange for this without any disturbance of equilibrium. The community would then plan collectively, just as before, the allocation of productive resources between the making of capital and consumers' goods and services, but would, in accordance with its estimates of the consumers' will to save, enlarge its distribution of money incomes without any change either in the supply of goods and services or in their prices. It would then, through a National Investment Board or some similar agency, or series of agencies, offer to receive the consumers' savings—this could be done either with or without interest, as seemed expedient—and would vary its total distribution of incomes in correspondence with changes in the actual desires shown by the con-

sumers to save out of their incomes. The requisite balance could thus be preserved, or continually restored, and the tendency for variations in the rate of voluntary saving to upset economic equilibrium could be effectively counteracted.

As for second-hand capital goods, if the community became the principal owner of capital the trade in them would be reduced to quite small dimensions; and with the elimination of speculation in stocks and shares and of speculation in real estate the tendency for money to flow into or out of the financial, as opposed to the industrial, circulation would be effectively removed, so that such transactions as did still occur in second-hand capital assets would exert no disturbing monetary influence, especially as bank credit would no longer be applicable under any circumstances to the buying of such assets.

There remains the large question of bank credit. It has been suggested that this should be retained solely for the financing of intermediate transactions, that is, transactions between one producer and another, involving the purchase, not of capital goods, but of raw or semi-finished products at successive stages of manufacture, of finished goods in transit from the factory to their final sale to the consumers, and of services used in the course of production and paid for by wages or salaries, or in certain cases fees or commissions. To the extent to which such payments take the form of wages, salaries, or similar remuneration passing into the pockets of final recipients of incomes, the bank credits issued to finance them must be made in the form of, or convertible into, consumers' money, and must accordingly be reckoned against the total amount of money which the community has decided to distribute in this way. In other words, credits of this type must be rationed in order to keep their total in correspondence with the total purchasing power which it has been planned to issue to consumers as monetary rewards for productive services rendered. As for the remaining part of bank credit, which is to be issued for the financing of intermediate payments other than final consumers' incomes, its magnitude must depend on the structure of the economic system—in other words, on the number of separate financial enterprises through whose hands goods pass, by way of purchase and sale, in their journey from the raw material stage into the possession of their ultimate consumers or purchasers. If the economic structure is such as to involve a large number of intermediate transactions, the same goods being bought and sold over and over again at successive stages of production, there will be a need for extensive bank credits for financing these successive sales; whereas if the stages are few the need for such credits will be comparatively small.

For fear of misunderstanding, let me try to get this point quite clear. The amount of credit needed by intermediate producers for paying out final incomes to those who render services in production is not affected by the structure of industry. But the amount of credit needed for making

other intermediate payments, which do not issue directly in final incomes, is affected.

The amounts needed for this latter purpose depend upon the structure of the economic system, that is, on the number of separate financial stages. But each credit granted for the making of intermediate payments becomes indirectly and at the next stage back in the productive series a means to making final payments to recipients of income. Sums received by business units out of such credits granted to their customers further on in the productive series must therefore be reckoned against them as credits used for the making of final payments, to the extent to which they are so applied. It is the business of the credit-granting authority to know what are the full resources available from every source to each enterprise that may become an applicant for credit. It follows that all intermediate credit payments, i.e. all inter-producer payments, must be made exclusively through the publicly controlled banking system, which will undertake to convert such part of them as may be necessary into consumers' money, either by handing the requisite sums of consumers' money over to the enterprises concerned, or by crediting the accounts of the individual income-receivers with the sums in question, on the demand for the enterprises in which they have rendered service.

How large these payments to individuals out of the intermediate production circulation would be would depend on the methods used by the community in distributing the available consumers' income. I have urged in my *Fifty Propositions* that the most desirable method is, for a large and increasing part of the total income available for distribution, that of the social dividend, in preference to that of the wage or salary, or other monetary reward for work done. I have not suggested that these latter forms of reward should be dispensed with, but only that they should be reduced as rapidly and as far as proves compatible with the offer of incentives adequate to secure a satisfactory level of productive effort. There is no need for me to repeat here arguments which I have expounded at length in my *Principles of Economic Planning*, and set out more briefly in my *Fifty Propositions*. I need only say that I regard the social dividend as an indispensable instrument, under modern conditions of large-scale production, both for securing that human independence of the individual on which Distributists have particularly insisted, and for ensuring that production shall be pushed to the limits set by the demand for leisure, and not held back by allegations that it pays better to leave productive resources unused when they cannot be so employed as to show a 'profit' over total 'financial costs'. I regard it, too, as a necessary recognition of the essentially social character of production, which depends not only on the current efforts of the individual producers, but also on the accumulated stores of knowledge which are the common birthright of us all.

