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BANK OF ENGLAND OPERATIONS

BANK OF ENGLAND OPERATIONS

1890—1914

BY

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PREFACE

THIS book does not pretend ^{to} be a history of the Bank of England during the period 1890-1914. Nor does it pretend to be a monetary history. It is merely a study of the operations of the Bank of England, as those operations appear to one whose interest is derived from an interest in the working of the pre-war gold standard. The book therefore ignores many aspects of the Bank's work, aspects which would interest perhaps an antiquarian, perhaps a political historian, perhaps even historically-minded bankers.

The principal sources used are the files of the *Economist* and the *Statist* and the various documents issued by the U.S.A. National Monetary Commission (1910). Among the latter documents is an "Interview with the Governor and Deputy Governor of the Bank of England," which is the only source of its kind between the Select Committee of 1857-58 and the Macmillan Committee of 1929-31.¹ It is unfortunate that on the only occasion, in seventy years, when the Bank gave official replies to questions, the questions were raised by a foreign commission and the Bank accordingly felt itself under no obligation to explain

¹ The Select Committee on Banks of Issue, 1875, having been very much restricted in the field of its inquiry.

its actions in any detail. The use of this particular source is therefore limited to securing inside confirmation of the existence of certain practices which can be gleaned from the weekly paragraphs of the financial journalists. While Edward Johnstone was editor (from 1882 until 1907), the *Economist's* money market reports abounded with even the most trivial incidents throwing light on the Bank's technique. After he retired, and particularly after 1910, the *Economist* appears to have lost interest in the smaller points. The *Statist* is useful mainly in giving much more detail about the Bank's gold operations.

I have, of course, also found a source, in Mr. Hartley Withers' "Meaning of Money," which takes its place alongside Bagehot's "Lombard Street" as a classic contemporary description of the centre of the monetary system. A word is also necessary on the relationship between this study and Palgrave's "Bank Rate and the Money Market." I have designedly avoided covering here the ground which Palgrave has already covered. On the whole our interests have diverged. Where they coincided I have simply used, without repeating, his work.

Some apology is perhaps needed for the introductory sketch of the period. It is not to be regarded as an integral part of the book ; its purpose is merely to give the most relevant historical facts of the period, for the convenience of those whose memories do not extend so far back. Older readers and those other readers who are interested in the Bank's technical problems only may quite well omit it. To

these latter, Chapters I. to IV. contain most of what they require. Chapter VI. is more conjectural, but should help to give a more complete picture of the Bank's activities. In Chapter VII. I have formulated some of my general conclusions, some of the opinions expressed therein being based on material which has found no place in the book. I do not wish these opinions to be emphasised.

Throughout the book I have rather minimised the use of statistics. There seemed to be no case for supporting my arguments with heavy batteries of statistics unless I reproduced the complete series which I have collected. That course would have involved me in writing a monetary history of the period, whereas the present study is properly a mere preliminary to such a history.

I hope that those older readers to whom the facts recounted in this book are already known will bear with the attitude of one who has learned his subject in these post-war years. In post-war literature the pre-war years have acquired the status of a golden age in monetary history, and there has been a tendency to write with a fond regret of "the sweet simplicity of earlier days." To myself, brought up in this atmosphere, the material collected in this book naturally had an interest which I do not expect to be felt by those whose memories are much longer than mine.

My greatest regret is that the material is not so accurate as it might so easily have been. The Bank of England did not see fit to allow me to inspect its records, the years here studied (as well as earlier

years which I had originally intended to cover) being regarded by the Governor as too near our own day. Perhaps the Bank will some day provide us with an official history. Is it too much to hope that the Bank will one day turn aside from exercising the vigour of its maturity to indulge in that privilege of old age, reminiscing of younger days?

This book was written during my tenure of an Assistant Lectureship at the London School of Economics, and I wish to acknowledge my indebtedness to many friends, among whom I would mention particularly Professor T. E. Gregory, Professor L. C. Robbins and Mr. Barrett Whale, without whose encouragement and help this book could scarcely have appeared.

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March, 1936.

INTRODUCTORY NOTE ON THE PERIOD 1890-1914.

BEFORE plunging into the problems which immediately concerned the Bank of England, it is perhaps fitting to consider for a moment the outstanding features, to economists, of the period with which this book is concerned. A mere sketch must suffice; details of the incidents and problems, mentioned in the succeeding paragraphs, can be sought elsewhere.

The period opened with the Baring crisis in the autumn of 1890. This crisis, marked by the collapse of the City house which stood next in credit to the Bank of England itself, closed a burst of over-investment in South America. It was the most serious financial crisis in this country for twenty-four years; but, unlike its forerunners of 1825, 1847, 1857 and 1866, there was no panic. The crisis was, indeed, most notable for the part which the Bank of England played in organising, with the support of the joint-stock banks and other leading financial houses, temporary support and ordered liquidation of Barings. Although the crisis was less spectacular than earlier crises, it was none the less effective in checking investment and heralding depression over a large part of the world. The early

'nineties were consequently years of economic difficulties in the new countries and slackened trade at home. Not that the crash had been simultaneous: there were symptoms of coming collapse in Australia in 1891, but not until 1893 did the tide of prosperity there definitely turn.

The full force of depression was not apparent at once. 1891 saw trade somewhat restricted and unprofitable; but unemployment in England did not reach its maximum until 1893.¹ Tariff changes in the States and in France and the continuance of the boom in Australia obscured the general economic situation for a time. 1893, when the banking crisis in Australia threatened to have unpleasant repercussions on English credit conditions, proved to be the worst year. The uncertainties of currency policy in the United States (where the Sherman Act compelling the Treasury to purchase 4,500,000 ounces of silver every month had been in operation since 1890) had been continually depressing English investment there. In 1893 the continued loss of gold by that country made a suspension of gold payments imminent. A hoarding panic arose, forcing a short spell of dear money on England. The price of silver was still moving downwards with jerks which disturbed the Far Eastern trade. At home a drought made the farmers' year the worst of an uncomfortable series; while a long strike in the cotton trade further depressed conditions at home.

¹ When the trade union unemployment percentage averaged 7.5 for the year.

The upward swing in trade which culminated at the end of the decade can be dated from 1894. That year there were no further shocks to retard recovery, while the cheap-money period had definitely begun. In the middle 'nineties trade was definitely improving as a result of two important stimuli operating in the absence of intensification of the adverse factors which had operated in the earlier years. The first factor was cheap money : Bank Rate stood at 2 per cent. for two and a half years, and for most of that period was completely ineffective. The second factor was the opening up of the Rand goldfield. In its initial stages that sudden spurt in the production of gold affected world economy in the same way as had earlier gold discoveries¹ : it stimulated world trade by providing a new opportunity for investment. The addition it made to the world's stocks of monetary gold was trivial at first. In fact, the circulation requirements of the goldfield absorbed by far the larger part of the early production.²

Though slow for about two years, recovery eventually made rapid headway. In 1896 wages once more began to rise,³ and continued to do so for the remainder of the century. 1897 proved a disappointing year for foreign trade, owing to the widespread crop failures—India experiencing a serious famine. The United States was an exception, but English exports thither were restricted by the

¹ I am thinking particularly of the Californian and Australian discoveries. 1933-35 provides some analogy, in South Africa.

² Cf. *Economist*, "Commercial History and Review of 1895."

³ According to the Board of Trade statistics.

operation of the Dingley tariff. The last factor again exercised a restraining influence in 1898 ; but in that year England benefited by the improved conditions in India and other great agricultural areas. By that time home trade was booming. Meanwhile the cheap-money period had come to an end, largely owing to the revival of normal progress in the United States leading to a resumption of autumnal drains of gold thither. Recurring spasms associated with political troubles and the German economic situation in 1898 ushered in the dear money period which lasted into the new century. In April there appeared the inevitability of a war between Spain and the United States, and at midsummer came the Fashoda incident which for a moment threatened war between France and this country. Hardly had that crisis passed when severe monetary stringency developed in Berlin. The production of new gold, now rapidly rising,¹ helped to mitigate the effects of these strains, and 1898 passed without Bank Rate going beyond 4 per cent., which trade was buoyant enough to stand. The peak of industrial activity was reached in 1899. Exports to India, Australasia and Canada particularly expanded. Prices and wages rose substantially, causing an appreciable drain of gold into circulation.

The year 1899 closed with exceptionally high rates for money, a result of the coincidence of the climax of the boom with the outbreak of the Boer War.

¹ World production rose from 197 tons in 1892 to 300 tons in 1896 and 454 tons in 1899 (Layton, "Introduction to Study of Prices," Appendix B).

Business activity in South America, in the United States and in Germany reached its peak with the turn of the century, the consequent gold requirements for South America being particularly important in forcing dear money on London. The Boer War disturbed the situation in many ways. It completely stopped the economic progress of South Africa, which had been such a potent stimulus to the previous revival. It stopped the flow of gold from the mines and actually created apprehensions that gold would have to be shipped to the Cape, gold being the currency of war. For some long time thereafter, too, Government borrowing for war purposes helped to keep money rates up. The spending of the money by the Government of course helped particular industries so long as the war lasted.¹ By the latter part of the year, however, British industry was already feeling the effects of the collapse in America.²

Then began a series of years when, year after year, improvement was expected but depression actually increased. The subjection of the Boers proved a much more troublesome affair than had been anticipated. When at last peace had been arranged, that meant the collapse of the war trade, and it was a long while before conditions in South Africa were settled enough for the economic development of the country to be resumed. Acute depression still held Germany in its grip at the end of 1901; trade in the United States began to recover in that year. With sagging

¹ Coal went to famine prices in 1900, but the prosperity did not outlast the war

² Particularly sharper competition in exports of iron and steel.

trade money rates in London gradually passed their high period and for three years a 3 per cent. Bank Rate in summer and a 4 per cent. Bank Rate in winter were the rule. 1903 was a more difficult year: a minor speculative boom in the United States threatened to make large demands on the available monetary gold. In the same year the initiation of Chamberlain's campaign for Tariff Reform, based as it was on the thesis of a secular decline in British trade, probably had some depressing effect on the business outlook at home. Agriculture had a very bad year. Abroad political troubles in Macedonia and the Far East were an adverse factor. Wages and employment both showed further declines.

1904 opened with higher hopes. India, Australia and the Argentine appeared to be set for better business. The disturbing effects of the Boer War had now become history. There appeared no reason to expect any difficulty in the money market as gold was once more coming from the Transvaal. But again the optimists were disappointed, for 1904 actually saw the unemployment average reach its maximum. Why this was so, it is difficult to say. Foreign trade was certainly better, despite the disturbance of the Far East which culminated in the Russo-Japanese War. Money was cheap. Agriculture had a better, though not yet quite an average, year. There were no important trade disputes. True, there was some political uncertainty at home, associated with the Tariff Reform campaign. On the whole one can only ascribe the very poor trade of

1904 to the accumulated results of the depressing factors which were operative in the previous year. This view is consistent with the fact that in the latter part of 1904 trade was definitely improving. The stimulus of cheap money was evoking more activity in the capital market. Japan was borrowing heavily for war purposes, South Africa for economic reconstruction. Electricity, tramway and omnibus, gas and water undertakings were all prominent borrowers during this and the succeeding years.

This improvement in the latter part of 1904 proved to be the inception of a vigorous boom. Internal difficulties in Russia, particularly the financial troubles of the Government, following her defeat by Japan, helped to accentuate a rising trend in interest rates, which was itself partly a reflection of improved conditions in many parts of the world. This rise in interest rates was not, at first, sufficiently marked to check trade ; but towards the end of 1905 the higher interest rates were patently causing postponement of projected industrial enterprises. The impetus to expansion came, despite the Russo-Japanese War and the Morocco incident, mainly from abroad. Bountiful harvests in most parts of the world encouraged the acceleration of economic development. In London, borrowing by colonial and foreign railways, notably those of Canada, the Argentine and Japan, was unusually large. Miscellaneous issues for South Africa were again large. The activity in the capital market in the latter part of 1905 marked the extension of boom conditions to home trade. Electricity issues had been prominent throughout the

year : then came a rush of issues for the supply of motor-omnibuses and motor-cabs in London, the manufacture of motor cars, and for rubber plantations (the prospects for which were based on the demand for tyres). Wage-rates at last ceased to fall and unemployment decreased sharply.

The year 1906 was described by the *Economist* as "one of the most prosperous and active that this country has ever experienced." Another year of good harvests, and booms in Germany and the United States helped our export trade. Particularly marked was the prosperity in the iron and steel industry, based on the enormous railway building in the United States and elsewhere. Among home industries, the new industries were again prominent in leading expansion. The strain which the boom was placing on the leading monetary systems was beginning to make itself felt. There were already signs of hesitation in American speculation when the great San Francisco earthquake and fire, in the spring of 1906, caused a break in speculation and a monetary stringency in New York.¹ The summer was not far advanced when the illiquidity of the German banks was suspected. These troubles were overcome, largely owing to the confidence of industrialists, who continued to initiate, and of the public, which continued to support, extensions in the capital structure of industry at home and abroad.

At the end of 1906 the exaggeration by American

¹ Apparently the break was forced by the insurance companies' sales of shares in New York, in their effort to secure the funds to meet San Francisco claims. (*Economist*, May 12th, 1906.)

speculation of the usual seasonal movements caused a serious spasm of tightness in the money markets. Bank Rate in London went to 6 per cent. and threatened to go to 7 per cent. The absence of any complete relaxation from dear money ¹ was having effects in some directions, notably in the building trade. Ship-building, too, showed a definite reaction, the market being obviously satiated. Wholesale prices passed their maximum in May, 1907. The financial crisis broke in Japan and in Egypt early in the year. Anxiety about the credit situation in New York and Berlin increased as the summer passed. Early October saw difficulties in Amsterdam, then ominous failures in Hamburg and New York. On October 22nd the crash in New York was signalled by the Knickerbocker Trust closing its doors and the banking panic which ensued. The extraordinary demand for gold for America forced a 7 per cent. Bank Rate in London. In the United States the financial crisis very quickly merged into a general commercial crisis ; but on this side the full effects of dear money were not at first apparent.² But as the boom had been brought on in England mainly by a flourishing export trade, the collapse in America and in Germany could not but bring less prosperous times to England. In addition, there coincided an Indian famine, an Australian drought, and bad harvests in Russia and Turkey.

¹ Bank Rate's lowest point in 1907 was 4 per cent., which lasted from April to August.

² See the *Economist*, November 23rd, 1907, where statements of the expectations of many trades were collected in an article, "The Outlook for British Trade."

The remaining years before the outbreak of the War were comparatively placid. The fall in prices after the 1907 crisis was not very great; but unemployment was severe, both in 1908 and 1909—more severe perhaps than it had been since the 'eighties. The cheap money which accompanied depression eventually gave a decided fillip to stock market and commodity speculation, both here and in other centres. The speculation in London and New York centred particularly round the new oil and rubber developments. Industrial recovery was rapid in 1910, particularly in England; but it was stock market speculation rather than world industrial prosperity which led to a minor monetary squeeze in the autumn of 1910. A small set-back ensued in America; but English revival continued, activity being maintained at a high level right down to 1913.¹ The activity of those years immediately before the War was associated with two phenomena—the rapid revival and growth to unexpected heights of British foreign lending, and the demand for armaments over a large part of the world. In one sense English trade appeared for a time to feed upon the international instability which characterised the period. The foreign demand, based on the two phenomena mentioned, for British iron, coal and steel encouraged those industries to intensify their efforts for expanding their own capacity. The notorious "bulge" in the capital-goods industries in England was already becoming apparent before the War.

¹ With the exception of the temporary paralysis caused by the prolonged coal strike in 1912.

Those years 1909-1914 were of course most sensational in the field of international politics. In the Mediterranean and the Near East there was almost continually war in one part or another. The strain between France and Germany, signalised by the Agadir incident: the jealousy between the Dual Monarchy and Russia over the recalcitrant dominions of the Sick Man: the re-orientation of Italian policy consequent upon these other changes: all these factors helped to make Europe an armed camp. To the strategic railways built in the East were added the railways built for other purposes in Canada and South America. All alike they were grist to the industrialist's mill. These conditions, and particularly the Governmental borrowing to which they gave rise, had much influence on money rates. After the flurries of late 1909 and 1910, connected with stock market speculation, interest rates were tending gradually upwards until 1914. The two Balkan wars which proved to be the curtain-raiser were particularly important for the money markets of the world. Early in 1912 the *Economist* often remarked how Paris was taking, at very high rates, short-term paper offered by the Balkan belligerents. Although the leading London houses refused to touch that particular type of paper, the fact that Paris was gorged with it meant that London took much other business. In April it was reported that "London is still stuffed full with short-term notes and short-dated securities issued by hard-up Governments and extravagant corporations." ¹

¹ *Economist*, April 5th, 1912.

By the end of 1913 dearer money, the extreme uncertainty of the international situation, and the growing feeling that expansion in certain directions had reached satiety point combined to break the boom. The London new issue market contracted sharply. Shipping freights collapsed. Trade was notably declining before the New Year. Early in 1914 there were financial difficulties in South America, then in Paris ; but the break was infinitely less violent than that of 1907. The peak had passed gradually and without alarming symptoms. A fortnight before Serajevo the *Economist* remarked that conditions everywhere “ portend inactive trade and cheap money.”

In looking at the period as a whole, its chief interest to the economist lies in the fact that it was the heyday of the international gold standard. In 1890 that standard was a decade or so old, and had worked discomfort enough to provoke a bimetallist agitation. In 1914 it was regarded as one of the corner stones of economic sanity, and the war period which ensued was regarded as an unpleasant interruption of its history. Yet in those twenty-five years, 1890-1914, the international gold standard had worked under disadvantages of the same kind, though not the same degree,¹ as those of post-war years. Tariff policies, war debts, reparations, political insecurity—all were present in the pre-war world. Not infrequently the steady upward trend of

¹ It is in this difference in degree that part of the explanation of the contrast between pre-war and post-war perhaps lies.

English exports was interrupted by violent changes in the United States, the German and even the French tariffs. The war debts and reparations which resulted from the Sino-Japanese and the Russo-Japanese Wars were responsible for large international monetary movements, and complicated London's reserve situation over many years. And as for the political insecurity, the whole period was one of wars and rumours of wars. One of these wars disturbed the supply of newly-mined gold for some years. Moreover, gold was subject to certain extraordinary demands which have hardly any parallel in the post-war world.¹ France was as tenacious of gold as she has been ever since. In such conditions it is remarkable that the international gold standard ever worked at all.

There were of course other conditions which definitely favoured the international system. Other than London, the only important foreign investor at long-term was France, and her capital was largely devoted to seducing the Sick Man of Europe and propping up the anæmic Russian giant.² The most rapidly developing countries of the world (particularly North America) relied rather on British investors, which meant that they were subject to the sway of one financial head—the City of London. But when all such factors have been duly weighed, the success of the international gold standard remains

¹ I am thinking of the circulation demands which reflected boom conditions anywhere.

² At the beginning of 1906 Russia actually left the gold standard temporarily (although her gold reserve was about £80,000,000).

something of a miracle. The internationally mobile short-term funds must have been much smaller ; but, even allowing for that, international financial disturbances were extraordinarily small. Our fathers and grandfathers must have been less sensitive, less ready to take fright at the succession of shocks which occurred. To that insensitiveness the success of the pre-war gold standard must in part be ascribed.

Such was the world in which the Bank of England had to work. We must proceed now to consider the peculiar problems inherent in its position and the way in which it tackled those problems.

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BANK OF ENGLAND OPERATIONS

CHAPTER I

POSITION OF THE BANK IN THE EARLY 'NINETIES

I

WHEN Bagehot wrote "Lombard Street" in 1873 relations between the Bank of England and the outside market were simple and extremely limited. The Bank had in fact, though not explicitly, accepted its position as the ultimate source of cash in a crisis. But in normal conditions it refused to supply funds for the operations of the bill-brokers. In 1858 it had adopted a policy of forcing the bill-brokers to be more self-supporting. Re-discounting bills for and making advances to the bill-brokers was therefore restricted to times of crisis and the "dividend dates." At the same time, the Bank was able to maintain a considerable measure of control over the market rate for bills by being one of the largest buyers ordinarily in the market. "At all ordinary moments," wrote Bagehot,¹ "there is not money

¹ "Lombard Street," p 110.

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enough in Lombard Street to discount all the bills in Lombard Street without taking some money from the Bank of England." Under those circumstances Bank Rate was necessarily either the effective market rate or very near to it. But even when Bagehot wrote a change was already beginning.¹ With the growth of the discount market the Bank is said to have found itself losing touch. A larger market was able to control sufficient funds to quote a finer rate than the Bank, which, following its practice of fixing Bank Rate weekly in multiples of $\frac{1}{2}$ per cent., found its custom and therefore its profits dwindling.

Between the date of "Lombard Street" and 1890 the outstanding change was that officially announced in 1878. The Bank announced that henceforth it would not consider itself bound to adhere to its official rate when discounting fine bills for its regular customers.² Bank Rate as an effective Market Rate of Discount was thus officially abandoned. In this way the Bank assured itself of an income. We may surmise that in the preceding years regular customers of the Bank had sometimes found it profitable to take their bills elsewhere and that the Bank, endeavouring to avoid the consequent loss of income, may occa-

¹ Goschen, writing more than ten years before Bagehot, had given a rather different account of the significance of Bank Rate: "The real importance of a variation in the minimum rate of the Bank does not consist in the power exercised over, but in the indications afforded of, the money market" ("Foreign Exchanges," p. 132.)

² Until 1890 the Bank in fact "only occasionally discounted for its customers at the market rate when that rate was below the official rate." In that year it began discriminating in their favour even when the market rate equalled or exceeded the official rate. (*Economist*, July 12th, 1890)

sionally have taken customers' paper below its own published rate. There is no definite evidence of this ; but it is at least possible to regard the announcement of 1878 as a generalisation and regularisation of an important practice. That is the most natural way of change in the City of London.¹

The Official Bank Rate was thus divested of much of its meaning. Not all ; for it had already been tacitly constituted a guide for the bankers of the country, the basis on which many of their interest rates were fixed.² And it was the rate at which the Bank would help the market in a crisis and at the recognised dates of the year. But no longer was it what it claimed to be—a minimum rate at which the Bank would discount fine bills. However, the Bank at this same time (1878) gave the rate fresh significance by revising its attitude towards the bill market. It announced that at this penal rate or thereabouts it would lend to the market, not only at times of crisis, but as a general rule. It would not discount bills outright, but would make advances to bill-brokers and the discount companies. These advances would be for very short periods (a week or a fortnight generally), and would be secured by approved bills deposited. In the twelve years

¹ For a detailed account of the relations between the Bank and the market before 1890, see King, "History of the London Discount Market," which appeared when this book was already completed

² Cf. Ellis, "The Rationale of Market Fluctuations," p. 51 (quoted by Walker, "The Working of the Pre-War Gold Standard," in "Review of Economic Studies," June, 1934, p. 203, footnote). The conventions had naturally been elastic in their early days, but in the 'nineties they had become as the laws of the Medes and Persians.