So far, I hope my views will go far towards meeting the essential desires

and contentions of monetary reformers of a number of different schools, and even perhaps towards reconciling certain of their differences. But I am unable to close this introduction upon so pleasantly harmonious a note without a word of warning. It is fatally easy, having realized that money is at present failing to serve with even tolerable efficiency its one legitimate use of financing the exchange of goods and services, to pass on to the quite unfounded idea that the manipulation of money can somehow work miracles, by enabling these goods and services to be produced without the expenditure of human effort. I do not mean that anyone would assert quite this; but there are monetary heretics, such as some of the advocates of the Townsend Plan in the United States, who have come perilously near it. It is of no use for me to talk to anybody unless he is prepared to agree that by no possibility can humanity as a whole consume more than it can wrest from nature, and that there is *some* limit to the quantity of things that can be made available, however fully we succeed in using the productive resources that lie ready to our hands. How far we could, by removing the existing trammels on production, actually expand our total output in the near future is a question to which there can be no exact quantitative answer. I have known trained persons, not fools, who put the potential increase as low as 10 per cent. I should put it at nearer 30 per cent. as soon as the new machinery could be got into working order, and at nearer 60 per cent. within a comparatively brief period of years. But such figures are little more than guesswork. What I am prepared to assert dogmatically is that it cannot, on the basis of men's present technical knowledge, be put at 1,000, or even at 100 per cent. If I am wrong, so much the better; but I am convinced that those who put forward dogmatically claims which most people regard as extravagant—claims which, in the nature of the case, they cannot *prove*—harm the cause of reformation, and do much to bring sensible theories into discredit and derision. For, let us always remember, it is not a matter merely of piling up the total heap of goods, no matter what they are, but of adding to the heap in a balanced way, proportionate to the expansibility of human needs and desires. That is by no means an easy task; and I feel sure that it involves, not only an amended monetary system, but also, as I have tried to show in the following *Propositions*, a planned and balanced economic order very different from that under which we muddle along to-day.

Fifty Propositions about Money and Production

Let me begin with certain propositions designed simply to clear the ground.

1. The total income distributed to all the members of the community cannot buy more than the community is able currently to produce, save to the extent to which the community is either using up accumulated stocks,

or importing more than it exports on account of current borrowing or past lending overseas.

NOTE.—For simplicity, these qualifications are omitted in the subsequent argument, i.e. it is assumed that imports and exports balance, and that stocks are not being depleted.

2. The total income distributed to all the members of the community ought to suffice to buy all the community is able currently to produce, up to the point at which a higher value is set on leisure than on an increase in the supply of goods and services. In other words, the distribution of incomes ought to be in proportion to the available productive power.

NOTE.—Incomes here include what is to be 'saved', i.e. spent on capital goods, as well as what is to be spent on consumers' goods. If capital goods are to be provided collectively, the sums distributed as incomes to the members of the community must suffice only to buy the consumers' goods which the community is equipped to produce, and not the capital goods as well.

3. What matters for the purpose of the above two propositions is not the absolute amount of money income distributed, but the relation between this amount and the prices set upon the goods and services which it is to buy.

NOTE.—Units of income are, fundamentally, units of purchasing power. They have no meaning except in relation to prices charged.

4. Under the present economic system, the sum-total of prices adds up to far more than the sum-total of incomes, because many goods change hands a number of times in intermediate transactions, either at various stages of manufacture or in the processes of distribution.

NOTE.—The total of incomes should be enough to buy all the finished goods and services that can be made available at the prices charged for them at their final sale. It should not, and cannot, suffice to buy the same goods over and over again at their various intermediate stages.

5. The purchase of intermediate goods and services can be achieved by means of either 'capital' or 'credit'.

6. 'Capital' is purchasing power derived from income, but used for the purchase not of goods or services for consumption, but of either instruments of production (capital goods) or for the holding of stocks of intermediate goods for further manufacture or re-sale.

7. 'Credit' is purchasing power not derived from income, but created by financial institutions either as an offset to idle incomes held by depositors in the banks, or as a net addition to the total amount of purchasing power.

NOTE.—In practice, banks create credit in both these forms. They become indistinguishable, because there is no way of distinguishing between those bank deposits which are the result of holding idle balances out of income, and those which are themselves the result of loans made by the banks.

8. Current incomes can be applied in four ways: (*a*) purchase of goods or services for consumption; (*b*) purchase of instruments of production (capital goods); (*c*) purchase of goods, consumable or intermediate, for adding to stocks held as 'working capital'; (*d*) deposit in the banks or elsewhere as unexpended balances of purchasing power.

NOTE.—(*a*), (*b*) and (*c*) all take goods and services off the market, and send money circulating further. (*d*) in itself takes no goods or services off the market, and does not cause money to circulate. (*d*) does, however, supply the banks with resources on the strength of which they can proceed to supply credit.

9. If all finished goods and services were bought out of incomes, and all intermediate goods by means of credits, no problem would arise, beyond that of making the total of incomes coincide with the total price of all finished goods and services, and ensuring that no incomes should remain unspent.

10. But in fact some finished goods and services are bought by means of credit, and some intermediate goods out of current incomes. There is therefore no assurance that, even if all incomes are spent, and prices known, purchases of finished goods will coincide with the purchasing power of the incomes distributed.

11. As long as the same sort of money is used for making both intermediate and final purchases, confusion is unavoidable. It is to this confusion that the banks owe much of their power to upset financial equilibrium.

12. In a well-ordered society:

(*a*) the provision of capital goods will be made collectively, i.e. by collective decision to appropriate such and such productive resources to the making of capital goods;

(*b*) the incomes distributed to the members of the community will be designed to enable them to purchase the entire supply of final consumers' goods and services, neither more nor less, and not to enable them to purchase either capital goods or intermediate goods;

(*c*) the purchase of intermediate goods will be financed exclusively by means of credits, which will not be available for the purchase of either capital goods or consumers' goods.

13. The situation envisaged in proposition 12 involves:

(*a*) power in the hands of the community to order what goods are to be made;

(*b*) power in the hands of the community to decide upon the total income to be distributed to its members, and the prices to be charged for final goods and services, or, alternatively, to regulate the distribution of incomes in relation to the prices charged for such goods and services so as to achieve a balance;

(*c*) power in the hands of the community to regulate the supply of credit in such a way as to ensure its adequacy to finance intermediate transactions and prevent its use for any other purpose.

14. The productive power of the community is a social power: it depends on the accumulated capital resources and knowledge at the disposal of the community as well as upon the current efforts of individuals. Wealth-creation is a social, as well as an individual, process.

15. Accordingly, the entire body of citizens has a social right to share in the current product of industry, not only as a reward for current service rendered, but as a right of citizenship.

16. The production of goods and services involves current efforts by individuals, working upon and using the social resources of capital and knowledge.

17. Accordingly, some part of the product of industry should be distributed by way of reward for such effort, to the extent required to elicit an adequate response in terms of individual energy.

18. The proportions in which the available income should be distributed in these two ways—i.e. as social dividends granted to every citizen as a social right, or share in the social heritage, and as incentives to individual effort—cannot be determined on grounds of principle. But the proportion distributed in social dividends should be as large as possible, and the proportion distributed as rewards or incentives related to individual efforts as small as is consistent with securing a satisfactory output of goods and services.

19. The reason for this is that equality is preferable to inequality, both as making for more comradely living together and because of the diminishing marginal utility of money, which involves that the total utility of a given supply of purchasing power is greatest when it is most evenly distributed.

20. It is implied in the above proposition that the social dividend should be equal for all citizens. Every citizen has an equal right to share in the social heritage.

NOTE.—This does not exclude decisions by the community to make additional grants to certain citizens on grounds of special need, e.g. to the sick or infirm, or decisions to vary the dividend in the case of children, who are receiving free services such as education, or of other persons receiving special free services at the public expense.

21. It is further implied that the incomes distributed as rewards or incentives should be unequal, and as far as possible proportionate to what is needed for eliciting the required response.