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following these announcements Bank Rate was not a rediscount rate at all, nor even a discount rate for customers' paper. It was the rate at which the bill market could obtain advances for a week or a fortnight.

Such were the official relations between the Bank and the money market at the close of the 'eighties. Meanwhile, almost every year gave evidence of the need for solving the problem set by the growth of the resources of the market and the comparative aloofness of the Bank of England. In the early 'nineties this problem became acute, and at times threatened to lead to the disintegration of the central reserve system.¹ The Bank frequently found its rate entirely out of touch with the market, and, since the foreign exchanges were influenced by the actual rate prevailing in the market and not by the official (and ineffective) rate,² the Bank found itself powerless, in the ordinary course of events, to exercise control adequate for the protection of the gold reserve.

The acuteness of the problem varied to some extent with the activity of trade, which would influence the supply of bills, and with the general gold situation, which would influence the supply of funds. But even in 1889, a year of relatively good trade, the weakness of the Bank was the subject of remark in the *Economist's* Annual Review. It appeared then to have been "increasing year by

¹ Cf. *Economist*, January 11th, 1890, January 28th, 1893, and January 20th, 1894.

² Cf. *Economist*, April 5th, 1890.

year.”¹ At the beginning of 1890 the Bank did appear to be making some attempt to make its rate effective by “borrowing on securities.”² But, generally speaking, unless there was a rapid collection of Government revenue or a great efflux of gold, Bank Rate was guided by the Market Rate rather than *vice versa*. The position of the Bank may be illustrated by two incidents which occurred during the months preceding the Baring crisis. The first was at the end of January, 1890, when Bank Rate was 6 per cent. and the market was rather shorter of funds than usual. On that occasion 6 per cent. was not effective in attracting gold, largely because there was “an organised attempt on the part of some big finance houses to beat down rates” with a view to their flotation of certain foreign loans.³ In March, 1890, when heavy Government disbursements began, the Bank reduced its rate from 4½ to 4 per cent., although an export of gold appeared highly probable.⁴ In the following month Bank Rate went down further, to 3½, and finally to 3 per cent., despite a persistent dribbling away of gold⁵ and the appearance of crisis conditions in the

¹ The *Statist* (January 18th, 1890) described the state of the market then as “a striking and new illustration of a remark that has been frequently made for years past, that the Bank has been losing its control over the outside market. It is not able to affect rates, except at very great and increasing cost to itself, and of late it is apparently quite unable to affect the foreign exchanges.”

² *Economist*, January 4th, 1890.

³ *Economist*, January 25th, 1890.

⁴ March 15th, 1890.

⁵ There was a similar occasion early in 1892 (*Economist*, January 23rd, 1892).

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Argentine. On such occasions as the latter the Bank felt compelled to follow the market downwards, if it could not force it up, for provincial traders were subject to charges which varied directly with Bank Rate.¹ There were frequently times, as will be seen later,² when the Bank wanted to enforce high rates in the City in order to deal with some temporary movement in the balance of international payments, but did not want to penalise home trade. In the early 'nineties all too frequently the Bank found that it was penalising home trade without having the desired short-period effect on the balance of international payments.³

The Bank was further constrained to keep its official rate in some fairly close relationship with market rates by the fear of losing what little power was left to it. The London joint-stock banks had long established their practice of regulating their Deposit Rate automatically with Bank Rate. If market rates were more than $1\frac{1}{2}$ per cent. below Bank Rate, the joint-stock banks were doing some business at a loss. When market rates were continually far below Bank Rate they felt inclined to

¹ This was continually insisted upon by the *Economist*, see, e.g., January 7th, 1893.

² See below, pp. 125-127

³ The Bank was perhaps inclined to over-estimate its own weakness. However independent the market was, it did take cognisance of Bank Rate, and a reduction of the latter was almost always followed by a further fall in market rates (see especially *Economist*, October 31st, 1891, when the inaction of the Bank was sufficient to cause a fall in market rates). Conversely, the Bank's refusal to follow the market downwards would act as a brake on the fall of market rates (*Economist*, April 12th, 1890).

THE BANK IN THE EARLY 'NINETIES 7

break away and fix their Deposit Rate independently.¹ In fact, it is said that in January, 1893, they did decide that if Bank Rate were not reduced from 3 to 2½ per cent. they would break away. The Bank bowed to the inevitable and the official rate went down. Since the Deposit Rates of the great joint-stock banks must have had some influence on discount rates,² the system would have been less workable with the joint-stock banks ploughing their own furrow in the way which they were obliged to consider.

Indeed, the consequences of such a departure from the established practice might have been extremely far-reaching.³ For London's position as the leading free gold standard centre depended fundamentally upon the Bank's power to control interest rates in London. With that power gone, London's position could only be maintained by the adoption of some radical change. In its "Commercial History and Review of 1889" the *Economist* suggested that "one of three things must be done: Either (1) the Bank of England must seek to make itself a greater power in the market, by allowing interest on deposits and competing actively for bills; or (2) the joint-stock banks must keep bigger cash [*i.e.*, gold] reserves themselves; or (3) they

¹ *Economist*, January 28th, 1893, and February 11th, 1893, and *Statist*, January 28th and February 18th, 1893, for full discussion of this point.

² *Cf. Statist*, May 12th, 1890, September 5th, 1891, and January 28th, 1893.

³ This was frequently pointed out by the *Economist*, which discussed the problem particularly in articles in the issues of January 28th and February 11th, 1893, and January 21st, 1894.

must give more loyal assistance to the Bank in keeping the cash reserve, upon which they depend. To us, the first of these alternatives appears best." The *Statist* did also suggest that the problem should be solved by the Bank accepting deposits and discounting freely,¹ though it more usually urged that the great joint-stock banks should support the Bank by refusing to cut rates indefinitely.²

To the first suggestion—that the Bank should offer interest on deposits and compete actively in the discount market—the *Economist* frequently returned in the difficult years which followed. It had the great advantage that it would, were it followed by no further change, restore the Bank to its lost power over rates in London. But the possible reaction of the joint-stock banks could not be ignored. If the Bank of England competed actively for deposits and discount business the joint-stock banks would view it as an ordinary competitor and be unwilling to leave their usual interest-free deposits with it. If the Bank wanted to retain those deposits it could only do so by offering substantial interest for them, and that it could not afford to do unless it used its funds in as profitable ways as those of any other bank. The only logical end to such a development would thus be the complete disappearance of the one-reserve system and a reversion to "free-banking." The *Economist*, following in the tradition of Bagehot, thought that possibly central banking was not the best system ;

¹ January 18th, 1890.

² *E g.*, May 30th and July 4th, 1891, and February 18th, 1893

but it viewed with alarm the disturbed period which would almost certainly mark the transition to a free-banking system. The *Statist* viewed the possibility of such a development with equanimity.¹

The second of the possible solutions suggested above would probably have come to the same end. The Bank was too weak to bear all the responsibilities of the system: then let the joint-stock banks strengthen themselves in order that they themselves may bear strains and stresses which have previously been part of the Bank of England's burden. Such was the argument. In effect it implied the substitution of a multi-reserve system for the one-reserve system. The last of the three suggestions, that the joint-stock banks should give more loyal assistance to the Bank, was the only one which was consistent with the maintenance of central banking. Paradoxically enough, while it was the only course which would not involve a radical change of system, it was the one reform which was likely to be most difficult of achievement. One obstacle was the traditional cleavage between the Bank of England and the joint-stock banks. More serious—in fact, an almost insuperable obstacle to any lasting arrangement—was the strong competition between the joint-stock banks themselves. Altogether the future evolution of the English banking system looked, at the beginning of our period, very uncertain. Yet the system struggled on, and, without any systematic or really satisfactory solution, lived

¹ January 18th, 1890, *cf.* its article: "Our Ultimate Banking Reserve," February 4th, 1893.

to be gloated over as though it were the acme of perfection. Most of this book will consist of an analysis of the various devices which were used from time to time to overcome the difficulties which remained implicit in the system right down to 1914.

II

For the moment the Baring crisis, in the autumn of 1890, made the problem appear more urgent and at the same time did something to facilitate its solution without radical change. The most striking effect of the Baring crisis was the scare about our gold reserves. The transaction of borrowing gold from Russia and France was felt as something of an humiliation. Goschen, the Chancellor of the Exchequer, initiated an agitation for increased gold reserves,¹ an agitation which lasted more or less until 1914. The need for larger reserves was generally admitted.² But so long as the Bank was so weak it could hardly protect its existing stock, except at great cost. Any further increase in its idle asset (gold) would necessarily leave it more remote from the market than ever. If the Bank was to control the market the cash basis of the banking system as a whole must be diminished. This implied a reduction in the Bank of England's assets. If it reduced its earning assets it destroyed, to that

¹ See his "Economic Essays and Addresses," pp 106 ff. With the particular solutions proposed by Goschen we are not concerned.

² Correspondents of the *Economist* and the *Statist* generally agreed on that.

extent, its livelihood. If its gold reserve decreased people would be alarmed. People were now urging that it should be increased. Thus was the problem made more urgent by the Baring crisis.

To some slight extent the dilemma was solved by the action of the joint-stock banks. They found themselves very much criticised for having reduced their cash ratios in the previous decade, and were urged to do their share towards improving the system.¹ They responded by increasing their deposits at the Bank of England by several millions, for the express purpose of enabling that institution to maintain a considerably larger cash reserve than previously.² The Bank was thereby enabled to increase its idle assets without reducing its income.³

This action on the part of the joint-stock banks, while no doubt partly to be ascribed to the pressure of informed opinion, is also to be regarded as symptomatic of the second important effect of the Baring crisis—the breakdown of the traditional cleavage between the Bank of England and the joint-stock banks. One of the many ways in which William Lidderdale showed himself to be one of the

¹ Characteristic of a gold circulation system was the confusion between the need for internal cash reserves and the gold reserve held to meet external drains. Goschen was on this as confused as anyone else.

² *Economist*, October 10th, 1891, and October 22nd, 1892. Absence of analysis of the item Other Deposits in the Bank Returns makes it impossible to give a less vague statement.