NOTE.—The closer the approach to economic equality in the community as a whole, the smaller will be the financial incentives needed to elicit special effort.

This follows from the law of the marginal utility of money. If my income is £5 a week, £1 extra is worth far more to me than if my income is £100 a week.

22. The total sum distributed as income available for the purchase of consumers' goods and services should thus be made up of (*a*) the total sum distributed in social dividends; and (*b*) the total sum distributed as rewards for work, or incentives. These two should suffice to purchase all the consumable goods and services the community is equipped to produce, after making due provision for the supply of new capital goods and any required increase in the stocks of intermediate goods.

23. Under the present system, production takes place (except in the restricted group of public services) only when the entrepreneur expects to achieve a profit (or at all events to make a smaller loss by producing than by not producing the goods or services in question). This often results in productive resources remaining unused, because restricted supply offers better prospects of profit than supply up to the limits of productive power.

24. This situation can arise because the main costs of production fall mainly upon the entrepreneur, whereas the main costs of non-production do not fall upon him. The main cost of non-production is the maintenance in idleness of the producers who are thrown out of work. This cost falls at present mainly upon the community, and is largely transferred, by means of regressive taxation, to the employed workers.

25. Under a system of social dividends, part of the cost of production —i.e. the part of the producers' maintenance met out of the dividend, would cease to fall upon the entrepreneurs. It would therefore often pay them best to continue production, where it now pays them best to abstain from production.

NOTE.—How much difference this would make would depend on the relative magnitude of the incomes distributed as social dividends and as rewards for work.

26. If costs of production fell, and prices remained unchanged, the entrepreneurs would reap large additional profits. But if the entrepreneurs were able to use these profits as incomes, clearly the total purchasing power made up of (*a*) rewards for work *plus* (*b*) profits *plus* (*c*) social dividends would more than balance the available supply of goods and services; for (*a*)+(*b*) would be equal to the total cost-prices of the goods and services, and (*c*) would be available in addition for buying these same goods and services.

NOTE.—This assumes that 'costs' consist entirely of rewards for work+profits. I omit the possible qualifications in order to simplify the argument, which is not affected.

27. Clearly, then, the entrepreneurs cannot be allowed to retain these additional profits, which must be appropriated by the community and employed as a fund for meeting the cost of the social dividend.

28. It will be argued that, if these profits are not to be retained by the entrepreneurs, their incentive to produce more will be destroyed. In order to prevent this, the entrepreneur, as long as he remains, should be taxed, not on the profits he actually makes, but on those he could make by using fully the available productive resources. If he fails to use them, or to pay the tax on this basis, he must be expropriated, and his productive resources be taken over by the community.

29. As the entrepreneur would not be called upon to provide new capital, which would be provided by the public, all new instruments of production would be public property. The entrepreneur, *qua* owner of capital goods, would in due course pass out of existence, and his departure could be hastened, to any desired extent, by levies upon inheritance of capital.

30. This would not prevent the entrepreneur, *qua* undertaker of business enterprise, from remaining in existence to any extent that might be considered desirable. But the entrepreneur would then be operating not as the owner of the capital goods whose use he supervised, or as the representative of a body of share-holding capitalists, but as the person entrusted by the community with the administration of a certain part of its collective resources of production.

31. Just as it is necessary to establish and maintain a balance between the money incomes available for buying consumers' goods and services, the supply of consumers' goods and services available for purchase, and the prices at which these goods and services are offered for sale, so it is necessary to ensure a similar balance in the case of both capital goods and intermediate goods and services.

32. In the case of capital goods, the establishment of this balance is purely a matter of accounting. The community itself is to order the production of these goods, and the appropriation to this purpose of the requisite proportion of the available productive resources. The community is also to order the distribution of these goods in accordance with its estimates of the need for relative expansion of output in the various industries and services producing final goods. There is accordingly no need, except for accounting purposes, for any prices to be set on capital goods: nor need any money change hands in respect of their distribution. If prices are set on them for purposes of accounting, such prices will have no effect on the balance between incomes, prices, and supplies in the realm of consumers' goods and services.