³ To the extent that the banks actually increased their cash ratios, this action of course tended to increase the Bank of England's power over the market; but the transaction was probably largely a mere transfer from till money to deposit at the Bank.

most capable of the Bank's pre-war governors¹ was in his calling on the great joint-stock banks and other financial houses to co-operate, under the Bank of England's leadership, in guaranteeing the liabilities of Barings. This co-operation was a useful precedent which was to bear fruit in difficulties of much smaller order than those of 1890. The notion that the London system might be made more workable by the joint-stock banks giving more loyal assistance to the Bank appeared much more plausible now. It became, in fact, practical politics in the following year; but only to have its drawbacks illustrated. At the end of May, 1891, "half-a-dozen or so of the larger joint-stock banks" made an effort to support the Bank of England in its endeavour to maintain market rates. They increased their balances at the Bank and refused to take fine three months' bills under 4 per cent. (Bank Rate was 5 per cent.).² But the combination was only partially successful, as other banks, among them the foreign banks, underbid and captured business from the "loyalists."³

¹ There are continual references in the *Statist* and *Economist* to his able conduct of the Bank's affairs. Even before the Baring crisis, the Directors had been asked in a General Court of the Bank to consider "the question of inviting the present Governor . . . to continue his period of office for a further two years." (*Economist*, September 13th, 1890, and *cf. Statist*, February 8th, 1890)

² The action was taken at the request of the Governor of the Bank of England. (*Statist*, May 23rd, 1891)

³ *Economist*, May 30th, 1891. Thomas Moxon had, in a paper read to the Manchester Statistical Society as early as 1878, suggested that the Bank's increasing weakness might be remedied by the commercial banks forming "a pool of £10 millions or £15 millions, to be employed in the discount of bills at not under Bank Rate" (Ashton, "Economic and Social Investigations in Manchester, 1833-1933," p. 82)

The following week there was a meeting of bankers, which considered the establishment of a permanent committee to fix rates. Apparently the danger, that such a committee might thwart rather than aid the Bank of England, was realised and that proposal was dropped. But it was resolved to meet "in times of difficulty" for the purpose of rendering support to the Bank of England.¹ Merely as a resolution this marked an appreciable step in the direction of more concerted action by the various elements in the money market. Near the end of the decade a Bankers' Committee was apparently supporting the Bank's efforts to maintain rates.² And the development of this more friendly feeling between the Bank of England and the joint-stock banks was to make possible one of the Bank's most potent devices for "screwing up the market" in the first decade of the twentieth century.³

The immediate effects of the Baring crisis may be summarised thus: it made a solution of the fundamental problem appear more urgent, and it made the joint-stock banks more willing to support the Bank of England. But for half a decade afterwards the difficulties seemed more intransigent than ever. One of the inevitable repercussions of the Baring crisis was a check to foreign investments. Currency uncertainties in the United States aggravated the tendency to retard the opening-up of the new countries. In

¹ *Economist*, June 6th, 1891.

² Based on a statement by Felix Schuster, Chairman of the Union Bank. (*Economist*, "Commercial History and Review of 1899.")

³ See below, pp. 36-39.

such circumstances trade at home and abroad languished year after year. Slack trade meant a relatively short supply of bills—hence ease in the money market—just the condition with which the Bank could not cope. Then at the beginning of 1894 began an immense influx of gold into the Bank as a result of the coincidence of American silver purchases (under the Sherman Act) with the rapid development of the Rand gold mines. Roughly speaking, the new supply from the Rand sufficed to meet the usual Continental demands, the entire efflux from the United States being available to add to the stock of the Bank of England.¹ Between January, 1894, and March, 1896, the Bank's gold stock increased from about £24,500,000 to £49,000,000. The direct result was the celebrated "cheap money period" of the middle 'nineties, when Bank Rate stood at 2 per cent. for two and a half years and when for months at a time the market did not go near the Bank.

Had the Bank viewed this increase in its gold reserve as likely to be permanent, it might have considered being content with the situation, allowing cheap money to have its effect in stimulating trade

¹ The mechanism of this gold flow would be worth a special study. The gold might have come to England as a result of the working of ordinary bimetallic principles, *i.e.*, the addition of silver certificates to the U.S.A. currency raised U.S.A. prices above English prices, therefore turned the balance of trade against America, and so led to the efflux of gold. Or the efflux may have been chiefly the result of English investment in the United States being checked, the balance of payments thus moving against the United States. Lastly there is the possibility that some of the silver purchased may have been imported, gold going out in consequence. I have not investigated this most interesting problem.

and the eventual expansion of the credit structure, sending the market once more within its walls. Had it been content to follow the principles of 1844 this would have been the proper course ; but in fact the Bank had moved far from these principles. The accession of gold, being more apparently due to the Sherman Act than to the development of the Rand, was regarded as ephemeral. A change of *régime* in the States might soon upset the silver party and bring about a return to the golden path which would lead to increased receipts from English investors.¹ It seemed desirable, therefore, to prevent the influx of gold from having its automatic effect in London. There was a *prima facie* case for " offsetting " operations. To carry through such a policy would have meant for the Bank a severe loss of its income from investments. This course the Bank felt itself unable to afford. On the contrary, when in 1895 the market remained consistently independent of the Bank, so that the latter felt the absence of the dribs and drabs of income from that source, the Bank actually added to its investments very substantially, apparently for the purpose of increasing its income. The total securities in the banking department, which had fallen to the neighbourhood of £30,000,000 to £32,000,000 when the gold influx began in 1894, rose beyond the £40,000,000 mark in the course of 1895. Thereafter the total securities in the banking department rarely fell as low as £40,000,000. This movement intensified and prolonged the cheap money of the middle 'nineties, and it did of course help the

¹ Cf. *Economist*, February 11th, 1893.

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Bank of England's income. At the same time, by increasing the market's resources yet further, it made the Bank's control over the market more remote than ever.

Before that the Bank had been endeavouring for some years to increase its power by facilitating the market's business with it in various ways. On July 10th, 1890, it began discriminating in favour of its regular customers, discounting for them at a rate below market rate, and below the rate at which it would discount bills for other people.¹ This was not, perhaps, important in itself ; but it is significant of a desire on the part of the Bank to build up its regular discounting business. Later in the same month the Bank intimated to bill-brokers² that it was willing to discount for them, at not less than Bank Rate, approved bills not having more than fifteen days to run.³ The *Economist* remarked : " This step is only one of several that, under the guidance of the present Governor,⁴ the Bank has taken to bring itself into closer touch with, and to acquire better control over, the market, and there can be no doubt whatever that as the result of these measures the Bank is now making its influence felt much more than it has done for a very long time past." Apparently in the succeeding years this

¹ Its rate to customers was 4 per cent., Bank Rate was 4 per cent., market rate was $4\frac{1}{2}$ per cent., and the Bank's charge to other than regular customers was $4\frac{1}{2}$ per cent. (*Economist*, July 12th, 1890, cf August 12th, 1893.)

² Who had been excluded from discounting facilities since 1858

³ *Economist*, July 26th, 1890.

⁴ Lidderdale (cf. above, p. 12).

fifteen-days limit was extended in the sense that the Bank accepted parcels of bills whose *average* currency was fifteen days. Early in 1894 the Bank intimated to the bill-brokers that it would henceforth take, at its published rate, parcels of bills whose average currency was thirty days, "so that presumably parcels of bills running from three up to sixty days would be accepted."¹ In 1897 the *maximum* currency of eligible bills was apparently extended to three months.²

These successive changes, besides giving to Bank Rate a less fictitious meaning than it had had for many years past, did facilitate business between the market and the Bank and no doubt increased the latter's influence. But they did not go to the root of the Bank's difficulties. Down to the 'nineties the banking system was freeing itself from control by economising the cash basis, and in the 'nineties there was a great expansion in the cash basis as an automatic result of the gold influx. To maintain at once its control *and* its income was to the Bank impossible in the short run. In its form as a persistent malaise the problem was bound to be solved by trade revival and monetary stringency, both of which came in the later 'nineties, partly as a sequel to the cheap money period of the middle 'nineties, partly as a result of political circumstances. Even then,

¹ *Statist*, February 10th, 1894. Both the *Statist* and the *Economist* hailed this change as a step "in the right direction."

² *Economist*, September 11th, 1897. The step had been preceded by rumours of the Bank's intention to compete more actively for discount business (see *Economist*, June 12th, 1897). On the currency of eligible bills, Palgrave's statement, on p. 52 of "Bank Rate and the Money Market," is inaccurate.

however, the Bank was bound to find itself faced with the same difficulty from time to time, when circumstances—slack trade for example—created periodic ease in the money market.

Had the Bank been prepared to follow the methods intended by the authors of the Act of 1844, none of these problems would have arisen. The Bank would, when the market was independent of it, simply wait until there was a sufficient efflux of gold to send the market into the Bank. The Bank would have been purely passive in its relations with the market. But in fact, as will be apparent at many points in this book, the Bank was not content to behave in that manner. It wished to take *precautionary* action very often, removing some purely ephemeral ease from the market. For this purpose it had to employ certain devices for acting directly on the open market discount rates, which, to the exclusion of the official Bank Rate, influenced the foreign exchanges. Some of these devices were already being employed by the vigorous Mr. Lidderdale at the beginning of our period. The elaboration and development of the Bank's methods of acting directly on Market Rate are detailed in the next chapter.

CHAPTER II

MAKING BANK RATE "EFFECTIVE"

I

THE constantly recurring problem facing the Bank was to find some means, with a minimum risk and expense, of making Market Rates more accurately reflect its own official rate. The most obvious and most direct way of raising Market Rate was to reduce, in some way or other, the supply of funds at the disposal of the market, just as an outflow of gold would reduce the market's funds. Conversely, a reduction in Market Rate could be effected by increasing the funds at the disposal of the market. In this chapter we shall be concerned with the various devices employed by the Bank for altering the market's supply of funds, deferring to Chapter III. certain other devices which the Bank employed when it wished to alter the relationship between Bank Rate and Market Rate.

But before considering the various ways in which the Bank of England manipulated Market Rate, it is essential to consider certain conventions which increased the necessity for some elaborate technique. The first of these conventions was that it did not ever buy bills in the open market, as it is generally understood to have done since the war. Bills held

by the Bank were all bills which had been taken to the Bank, either by its own customers for discount in the ordinary course of business or by the bill market for rediscount at the official rate. For the existence of this convention there is the purely negative evidence of the absence of remark of any such transactions in the financial journals and literature of the day, and in 1910 definite evidence in the "Interview with the National Monetary Commission" ¹:

Q. Is it your custom to employ surplus funds in purchase of bills from discount houses?

A. No.

Q. Do you sometimes purchase "prime bills" in the market at a lower rate than Bank Rate?

A. The Bank does not purchase bills in the market.

The second convention was that a bill once acquired by the Bank of England was held until maturity. Of this there is no mention in the "Interview with the National Monetary Commission"; the evidence for it consists in the continual mention in the *Economist* of the Bank of England bill maturities as a factor reducing the market's supply of funds. The market knew the maturities of bills which it had taken in for rediscount and on that knowledge based an expectation (*ceteris paribus*) of a reduction in its supplies of money at the due time. Again and again this can be checked. There are two further supports for this view. The custom of all the big London banks was to hold bills until

¹ Pp. 21 and 23.

maturity.¹ On that one of the functions of the bill-broker depended.² It seems reasonable to suppose that the Bank of England would traditionally have been in line with the other London banks in this particular. Further, and more important, there was some reason for the Bank in particular not wishing to put out in the market again bills which it had once held. Before 1914 the volume of Treasury bills was always very small.³ The bulk of the bills taken by the Bank would therefore be commercial bills.⁴ Any bills which it resold to the market would remain a liability of the Bank, and the Bank would incidentally leave itself open to the criticism that it was indulging in a practice which the latter part of the nineteenth century had come to regard as doubtful banking practice.

A direct consequence of these conventions was the restriction of the currency of bills which the Bank would accept for rediscount. In 1890, when rediscounting was reintroduced, the bills presented

¹ *Vide* "Interview with the National Monetary Commission," p. 22

² The function of providing banks with the distribution of maturities which they required.

³ The amount outstanding was usually far below £20,000,000. It reached maxima in the South African War period, and in 1910 (when the 1909 Budget dispute delayed tax collections). The absolute maximum was £36,700,000, reached in April, 1910.