33. The supply of credits for the exchanging of intermediate goods and services must be kept at a level just adequate to finance the intermediate exchanges required to secure the planned flow of all sorts of final goods and services. The amount of such credit needed therefore depends on the business structure of industry, i.e. on the number of distinct *financial*

stages into which the complete process of production is split up, or in other words, the number of distinct firms, or accounting units, through whose hands products pass, on a weighted average, on their way from the first to the last stage of production and marketing.

34. The credits issued for this purpose should be kept clearly distinct from all other sorts of 'money', and issued in terms of a 'money of account' not available for other types of transaction, and cancelled as soon as the transactions to which they refer are complete. Such 'credits of account' must, however, be convertible on demand into current money, to the extent to which such money is still required for the payment of wages and salaries arising out of the productive process. Sums so converted will be debited against the total income available for distribution to consumers, and will reduce the total available for distribution in other forms.

35. There will be no need for payment of interest in respect of either capital supplied to business units, or credits advanced in respect of intermediate transactions. For it can be of no advantage for the community in one capacity to pay interest to itself in another capacity.

36. The amount of capital and credit locked up in the various productive processes will remain nevertheless a relevant factor in national cost-accounting; and in the national accounts the amount of such lock-up in every type of enterprise will be separately shown.

37. The community's money will thus be of three kinds: (i) consumers' money, available only for buying consumers' goods and services; (ii) producers' 'money', or 'credit money', available only for financing intermediate transactions, and consisting solely of bank entries expressed in a medium different from that of consumers' money; and (iii) capital 'money', being the monetary expression of the estimated value of the capital goods assigned to each business enterprise. This capital 'money' would of course be also purely a 'money of account', which could be expressed, if desired, in the same terms as credit money.

38. Credit money, but not capital money, would have to be exchangeable into consumers' money, up to the point requisite for financing payments of wages and salaries. But it would be so exchangeable only against approved requirements for such payments.

39. Complications arising out of international relationships have been left out of account up to this point. But clearly some of the firms using credit money will need to apply a part of it to the purchase of imported goods. If these goods are acquired from agencies situated within the country no problem directly arises. But these agencies at any rate will be incurring debts to business institutions abroad. Credits required for meeting such debts will therefore have to be convertible into 'money' acceptable abroad, i.e. into gold or foreign exchange. This conversion

will be undertaken directly by the banking system, which will make such payments as are approved on behalf of the firms in question out of the producers' credits allotted to them.

40. The banking system will, of course, do this out of the proceeds in gold or foreign exchange accruing from the sale of exports, including 'invisible' exports. These proceeds will be retained in the banking system, and the producers' credits issued to exporting firms cancelled against them. This involves the centralization of foreign exchange dealings in the banking system.

41. The banks, under the system contemplated in propositions 12 to 40, will become the custodians of the national accounting. It will be their function actually to conduct the financial transactions involved in such ways as to preserve the three forms of balance mentioned in proposition 31. But, though the banks will be called upon to administer these transactions, their function should be purely executive, and should not include any power to determine policy.

42. The determination of policy is a matter for democratic national planning. The community has to decide, by the most democratic methods that can be devised: (*a*) how hard it is prepared to work, or in other words, at what point it begins to prefer more leisure to more goods and services. This decision fixes the total productive capacity *currently* available. (*b*) How extensively it is prepared to accumulate capital goods, at the real cost of lowering *current* consumption, but with a view to enlarging *future* consumption. On these two decisions depends the total supply of goods and services available for current consumption. (*c*) How to distribute the resources allotted to the production of capital goods among different uses, with a view to the needs of future consumption, or in other words, in what kinds of capital goods to *invest*. (*d*) How to distribute the remaining resources among different uses, with a view to meeting the consumers' current needs and desires.

43. The settlement of these four problems is the settlement of the question of production. It requires an estimate of consumers' desires, i.e. of how the consumers will in fact allocate their purchasing power as between goods and services of different kinds. But clearly this allocation, even apart from changing currents in human desires, depends on two factors, the way in which incomes are distributed, and the relative prices set upon the various goods and services. Accordingly, (*a*) the planning of production is impossible except with a definite distribution of incomes in view, and (*b*) the prices at which the various goods and services are to be sold must be settled in conjunction with the decisions concerning the quantities of each type to be made available.