⁴ In 1910, when the volume of Treasury bills was subject to quite unusual movements, the Bank appears to have dealt in them to some extent, though how far it departed from the first convention discussed above (p. 19) is not clear (*Economist*, August 20th, 1910). In that autumn the Bank sold bills (presumably Treasuries) as part of its effort to make Bank Rate effective (*Statist*, October 22nd, 1910).

were to be not more than fifteen days from maturity. By thus restricting the currency of rediscountable bills the Bank could be certain that it would not, in helping the market at the moment, provide it with funds for such a period as would leave Market Rates free to move far from Bank Rate. When the market knew that bills which had just been rediscounted by the Bank would mature in a fortnight, it had to face the possibility of having to secure fresh funds, again at the Bank's rate of the day, at the end of the fortnight. This method of keeping the market under the thumb of the Bank did, however, restrict the usefulness of the rediscount system. At a time when the market was in the Bank for a large amount the system might not work at all smoothly. For the amount of bills near maturity which were held by the market¹ would be limited, and in addition bill-brokers and discount houses might be unwilling to see the maturity distribution of their portfolios seriously distorted in the direction of the proportion of non-rediscountable bills increasing.² Insistence on bills of short currency only would therefore tend to weaken the Bank's indirect control over, *e.g.*, the three months' Market Rate. The Bank of England, with its eye on the foreign exchanges, would naturally desire to keep the longer term bill rates of the market in

¹ It must be remembered that the Clearing Banks did not resell bills once bought

² Against this argument, it must be remembered that these non-rediscountable bills (*i.e.*, those exceeding the Bank's maximum currency rule) would be eligible as collateral for seven- and fourteen-day advances.

definite relationship to Bank Rate, rather than restricting the latter's direct influence to the market in weekly and fortnightly loans and bills of similar currency. In order to facilitate the smooth working of the rediscount system the Bank gradually increased the currency of rediscountable bills from the fifteen days fixed by the rule of 1890 to three months in 1897 and four months in 1910,¹ though the Bank retained its preference for short bills.

Having regard to the convention that the Bank should hold its bills to maturity, this gradual extension of the currency of rediscountable bills was compatible with the maintenance of continuous control by the Bank over the market only because the Bank had adopted various methods other than awaiting the maturity of its bills for taking money off the market, methods which could be employed at any time. These other methods, with which the following section is concerned, were probably developed specifically to operate on the market when the Bank held no rediscounted bills and had made no advances which were outstanding. But the development of these methods for use when the market was free of the Bank did allow the Bank to extend the currency of rediscountable bills, a procedure which amounted to giving the market temporary freedom.²

¹ On the detailed regulation of the currency of rediscountable bills, see below, pp 63-68

² It is perhaps worth noting here how the great increase in the supply of Treasury bills has allowed the Bank's control of market rate to be perfected since the war. The Bank is willing to resell Treasury bills. It also buys them in the market (a

II

The Bank of England, in order to reduce the market's supply of funds, had either to reduce the total of its assets, and so, as the impact effect, its liabilities to the commercial banks, or to bring about a redistribution of its liabilities to the disadvantage of the commercial banks and to the advantage of its non-banker depositors. It did, in fact, work on both these lines. But for several weeks in the first quarter of every year¹ its work was done for it, as the revenue was swept into the Government account. The Bank did not then, as it does nowadays, make any definite attempt to equalise the effects of variations in the rates of Government expenditure and receipts. In this particular at least the City was slow to recognise the full implications of central banking. One of the reasons usually given for Bank Rate rising was that "too many bills are being brought to it for discount,"² a curious way of looking at things. But in the March quarter when the strain of revenue collection sent large amounts of bills to the Bank, it was realised that such conditions alone did *not* justify a rise in Bank Rate. "It is the recognised policy of the Bank not to put any additional strain that can be avoided upon the

definite departure from pre-war practice). In addition it can arrange its holding of Treasury bills so that a part matures every week. In a very small way the Bank did occasionally, in pre-war days, anticipate its post-war methods (*e.g.*, see *Statist.*, July 30th, 1904, and August 20th and October 22nd, 1910).

¹ With the exception of 1910, when the dispute over the 1909 Budget delayed the usual collection of taxes.

² *Vide* Withers. "Meaning of Money," p. 223.

market when it has to meet the revenue drain," said the *Economist* in 1898,¹ and this "tradition," as it was called, was again invoked in 1905, when the market grumbled that the Bank was apparently departing from it.² In passing, we may notice that the absence of any system of offsetting by the Bank led to an interesting suggestion in one year when the strain was exceptional. The *Economist*³ raised the question "whether it is really necessary that the Government should always keep the whole of their balances at the Bank, or whether, when these become, from one cause or another, unduly plethoric, a portion might not be deposited with other banks."

In that quarter of the year, therefore, the Bank generally found that its work of making Bank Rate effective was generally done for it. At other times it had to devise other means of operating on Market Rate. The devices used or supposed to have been used were (1) outright sale (or purchase) of securities (Consols); (2) the classical method of selling Consols spot and buying back for the account; (3) borrowing "in the market"; (4) borrowing from the clearing banks; (5) borrowing from its

¹ January 1st, 1898 Cf. January 25th, 1890, and February 3rd, 1894, and *Statist*, January 18th, 1890, and February 7th, 1903

² *Economist*, February 25th and March 4th, 1905 Cf. also complaints in the spring of 1894 and the *Statist*, February 11th, 1890

³ February 26th, 1898. The exceptional accumulation of Government balances that spring "was due to the fact that while the revenue collection was going actively on the Government was not making its customary disbursements, because work that would have to be paid for was delayed by the engineers' strike" (*Economist*, "Commercial History and Review of 1898.")

own depositors; and (6) "the hint from headquarters."

(I) OUTRIGHT SALE OR PURCHASE OF
SECURITIES

This method appears at first sight to be admirably adapted to the Bank's ends. Yet it was used very rarely. Indeed, the evidence of its use *for the particular purpose of influencing Market Rate* is slight. Sale of Consols for the purpose, "on rare occasions" was admitted before the National Monetary Commission.¹ According to the *Statist*,² sale of Consols was one of the Bank's methods for making Bank Rate effective in August, 1893. In the summer of 1899 the Bank was again reported³ to be selling securities to make its rate effective. In November of the same year it again sold Consols at a time when Bank Rate had been raised to 6 per cent., and the Bank was, by various devices, to raise Market Rate even higher.⁴ At times in 1900 and 1901 there were suggestions that the Bank was selling securities to stiffen the market.⁵ Then in June, 1908, when the market was well out of the Bank, the latter was buying securities on a scale sufficient to be remarked, with the effect of widening the gap between Bank Rate and Market Rate.⁶ But in view of the general position at the

¹ P. 29.

² September 9th, 1893.

³ *Statist*, July 22nd, 1899.

⁴ *Economist*, December 2nd, *Statist*, November 25th, 1899.

⁵ *Statist*, July 28th and September 8th, 1900, *Economist*, January 26th, August 31st and November 15th, 1901

⁶ *Economist*, June 6th and 13th, 1908.

time¹ it is extremely doubtful whether the Bank was buying securities with a view to the effect on the money market. It is more likely that it was following its own precedent of 1895—buying securities to add to its income—for the Governor himself said that the Bank had had a "bad half-year from the money-making point of view."² Anyway, the movement was short-lived, the Bank wishing in the latter part of the year to see Market Rate rather higher.

The extreme rarity of the use of this apparently matchless weapon must, I think, be ascribed to the Bank's unwillingness to expose itself to the risks inherent in the purchase and sale of securities which, being long-term, could fluctuate much in price. The Bank might profit by a rise between purchase and resale, or a fall between sale and repurchase, but then again it might lose. And it is only reasonable to suppose that the Bank would take the view that it must not subject itself to the possibility of its resources being drained by a succession of losses. It is the duty of every bank, and most of all a central bank, to be rich.

(2) SELLING CONSOLS SPOT AND BUYING FOR THE ACCOUNT

Of late years it has become usual to ascribe the Bank's pre-war power to make its rate effective to this method alone. "The Bank of England," says

¹ Which suggested a further reduction in Bank Rate rather than a widening of the gap.

² *Vide* his speech at the General Court of the Bank, September 17th, 1908 (reported in *Economist*, September 19th, 1908).

Mr. Keynes,¹ " would occasionally supplement its bank-rate policy by the sale of Consols for ' cash ' and then simultaneous repurchase for ' the account ' (anything up to a month later), which was an indirect way of relieving the money-market of the equivalent quantity of resources for the unexpired period of the Stock Exchange account." Mr. Hawtrey² gives the same process as being that employed by the Bank " in the nineteenth century." Undoubtedly it was used in the middle of the century, as it was explained by Horsley Palmer before the Select Committee of 1848.³ Mr. Hawtrey refers to the process as the method which was called " borrowing on Consols." But, as will be shown below, there is evidence that this phrase was used to describe a slightly different process to the same end.

It seems highly probable that these recent references to the pre-war system are based on a question in the Minutes of Evidence of the Macmillan Committee. The question was asked by Professor Gregory in the following form :

I think it used to be said by experts, and it was reported in the interviews between the Directors of the Bank of England and the representatives of the National Monetary Commission of the United States, that you sold Consols for cash and bought them back for time when you operated in the open market. Is that a relic of bygone days or is it done at the present time? —I should describe it as a relic of past history.⁴

¹ " Treatise on Money," vol. 2, p. 229.

² " Art of Central Banking," p. 151

³ Q. 1041.

⁴ Committee on Finance and Industry, 1929-31. Evidence of Sir E. M. Harvey. Q. 402.

One might well suppose, from the wording of Professor Gregory's question, that evidence was given to the National Monetary Commission that the method was being used at the time—or at any rate after 1890. Actually there is no evidence whatever on the point. In the "Interview with the Bank of England," the most relevant questions and answers were these: ¹

Q. Does the Bank sometimes borrow money in the open market for the purpose of raising the market rate?

A. Yes.

Q. Do you sometimes sell consols for the same purpose?

A. Yes; on rare occasions.

Of the peculiar method of selling consols spot and simultaneous re-purchasing forward there is no mention whatever.

Mr. Hawtrey gives as the reason for the Bank preferring this process to the more straightforward one of borrowing in the market "like a discount house," that the latter operation "might attract attention to an inconvenient extent among those dealing in the money market." ² It is true that any steps which the Bank took to force bill-brokers to rediscount at an enhanced rate would be unpopular with them. But the Bank could not stop to consider such possibilities—otherwise it would never put up its rates in time. On the other hand, knowledge that the Bank was acting to stiffen market

¹ P. 29.

² "Art of Central Banking," p. 151.

rates would tend to hasten the rise in the latter. As will be shown below,¹ the Bank sometimes thought a threat sufficient. One would suppose that the Bank had only to gain, not lose, by its operations being known. It is true that in the later years of the period the Bank sometimes found that the market obstinately refused to treat an absorption of funds by the Bank as identical with the stringency forced by a loss of gold,² and to this extent secrecy might help the Bank's manipulations to achieve their end. But anyway, by whatever process the Bank took money off the market, the fact that it was operating was in fact generally known in the market.

Let us now turn to the evidence afforded by the two financial weeklies. In the *Economist* not once is the process mentioned as such. As the *Economist* occasionally gave some detail of other methods employed by the Bank to the same end, this absence of any specific mention is itself notable evidence. But various phrases do frequently appear, in the money market reports, phrases which might conceivably cover such operations. These phrases occur particularly in the early 'nineties and in the years 1897-1905. The phrase "operations in Consols" is used once, in 1903.³ On two occasions, one in 1892 and the other in the following year, the Bank is said to have been "borrowing on Consols."⁴ In 1890, 1892, 1893 and 1903 there are references to "borrow-

¹ P. 43

² *Economist*, May 12th, 1910, and see below, p. 46

³ *Economist*, April 25th, 1903

⁴ *Economist*, November 5th, 1892, and August 26th, 1893.

ing on stock" to explain decreases in the Bank Return item Government Securities.¹ In April, 1897, the Bank is said to have been "pledging securities," and in 1898 the phrase "redemption of pledged stock" is used once,² to describe the Bank's putting funds back into the market.