44. Therefore there must be, before the decisions under (*c*) and (*d*) of

proposition 42 can be made, a planned distribution of incomes. This involves (1) a decision as to the proportion of total available income to be distributed as social dividends on a basis of equality, and (2) a decision as to the broad allocation of incomes to be paid out as rewards for service between incomes of different sizes.

45. The expression of these incomes in terms of money is a reciprocal of the price-level. The absolute levels of incomes and prices do not matter: what does matter is that the total money income distributed to consumers should equal the total prices of the available consumers' goods and services.

46. But the relative prices set upon different goods and services do matter; for they settle the direction of demand within a given distribution of incomes. In settling how much of this or that thing to make available for consumption, the community must at the same time settle its relative price.

47. The basis of settling prices under Capitalism is marginal cost of production, i.e. the cost of producing the final unit required by the state of demand. This principle is subject to many qualifications in practice, but it possesses substantial validity under capitalist conditions. Under Capitalism, however, all incomes are charged, directly or indirectly, as costs against production, whereas under the system here projected incomes distributed as social dividends will not figure as costs, no interest will be payable in respect of capital or credit used in production, and the sole direct costs will be the wages and salaries paid out to the producers, *plus* any taxes levied directly on the productive concerns.

48. It follows that money cost of production will no longer form an adequate basis for the fixing of prices; for prices will have always to be greater in the aggregate than these reduced money costs, since the social dividend also will have to be cancelled against the prices of goods and services sold to the consumers. Under these circumstances, the normal price of a commodity will be its money cost of production *plus* an addition corresponding to the proportion of the total consumers' income distributed as a social dividend. If the social dividend accounts for half the total consumers' income, normal price will be twice the direct cost of production in terms of wages and salaries.

NOTE.—By 'cost of production' is here meant average rather than marginal cost.

49. There is, however, no reason why each commodity should be sold at this normal price. It will be open to the community to encourage or discourage the consumption of any particular product by charging more or less than the normal price. It will be open also to raise or lower the price when the process of production involves a use of capital or credit above or below the average lock-up in production as a whole.

50. In fixing the allocation of resources to various forms of production, the community will have in view an existing structure of incomes, prices, and demand. Demand, except to the extent to which it depends on incomes and prices, is an independent factor, to which the use of productive resources should respond, the allocation of resources to production changing as the desires of the consumers change. But demand, to the extent to which it depends on incomes and prices, will be a controlled factor. It will be open to the community to alter either the distribution of incomes, or the relative prices of different goods and services, or both; and any such changes will require corresponding changes in the allocation of productive resources.

These fifty points embrace, I believe, the essentials of a balanced economy based on the full use of productive resources up to the limit set by the demand for more leisure as against more goods and services. They provide for a balance between spendable consumers' incomes and available consumers' goods and services, and for striking this balance at a point which coincides with the *optimum* of social welfare. They avoid the confusion which arises from using the same 'money' to settle all sorts of transactions—capital transactions, credit transactions, and consumption transactions. They make as near an approach to equality of incomes as can at present be reconciled with the maintenance of adequate incentives to individual effort; and they provide for an increasing social dividend as the distribution of incomes in the traditional forms can be safely and progressively reduced.

They recognize as valid three of the main points associated with the advocacy of Social Credit. These points are:

(1) That under the existing system there is always grave danger of under-production, because there is no assurance of the adequacy of the incomes distributed to consumers to purchase all the consumers' goods and services that the community is in a position to produce.

(2) That the system of bank credit, as now administered, introduces an intolerable factor of instability into the economic system, because it permits the creation out of nothing of bank money ranking equally and indistinguishably with consumers' money arising out of production.

(3) That production is an essentially social process, based on the accumulated resources and knowledge of the community as a whole, as well as on current productive effort, and that this social character ought to be recognized in the system of distribution by the institution of a social dividend available for all citizens on equal terms.

On the other hand, these propositions do not recognize as valid certain other points commonly put forward by some advocates of Social Credit. These points include:

(*a*) The so-called 'A+B theorem', which is not accepted in the form in which it is commonly advanced, though the element of truth in it is recognized.

(*b*) The idea that consumers' credits (i.e. the social dividend) can be issued without the need for their subsequent cancellation against prices.

(*c*) The idea that the flaw in the price system can be put right by operating *solely* on the money system, without introducing a controlled system of income distribution, price-fixing and production so as to ensure a balance of production and consumption at the highest point consistent with the demand for leisure.

In other words, I am a Socialist, though not of a very orthodox brand; and I do not believe Social Credit can be made to work without the institution of the socialistic measures which I have outlined.

APPENDIX C

A NOTE ON THE JOINT STATEMENT BY EXPERTS ON THE ESTABLISHMENT OF AN INTERNATIONAL MONETARY FUND.[1]

THIS book had been finished, and the final proofs had been passed for the press, when there appeared, in the spring of 1944, the second thoughts of the British and American Treasuries on the question of monetary regulation in the post-war world. I take a last-minute opportunity to comment on this development, which now embodies a scheme agreed between the official negotiators, though not yet committing either the British or American Government, or those other Governments, including the Russian, which are said to have been consulted in the course of its preparation.

In one sense, the new agreed scheme is a step back. *Bancor* and *Unitas* have both disappeared; and there is to be no new unit of international accounting—no new kind of money in which the world can learn to reckon. It goes with this that there is to be no International Bank, nor even such an approach to one as was involved in the International Clearing Union of the Keynes Plan. There is to be no more than an International Fund, which will take the form of deposits in the Central Banks of the member countries or perhaps of other countries associated with the fund. The new agreed plan is a good deal less venturesome than the Keynes Plan, and sticks much closer, no doubt under American influence, to established banking forms.

This is regrettable; but regret is overmastered by relief at finding that Great Britain and other European countries are not, as the original White Plan seemed to threaten, to be 'crucified on a cross of gold'. The new plan, like the Keynes Plan of last year, leaves room, especially during the period of resettlement after the war, but also to some degree permanently, for changes in relative currency values, where they can be shown to be desirable as means of correcting serious lack of equilibrium. It is, moreover, expressly asserted in the new plan that each country is to be left free to follow its own internal policy of monetary management, with a view to the stabilization of economic activity—or, in other words, to follow a policy of full employment—and that it is not to be prevented from exercising such controls, and making such monetary adjustments, as a policy of this sort may require. Thus, the greatest danger which I saw in the White Plan has been removed, if not completely, at all events enough to make the plan as a whole worthy of careful consideration.

[1] Cmd. 6519. April 1944.

The other good feature of the new plan is that it faces the problem of 'scarce currencies'—that is, in effect, of the dollar, which will in all likelihood be *the* scarce currency for some time after the war. The methods proposed in the Keynes Plan for bringing pressure to bear upon 'surplus' countries to get rid of their surpluses by means either of long-term foreign investment or of admitting additional imports have been given up; and one can see them go without regret, in the knowledge that in the form proposed they could never have worked effectively. In place of them appears in the new plan a much more straightforward proposal for the actual rationing of scarce currencies, so as to prevent a scramble and bring about a tolerably equitable distribution of what is to be had. The details of this are not worked out, and are obviously important; but it is a great step forward to have secured from the Americans a recognition that dollars may have to be rationed—for this is both a recognition of the necessity of certain forms of exchange control and an admission that it is impossible for any 'surplus' country to push its exports unless it is prepared to accept imports in exchange or to convert its short-term credits into long-term investments, in such a way as not to place intolerable exchange burdens on those countries which accept its loans.

This point is so important that I quote here the actual text of the relevant passage from the new plan (VI. *Apportionment of Scarce Currencies*):

> '1. When it becomes evident to the Fund that the demand for a member country's currency may soon exhaust the Fund's holdings of that currency, the Fund shall so inform member countries and propose an equitable method of apportioning the scarce currency. When a currency is thus declared scarce, the Fund shall issue a report embodying the causes of the scarcity and containing recommendations designed to bring it to an end.
>
> '2. A decision by the Fund to apportion a scarce currency shall operate as an authorization to a member country, after consultation with the Fund, temporarily to restrict the freedom of exchange operations in the affected currency, and, in determining the manner of restricting the demand and rationing the limited supply amongst its nationals, the member country shall have complete jurisdiction.'