The *Statist* was much more definite on the point. It often mentioned that the Bank was "borrowing on Consols," or on "Indian Government Securities or the like." According to these notes in the *Statist* the timing of these transactions often appeared to be governed by the Stock Exchange Settlement dates. We must not, however, on the basis of this fact, jump to the conclusion that the Bank, on every such occasion, operated through the Stock Exchange. For in times of activity the market usually had to borrow temporarily from the Bank for settlement days, and the Bank might quite well have deliberately arranged its loans from the market to cover the period between one occasion of the market's being in the Bank and the next such occasion. There were other occasions when the period of the Bank's "borrowing on securities" cut right across the Stock Exchange settlement.³

On two occasions the *Statist's* reports leave no doubt that the Bank was actually selling Consols (or other securities) spot and re-purchasing for the

¹ August 30th, 1890, November 19th, 1892, September 9th, 1893, and September 12th, 1903.

² April 18th, 1897, and October 9th, 1898. See also December 10th, 1898

³ As, *e g*, in its first open market operations in October, 1897 (*Statist*, October 16th, 1897).

account. The first occasion was in 1890 : the *Statist* then reported ¹ : " We understand that it has borrowed on ' other ' securities up to the next settlement, viz., June 13th, and to-day it was reported that the Bank was also borrowing on Government Stock." In another column it remarked on " the Bank's broker having been borrowing on Indian or other securities up to the mid-monthly settlement." The second occasion was in 1897, when the *Statist's* " Stock Exchange Notes " in particular left little doubt that the Bank was operating through the Stock Exchange.² The Bank's borrowing, in one way or another, was exceptionally large that autumn,³ and it is therefore possible that it was resorting to a method which had become quite extraordinary, though it was not hailed as such by the *Statist*.

There is no more direct evidence than this, so far as the first decade of our period is concerned. During the remainder of the period, though phrases such as " borrowing on securities " often occurred in the

¹ June 7th, 1890.

² The relevant notes are these " The Bank return shows that about a million and a quarter of Consols have been borrowed upon by the Bank of England. The strong market for Consols till to-day (Friday) is therefore all the more remarkable " (October 23rd, 1897). " It is said that the Bank contemplates repaying its borrowings on Consols amounting to some £2,000,000 at next week's settlement " (October 30th, 1897) " The last day or two . . . the Bank has seen the necessity of again taking money off the market, and has been selling Consols for cash. . . . We are inclined to believe that the Bank, while selling Consols for cash, is arranging to take up Stock when the new year has turned " (November 20th, 1897).

³ The Bank altogether took about £4,000,000 off the market (*Statist*, December 25th, 1897).

financial journals, there was nothing more explicit. But the works of Mr. Hartley Withers are an important source of information on the practices of the first decade of the twentieth century.¹ His books are of particular importance to us because they were written for the specific purpose of explaining the working of the system. Now it is highly significant that, while in "The Meaning of Money" another process of "borrowing on securities" is explained, in neither of the above-mentioned books is there any mention whatever of the process, the use of which we are seeking to discover. Mr. Withers says in that passage that the Bank, when it borrowed in the market, deposited securities with the lenders as "collateral." He mentions, as the lenders, the banks, the bill-brokers and finance houses.

In the light of that explanation, it is impossible to base on the use of phrases such as "borrowing on securities" and "pledging of stock" any presumption that the Bank at this time used the method we are discussing. The absence of any positive evidence, particularly in the books of Mr. Withers and the National Monetary Commission documents, must be regarded as almost decisive for the years to which they particularly relate. We must therefore conclude that it is highly probable that "on rare occasions" in the 'nineties the Bank, when selling Consols spot to raise Market Rate, re-purchased the

¹ Mr. Withers was in *The Times* City Office from 1894 until 1910, being City Editor during the last five of those years. The relevant works are "The Meaning of Money" (1909) and "The English Banking System" (written for the U.S.A. National Monetary Commission in 1910).

stock for delivery at a subsequent settlement. And it is highly probable that before Mr. Withers wrote in 1909, and the National Monetary Commission sat in 1910, the Bank was relying exclusively on those slightly less roundabout methods which are discussed below.

(3) BORROWING "IN THE MARKET"

On the numerous occasions in the early 'nineties, in the period 1897-1906, and again in 1909-10 when the Bank was "making efforts to control the market," the phrase "borrowing in the market" was used again and again in the *Statist* and *Economist* reports. The Bank was certainly operating in some way which could be so described in June, 1890, in April and October-November, 1891, in January, 1892, and often in 1893. On most of those occasions a simultaneous movement in "Government Securities" or "Other Securities" could be traced. Yet when the method was much used in 1897 it was hailed as something new. Reviewing the events in the money market in that year, the *Economist* said¹: "It also borrowed largely from the market . . . the way in which the Bank thus asserted and maintained a close control over the market has been one of the chief financial features of the year. In view of it, we shall probably hear no more of the foolish talk about the decrepitude and decadence of the Bank, in which a few hypercritical persons indulged not

¹ "Commercial History and Review of 1897." The "borrowing in the market" on this occasion was supplemented by another method (*cf* p. 32, above).

long ago. . . ." Thereafter until 1911 scarcely a year passed ¹ without the weekly reports frequently stating that the Bank was "borrowing in the market." In his "Meaning of Money," Mr. Hartley Withers explained that the Bank took money off the market sometimes by borrowing from the bill-brokers and finance houses.² Before the National Monetary Commission the Bank admitted the practice of borrowing "in the open market" ³ and did *not* qualify the statement with its phrase "on rare occasions."

It is curious that the Bank should have deposited collateral security when it took a loan from a bill-broker. One would have thought that the word of the Bank of England would have been security enough. Yet whenever the Bank borrowed thus directly in the market, it evidently did deposit securities, and treated the transaction in a curious manner for the purpose of making up its weekly return. Instead of showing the securities pledged as remaining part of the assets, and showing a redistribution of its liabilities, bankers' deposits being reduced and a liability to "sundry creditors" appearing, the Bank deducted the pledged securities from its total assets, and showed these as shrunken by the same amount as its deposit liabilities had shrunk as a result of the operation. This method of accounting was, however, the only possible under

¹ Apparent exceptions were 1904 and 1908—the latter for a reason to be explained below (p. 47)

² P. 230. Cf his "The English Banking System" (N.M.C., 1910), p. 17.

³ P. 29.

the provisions of the Bank Charter Act of 1844, pursuant to which the Bank Return was made.¹ As the Bank was obliged to adopt this method of accounting, it probably thought it convenient to itself to pledge securities when it borrowed in the market. It is possible that this treatment of such operations, in the Bank Return, together with the occasional incidence of settlement days in the timing of the transactions,² helped to give rise to the notion that the Bank generally acted by selling Consols spot and re-purchasing for the account.³

(4) BORROWING FROM THE CLEARING BANKS

Occasionally in later years the Bank found it convenient to effect its purpose by borrowing, not from the bill-brokers and "finance houses," but from the clearing banks. The Bank may have wished to adopt this method in order to avoid dependence on the bill-brokers who stood to lose by the effects of the Bank's operations⁴; but it was made possible

¹ *vide* 7 & 8 Vict. c. 32, section VI and Schedule A. The Bank might conceivably have regarded the loans as "Other Deposits." That it did not do so we may deduce from its denial to the National Monetary Commission that it ever paid interest on deposits (pp. 18-19).

² See p. 31, above.

³ I do not, of course, wish to imply that the effect of the operation was any different—merely that the mechanism adopted was different from that commonly supposed.

⁴ A bill-broker's income depended on three sources :

- (1) Differences between discount rates he quoted and discount rates at which he sold his bills (this may be described as "commission");
- (2) The difference between the cost of borrowing from the

only by the development of a more friendly and co-operative feeling between the Bank of England and the clearing banks after 1890, and particularly in the early years of the present century.

The first occasion when this method was used was early in December, 1905, when the Bank, as its measure to control the market, borrowed "some millions" from the joint-stock banks. This step was remarked by the *Economist* as "a new departure,"¹ although it was stated that the Bank had on previous occasions borrowed "from one or two banks."² The loans were apparently repaid early in January, but the precise arrangements as to date cannot be traced. In the middle of February the Bank again borrowed from the joint-stock banks, the amount this time being £5,500,000, and the loans were repaid at the end of one week.³ Immediately after this loan had been repaid, the Bank of England "again arranged with the joint-stock banks to borrow a considerable amount from them, to be held until the 21st instant, by which time it is thought that through the operations of the revenue collection outside supplies will be so far reduced . . ."⁴ The loan was repaid on the due date.⁵

banks, etc, and the rates at which he had discounted bills held in his own portfolio, and

(3) "Turns" of the market.

This last part would be negative when discount rates were rising and he was obliged to rediscount on account of banks calling in loans.

¹ "Commercial History and Review of 1905."

² *Economist*, February 10th, 1906.

³ *Statist*, January 20th and 27th, 1906.

⁴ *Economist*, February 3rd, 1906

⁵ *Economist*, February 24th, 1906.

Owing to cross influences at the time, it is impossible to be certain how the Bank treated this loan in its accounts. As it would necessarily have to pay a rate of interest, we can be certain that it did not call the loan "special deposits." Presumably what it did do was to reduce the Bankers' Deposits by the relevant amount, and set aside (even if it did not actually hand over to the clearing banks) an equal amount in securities. The effect on the market was clear enough. The clearing banks' cash reserves being decreased by the loan, they called in loans from the bill market, which had to secure funds from the Bank of England at the latter's own price.

In 1910 certain of the joint-stock banks helped the Bank of England in a quite extraordinary manner. It was reported in February that they were buying gold in the market "for the express purpose of preventing the Bank of England's reserve from rising too rapidly and of checking the fall in discount rates."¹ Throughout the spring there was continual mention of joint-stock banks importing gold, while later on there were exports of gold by at least one of those banks, with a view to averting a drain from the Bank of England which would imply dearer money.² The entire episode was a

¹ *Statist*, February 6th, 1910. The effect in supporting market rates might be twofold: (1) the addition to their holdings of gold might mean an addition to their cash ratio, so reducing the supply of funds in the market and forcing rates upwards directly, and (2) by preventing gold from going to the Bank they would prevent the Bank's position from looking so strong as to encourage the prospect of cheap money.

² *Statist*, July 16th, 1910.

result of the agitation for larger gold reserves, it having been frequently urged that the joint-stock banks ought to take "their share of the burden." Such action as this must have involved some departure, by the banks concerned, from purely commercial principles—perhaps the pride of independence made it worth while. The *Statist* recorded the operations in approving terms, but it did not face the full implications of such developments.

There was evidence of some co-operation, for the purpose of raising Market Rates, between the Bank of England and the joint-stock banks at the end of 1913. Exactly what happened is not clear, but it appears that the joint-stock banks added to their cash reserves by calling in funds from the discount market, the funds being used not to add to their balances at the Bank of England, but to add to their holdings of notes and coin.¹

(5) BORROWING FROM SPECIAL DEPOSITORS

Another method used by the Bank was an exploitation of its position as banker to people other than the commercial banks. A payment made by a customer of a commercial bank to a customer of the Bank of England causes an equal reduction in the cash reserve of the commercial bank, and therefore causes a multiple contraction of commercial bank

¹ The *Economist* (December 13th, 1913) reported: "It is now clear that the large outflow of cash shown in last week's Bank Return was not wholly due to ordinary requirements but partly to co-operation of the joint-stock banks with the Bank of England with a view to maintaining rates and exchanges"

deposits, unless it is offset in some way.¹ The disturbance of the London money market by the heavy revenue collections of the March quarter was itself simply a special case of this, the payments being on the whole payments by customers of the commercial banks to the Government, which is a customer of the Bank of England. Apart from that special case, the money market is not generally much troubled by the operations of the Bank's other customers, since they are relatively small and tend to cancel each other. But that was not true of the period with which we are concerned. Among its other customers the Bank of England numbered the Japanese Government. Now the London balances of the Japanese Government were at this time exceptionally large and exceptionally variable. Mainly this resulted from the two wars—the Sino-Japanese War of 1894-95 and the Russo-Japanese War of 1904-05; but partly also it was due to the large London borrowing incidental to the Japanese Government's policy of economic expansion. Another outstanding customer of the Bank was the Government of India, which usually had substantial London balances, part of which, as of Japan's balances, would normally be lent out in the market.

Whether the co-operation of these customers had ever been sought before 1890 is not clear. In June, 1890, it appears that the resourceful Governor Lidderdale obtained the co-operation of the India Council. The latter called in loans which had been

¹ This is the basis of the case for the reserve bank being purely a "bankers' bank"

made in the market and lent the money to the Bank. The operation was described by the *Economist* as an "unusual, but perfectly legitimate, expedient."¹ In the autumn of the following year and again in 1892 the Bank made a similar arrangement with the India Council.²

Early in 1891 the Bank appears to have taken advantage of the arrangements (made under its own leadership) for the liquidation of Barings, for the purpose of stiffening the market. It secured from certain houses funds which were, in fact, for the time being, anticipatory payments, to the amount of "fully a million," and, either directly or indirectly, paid interest on the amount.³ But this was quite an exceptional arrangement, the feasibility of which depended upon the peculiar circumstances in which the Baring liquidation was carried out. A similar transaction took place in 1903, when the Bank secured from the Crown Agents for Colonies a temporary loan of part of the great Transvaal loan, the purpose being to keep market rates up.⁴

After the Sino-Japanese War in the middle 'nineties the Chinese indemnity payments to Japan directed attention to the disturbance of the money market which could be caused by changes in the Japanese Government's balances.⁵ The disturbances

¹ June 14th, 1890. Cf. *Statist*, July 26th, 1890.

² *Economist*, October 31st, 1891, and *Statist*, November 19th, 1892. On the latter occasion the Bank was understood to have paid the India Council 2 per cent., which was about the market rate for one month bills.

³ *Statist*, February 21st, 1891.

⁴ *Statist*, September 19th, 1903.

⁵ See, e.g., *Economist*, May, 1898.

reached a fresh maximum, for similar reasons, after the Russo-Japanese War of 1904-05.¹ Perhaps it was the magnitude of these latter disturbances that reminded the Bank of a method it had used many years before and which it proceeded to use again in the difficult years culminating in the crisis of 1907. In its issue of October 7th, 1905, the *Economist* reported: "It is believed that the Bank, in order to gain command, has succeeded in getting control of a portion of the Japanese money that had been lent out in the market." Again, in the autumn of 1906, when again the Japanese Government had been lending out some of its large London balances in the market, the Bank made its rate effective by gaining "control of a considerable amount of Japanese money."² The same step was taken at least twice early in 1907.³

Since the Bank did not pay interest, even on special deposits, it is difficult to see what inducements the Bank offered to the Japanese authorities to persuade them to forego the interest which the surplus funds might have been earning in the market. It is possible that the Bank treated the deposits as a loan,⁴ as it did when it borrowed from the clearing banks. But it is more likely that

¹ The Japanese Government at times, in the interests of its own loan operations in London, did do something to reduce the disturbance which its operations were apt to cause (for an example of such action, see *Statist*, November 19th, 1904).

² *Economist*, October 20th, 1906.

³ *Economist*, January 19th and February 2nd, 1907, *Statist*, January 26th, 1907.

⁴ It certainly appears to have treated the India Council funds as such in 1890 and 1891.

it found some way of compensating the Japanese Government for placing its money on non-interest bearing deposit. Between banker and customer there are many ways of making compensation. One possible *quid pro quo* is suggested by the operations of March, 1907. In that month the Japanese Government made a large conversion issue in London. If not with the Bank's help, at least with the Bank's acquiescence, conditions in the London market were, at a difficult time, made easier by funds being "freed" while the Japanese issue was being made.¹

Besides these occasions when the Bank stiffened the market, with the co-operation of the Indian and Japanese Governments, there is on record one occasion when the Bank achieved the same end by borrowing from the Argentine Government.²

(6) "THE HINT FROM HEADQUARTERS"

As the Bank developed these various methods of taking money off the market in order to make its own rate effective, there were doubtless many occasions when the mere fear that the Bank *might* take some such action had a hardening effect in the market.³ But in May, 1906, there was something more than this. There was what the *Economist*⁴ described as "a distinct hint from headquarters. In view of the need for strengthening the position

¹ *Vide Economist*, March 9th, 1907.

² *Vide Economist*, December 16th, 1905.

³ *Vide, e.g., Economist*, January 6th, 1906.

⁴ May 19th, 1906.

in London . . . though no official announcement was made, it was unofficially brought to the notice of bill-brokers, that if they allowed rates to fall away materially the Bank would be compelled to take some such measures as it did early in the year to gain control over the market." " This," adds the *Economist*, " sufficed to check the decline in discount rates." The Bank of England thus used the weapon of " moral suasion," and used it successfully, when its great exponent, the Federal Reserve System, was hardly imagined.

III

The efficiency of these weapons depended partly on lack of elasticity in the market's own cash reserves. Since the bill-brokers would not normally hold appreciable cash reserves, there could be elasticity only in the cash reserves of the banks. Unfortunately there was a certain amount of elasticity in these reserves. Between 1891 and 1914 the monthly returns of the London joint-stock banks referred to the state of accounts on one specific date about the end of the month.¹ Most of the country joint-stock banks, under the agreement of 1891, published quarterly returns only. Between the dates of these returns the banks would be free to vary their cash reserves at their pleasure. Furthermore, the cash ratios shown in the monthly, quarterly and half-yearly balance sheets were

¹ The banks did not all choose the same date. (*Economist*, June 17th, 1905.)

variable within limits wide enough to allow appreciable differences in the amounts available in the bill market. The overseas banks in London were, of course, even more free, and probably varied their cash reserves considerably more than did the English banks.

Accordingly the margin of "surplus funds" in the market was sometimes quite large, sometimes practically non-existent. It varied according to the feelings of the banks about the outlook. When the market was working on a fairly wide margin, a gold withdrawal might be insufficient to send the market into the Bank,¹ though this would not necessarily be so. The banks might be holding off the market more if they expected rates to rise. In such an event the market might be forced into the Bank despite the absence of any reduction in the latter's assets.² Sometimes the market would oversupply itself with funds temporarily, though this does not appear to have occurred except when the Bank Rate was effective.³ On the other hand, the market was sometimes working on a very narrow margin. Then the least tendency for gold to go out, or the least absorption of funds by the Bank would make the rate effective in a moment, even had the market

¹ In the slack trade period of the early 'nineties this was frequently so, particularly when the market was flooded with dividend money (as in the autumn of 1893). Again in the summer of 1908 slack trade was responsible for a glutted market.

² *E g*, September 23rd, 1899, March 31st and April 28th 1900, July 28th, 1900, February 13th, 1904, August 24th, 1907 and October 26th, 1907.

³ As March 18th, 1905, and frequently at the half-yearly balance sheet dates.

been quite out of touch before.¹ To the extent that the market's resources had this element of elasticity, the scale of the Bank's operations to make its rate effective would have to vary from time to time. If opinion in the market and particularly among the banks was changing in the direction of expecting lower rates, the Bank would have to act much more sharply to produce a hardening effect. For this reason secrecy in its operations was hardly to be desired. A "hint from headquarters" might help matters very much.

On the other hand, the market could, and did occasionally, render control by the Bank a very much more difficult matter by refusing to be impressed by the "artificial" contraction in the supply of money. In November, 1910 (to take the clearest case), the Bank, by borrowing in the market, brought about a great reduction in other deposits. But the market was inclined to treat the money borrowed by the Bank as if it were still in the hands of the market. If a shortage of funds were produced by a trade demand for currency or an export of gold the market would regard the money as irretrievably gone; but money borrowed by the Bank would soon be returned—meanwhile the market would simply work on a narrower margin. Accordingly the Bank's borrowing on that occasion did not have much effect in bringing Market Rate into close connection with Bank Rate.² Of course,

¹ *E.g.*, August 30th, 1902, and September 17th, 1904. In 1910, 1911 and 1912 (years of good trade) the market's margin was often notably narrow.

² *Economist*, November 12th, 1910.

the Bank could sooner or later force its will on the market by taking up more and more money until the market's margin had completely disappeared. But the market's attitude made necessary more extensive, and accordingly more expensive, operations by the Bank.

It was for such reasons as this that it was, in the early nineteen hundreds, becoming fashionable to urge that there should be more co-operation between the Old Lady, the commercial banks and the bill market.¹ But more important in drawing attention to the need for some development of the system, either in the direction of increasing co-operation or in the regularisation or elaboration of the Bank's control, was the convention that the Bank should not take money off the market except at a time when "the conditions of the international money market make regulation imperative."² It is significant that Bank action of this kind nearly always occurred in the autumn when there was generally an enormous demand for gold in the United States. The Bank was, by tradition, permitted to take action to force the market to follow Bank Rate as a weapon for the protection of its Reserve; but it could not use these weapons to force an increase in its gold reserve.³ This limitation of its powers was important at a time when it was generally thought desirable that the gold reserve should be increased.

¹ See, e.g., *Economist*, "Commercial History and Review of 1905," and *Economist*, August 24th, 1907

² Withers, "Meaning of Money," p. 235.

³ In the summer of 1904 the Bank's apparent departure from this convention was very slight. (*Statist*, July 30th, 1904.)

It is true that there was nothing but an unwritten convention to prevent the Bank from adopting control methods more generally; but it must be remembered that the market was extremely quick to complain of any departure by the Bank from even its youngest conventions.¹ Possibly the Bank did not consider it worth while calling down on its own head the wrath of the discount market once more, simply to achieve an end which it anyway thought should be sought at the expense of the commercial banks and not at the expense of the Bank itself.

The subject was discussed by Mr. Withers in his "Meaning of Money,"² where he suggested, as a solution for the problem, that the banks might agree to charge bill-brokers a rate 1 per cent. below Bank Rate. In that way Market Rate would regularly be fairly near to Bank Rate. Down to the outbreak of the Great War, however, the Bank continued to control the market when the external situation called for control, mainly by borrowing in the market and securing control of customers' funds previously lent out in the market. But the circumstances of active trade and international alarms were in the Bank's favour to such an extent that, from 1911 onwards, open market operations became increasingly rare.

¹ The market frequently grumbled when the Bank departed from very young conventions about the Advances Rate. (*Economist*, October 31st, 1896, and December 16th and 23rd, 1905)

² Pp 235-241.