All this is definitely to the good. As against it must be set the fact that the new plan, as it stands, is on a small scale in comparison with what was proposed from the British side last year. The whole Fund now proposed is to amount to about eight billion dollars for all the United Nations and possibly to ten billions for the entire world; and the American quota—not stated in the plan, but announced from Washington—is to be from 2½ to 2¾ billion dollars. This, in itself, will not go far towards putting the 'deficit' countries in funds until they

have had time to set their houses in order—especially as there are narrow limits to the amount in any one currency which the Fund will be entitled to hold. The Keynes Plan, with its authorization to the Credit Union to create 'bancor' much as national banks now create credit—out of nothing—was much more expansive in its initial effects than the new plan can possibly be, unless we are to regard it as merely a beginning on which, after a period of experiment, a larger superstructure can be built.

In form, the new plan follows much more closely the White Plan of last year than the Keynes Plan. It retains the feature that each country is to pay a part of its quota towards the International Monetary Fund in gold and the rest in its own currency; but the provision for payment in gold has been made much less stringent by laying down that, although the sum payable in gold is ordinarily to amount to a quarter of the total, no country is to be compelled to pay over more than 10 per cent. of its holdings of gold or of exchange convertible into gold. This is an advance, even though the retention of the requirement that gold must be paid over at all is indefensible except as a concession to the American standpoint. The nominal handing over of the gold may not make much difference in practice. As there is to be no International Bank, gold deposited with the Fund will presumably in fact be left lying in the custody of the Central Bank of the depositing country, which will be able to treat it as part of its own gold reserve for internal currency purposes, unless and until it is needed to meet international debts which cannot be liquidated in any other way.

It is made clear in the new scheme that the proposed Fund is not intended to be used to meet large movements of capital. It is not an investment plan, nor does it in any way supersede the second of the two White Plans discussed in the main text of this book. Presumably, the experts are still at the stage of discussion about the best means of stimulating and regulating post-war international investment, and hold that the short-term monetary problem can be tackled and settled in general terms apart from the investment problem, and that a settlement of it will make easier the handling of the long-term issue. It is a great advance on the earlier White Plan that the use of exchange control, which seemed previously to be ruled out, is now explicitly contemplated as an instrument for preventing capital movements which threaten to upset rather than to further international equilibrium.

It is unknown to what extent, if at all, the experts of the Soviet Union are consenting parties to the new plan, either in principle or in detail. Certain consultations between them and the British experts are known to have taken place; and there have also been British-American consultations with the other United Nations and British consultations with the experts of the Dominions. Parliament has been promised that Great Britain will not be committed to any international monetary

policy until the Members have been given a chance of discussing it; and presumably the United States Congress will also have a good deal to say before any plan is officially approved. The new draft cannot be taken as in any sense final: indeed, a good many things may happen before any plan is got into final form. What has happened since the rest of this book was written is that the second thoughts of the United States experts have largely removed from the realm of immediate discussion the outstanding danger inherent in the previous White Plan, and that there is obviously a greater tendency now for them to think realistically and to allow for the conditions of extreme and probably protracted dislocation which will exist in Europe and Asia after the war. In particular, the need for the continuance of exchange controls during this transitional period has been fully recognized, over and above the provision which has been made for control in the case of 'scarce' currencies even when the transitional period has ended.

The new plan, then, is good in the negative sense that it is not bad or actively dangerous. It would, however, be foolish to expect very much from it, as long as it stands alone. It deals neither with the finance of relief and rehabilitation, which is a matter for U.N.R.R.A., nor with the re-building of European capital resources, which is a matter for an international investment plan still to come; and it is admitted that it cannot be brought fully into force, even in the narrowly monetary sphere, until some time after the war has ended. It is, moreover, conservative in its structure, setting up neither an international currency unit nor an International Bank; and it will accordingly disappoint those whose hopes were set on a great advance towards positive internationalism in the monetary sphere. For such achievements the political conditions remain unripe: all we get is a mild proposal for more organized co-operation between the Governments and Central Banks of the United Nations—to be broadened out to include other countries in due course—aided by a 'buffer stock' of assorted currencies to be managed by an international authority on lines which will not allow very much freedom to range. Probably it would be utopian, at this stage, to expect more: certainly, we might have had to face something a great deal worse. Moderate reassurance is the feeling with which we can appropriately greet the new plan—that, and the hope that it will have prepared the ground for international economic planning over a much wider field and of a more constructive character.

5th May 1944.

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