CHAPTER III

OTHER METHODS OF RAISING MARKET RATE

WE have seen in the last chapter the various methods employed by the Bank to "make Bank Rate effective" by increasing the market's dependence upon itself. Sometimes it was not satisfied with these methods. There were occasions (some of which are detailed below) when the Bank used certain other devices for raising Market Rate without raising Bank Rate further. To some extent these devices were used simply to make Market Rate reflect more exactly its own official rate; but they were also used occasionally with the deliberate intention of making unnecessary a further rise in Bank Rate. That is to say, these devices were used sometimes to force Market Rate into its "effective" relationship with Bank Rate, and at other times to force Market Rate up *beyond* its usual "effective" relationship with Bank Rate. This latter working on Market Rate in a sense independently of Bank Rate was based on the accepted fact that while Bank Rate ruled the majority of home banking charges, Market Rate was the rate which influenced foreign exchanges. If, therefore, the Bank, in tenderness towards the internal situation, wished to

act on the foreign exchanges without forcing higher rates on home trade, it could use the devices detailed below to force Market Rate up beyond its normal "effective" relationship with Bank Rate. These devices were (1) the refusal to work at Bank Rate; (2) the raising of the Advances Rate outside its normal relationship with Bank Rate; and (3) the restriction of the eligibility of bills, generally by restricting their currency, but on one occasion at least by restricting their nature.

(1) THE REFUSAL TO WORK AT BANK RATE

"Bank Rate is the official *minimum* rate at which the Bank of England will discount bills. . . . But the fact that it is only the *minimum* is occasionally enforced in practice . . . on such occasions it sometimes refuses to take bills except at a higher rate, which usually becomes the official rate on the following Thursday." Thus was the position described by Mr. Hartley Withers in 1909.¹ According to an answer given to the National Monetary Commission in 1910,² the Governor had power to raise the rate at any time intermediate between the weekly meetings of the court. Yet in fact he seldom, if ever,³ did raise the official Bank Rate. When Bank Rate was raised on a Friday in 1906, it was arranged at a special meeting of the Court of Directors.⁴ But on a few occasions the rate charged

¹ "Meaning of Money," p. 223.

² P. 26.

³ Possibly in October, 1899.

⁴ *Economist*, October 20th, 1906.

to the market for rediscounts was increased. On the eve of the Baring crisis, when exceptional demands for gold (for Portugal and South Africa) sent the Bank's gold stock below £20,000,000, Bank Rate was raised to 5 per cent., but immediately after that rate had been fixed the Bank was refusing to take even short bills at less than $5\frac{1}{2}$ per cent.¹ During the crisis itself Bank Rate stood at 6 per cent., but $6\frac{1}{2}$ or 7 per cent., or occasionally a higher rate, was charged for rediscounts.² At the beginning of May, 1891, when there were expectations of a large withdrawal of gold for Russia,³ and Bank Rate was at $3\frac{1}{2}$ per cent., the Bank in fact charged 4 per cent., the official rate being raised to that figure on the Thursday.⁴ In the autumn of 1893, when home trade was still slack, the usual American autumnal demand for gold appeared at an earlier date than usual. Bank Rate was raised to 3 per cent. and the following week to 4 per cent. Immediately after Bank Rate had been fixed at 4 per cent. the Bank refused to accept business "except for its own customers" under $4\frac{1}{2}$ per cent.⁵

The next instances of such action were in the autumn of 1899. In September the Bank, as part of its effort for making higher rates effective in the

¹ *Economist*, September 27th, 1890. The following week the Bank was rediscounting at $5\frac{1}{4}$ to $5\frac{1}{2}$ per cent., Bank Rate remaining at 5 per cent. (*Statist*, October 4th, 1890.)

² *Statist*, November 22nd, 1890.

³ The Russian Government was supposed at the time to have "something like £20,000,000" standing at its credit with foreign bankers.

⁴ *Economist*, May 9th, 1891. Similar action was taken in May, 1893. (*Statist*, May 6th, 1893.)

⁵ *Economist*, August 12th, 1893.

market, charged $3\frac{3}{4}$ per cent. for short bills, and 4 per cent. for three months' bills, Bank Rate being at $3\frac{1}{2}$ per cent.¹ Bank Rate was very soon raised to $4\frac{1}{2}$ per cent. Then again at the end of November, 1899, the Bank refused to rediscount except at 6 per cent., Bank Rate being 5 per cent. 6 per cent. became the official Bank Rate on the following Thursday, though we are told that there was some disagreement in the Court about raising the Rate.² As a fortnight later the Bank was taking extraordinary steps to attract gold without raising Bank Rate any further, we may presume that the action at the end of November had been intended to avoid the necessity for a rise in Bank Rate as long as possible. Had it not been for some tenderness for the internal situation, the Governor would presumably have exercised his power to raise the official rate at the outset.

In June, 1901, when the collapse of the Leipziger Bank caused a crisis in Berlin, the Bank raised its re-discount rate to 4 per cent., though the official rate remained at 3 per cent.³ Then in 1906 there was a much clearer case of the Bank, in its tenderness for the internal situation, refusing to work at Bank Rate. The American demand for gold was abnormally large. On Thursday, September 13th, Bank Rate had been raised to 4 per cent. The drain continued. On Friday, September 21st, Bank Rate remaining at 4 per cent., the Bank in fact raised its

¹ *Statist*, September 30th, 1899.

² *Economist*, December 2nd, 1899.

³ *Economist*, June 29th, 1901. "Some irritation" was expressed at the charge of 4 per cent. for discounts.

re-discount rate to $4\frac{1}{2}$ (in addition to taking other measures described below). At this rate, above Bank Rate, the actual re-discount rate remained until November 4th, when the Bank reverted to its official rate of 4 per cent., the position in New York having eased for the moment. The following week when the Bank was again forced to act, and it raised Bank Rate to 5 per cent., the *Economist* criticised it for not having taken that step before. It considered that the Bank's action has been too restricted by its perceiving a divided duty. "The Bank probably felt," wrote the *Economist*, "that if any excesses had been committed in this financing of foreign enterprise, it was a little hard that our own traders should be made to suffer. Doubtless, occasions will sometimes arise when indiscretion in the money market may call for special punitive methods by the Bank, designed to occasion the greatest possible rise in money rates in Lombard Street with the minimum amount of inconvenience to the mercantile community, but such instances are the exception rather than the rule; and, given conditions such as those which have prevailed during recent months, the Bank will be well-advised in falling back upon the old-fashioned methods of attracting gold by advancing the Bank Rate, and making it effective until the object for which it was raised has been achieved."¹ Doubtless under its phrase "conditions such as those which have prevailed during recent months," the

¹ These "old-fashioned methods" were those upon which the Bank claimed to rely when it gave evidence to the National Monetary Commission in 1910.

Economist would include the booming state of English as well as American industry.

The next occasion of the Bank's refusal to work at Bank Rate was from August 15th to 17th, 1907. Bank Rate stood at 4 per cent., but on the 15th the Bank refused to re-discount at a lower rate than $4\frac{1}{2}$ per cent. The $4\frac{1}{2}$ per cent. rate became the official rate on Thursday, the 17th. A rise of Bank Rate of only $\frac{1}{2}$ per cent., when the Bank desired to influence the foreign exchanges, represented a breach of the tradition dating back to Goschen's "Foreign Exchanges" of 1863.¹ It had ever since been recognised as axiomatic that the rate must be raised by at least 1 per cent. to have any noticeable effect on the foreign exchanges. It is interesting to notice that on this occasion the more gentle movement, the departure from precedent, was described by the *Economist* as a commendable innovation, which would be "appreciated by traders who obtain loans from their bankers on the basis of Bank Rate."

In the acute crisis which developed in the late autumn of the same year (1907), the Bank again used various methods to obviate an extreme rise in the official rate as long as possible. At the end of October, after the Knickerbocker Trust had shut its doors on the 22nd, the Bank, though its official rate remained at $4\frac{1}{2}$ per cent. until October 31st, for several days refused to discount "at under 5 or 6 per cent.,"² even so restricting its discounts to

¹ The rationale is given in Goschen's Chapter VI., "Review of the So-called Correctives of the Foreign Exchanges," especially pp. 142-143.

² *Economist*, November 2nd, 1907.

short-dated paper. There is no evidence that the Bank—or anyone else in the City—had any illusions as to the seriousness of the American situation. The tardiness with which the Bank's official rate was raised can be ascribed only to its desire to avoid as far as possible disturbance of internal trade.

In the autumn of 1910, when again American speculation was active and when there was an extraordinary efflux of gold to Egypt, the Bank had recourse to extraordinary measures to protect its reserve. Among these measures,¹ it raised its effective discount rate from 3 per cent. to 4 per cent. (except for bills within a few days of maturity) on a Wednesday, Bank Rate being raised to 4 per cent. on the following day.¹ At the end of the month, after Bank Rate had been raised to 5 per cent., the Bank, having borrowed heavily in the market, refused to discount anything except bills with not more than a week to run, and for these it charged a rate $\frac{1}{2}$ per cent. above Bank Rate. The *Economist* commented: "This is a very unusual course, except as a preliminary to an immediate rise in Bank Rate, which did not follow it on this occasion. But the circumstances are in many aspects unusual . . ." ² After this there were apparently no further incidents of the kind.

(2) RAISING THE ADVANCES RATE

The device which the Bank most commonly employed to stiffen Market Rate when the market

¹ *Economist*, October 1st 1910

² October 29th, 1910.

was already in the Bank was the raising of the Advances Rate. Ever since 1878 it had been accustomed to supplying funds to the market very frequently for a week or a fortnight. These advances had at first to be secured by the deposit of bills which had almost reached maturity. The collateral security allowed had been substantially broadened by 1910.¹ But the advances to the market remained weekly and fortnightly advances. As these short advances were the staple means of obtaining funds from the lender of last resort, the market could be in the Bank for quite a large amount without the three months' rate being driven up very much. If Bank Rate stood at 4 per cent., the market three months' bill rate might stand at 3. Then a disturbance forcing the market to the Bank, being satisfied by these short-term advances, might force the three months' rate up to, say, $3\frac{1}{4}$, if the market did not expect the disturbance to continue. If the Bank took a serious view of the situation, yet did not want to raise Bank Rate, it could do something towards raising market rate from $3\frac{1}{4}$ per cent. towards 4 per cent. by raising the Advances Rate, and this it occasionally did, with the effect desired.

At the beginning of the 'nineties the Advances Rate appears to have had much mobility. It is clear that the charge of 1 per cent. above Bank Rate, in the stringent opening month of 1890, was something out of the ordinary, and was one of the Bank's measures for increasing the efficacy of its 6 per cent.

¹ *Vide* "National Monetary Commission Interview," p. 22.

Bank Rate.¹ When the situation had been eased by an influx of gold, the Bank reduced its Advances Rate to $\frac{1}{2}$ per cent. above Bank Rate.² Subsequently it was giving fortnightly advances at Bank Rate, and shorter term advances at $\frac{1}{2}$ per cent. above Bank Rate. In July of the same year, when the development of the crisis in South America looked like involving London and the leading exchanges turned against London, the Bank again, as one of its protective measures, raised the Advances Rate to 1 per cent. above Bank Rate.³ In a lull a few weeks later the Advances Rate was once more equal to Bank Rate, then in September it went to $\frac{1}{2}$ per cent. above, and on further gold losses to 1 per cent. above Bank Rate.⁴ There it remained for the rest of the year (the weeks of the Baring crisis). Governor Lidderdale thus appears to have regularly accentuated the effects of any pronounced movement in Bank Rate by moving the Advances Rate more drastically.

In a sense this remained the rule in the early 'nineties, though the relaxation from crisis conditions made such changes must less frequent. Generally speaking, the Advances Rate remained equal to Bank Rate. A notable departure of Advances Rate from Bank Rate was in May, 1891. The situation in most European centres was extremely delicate, and the

¹ *Economist*, January 14th, 18th and 25th, and February 15th, 1890. The charge was 2 per cent. above Bank Rate in case of excessive borrowing by any one dealer. (*Statist*, January 4th and 11th, 1890)

² It was also facilitating market borrowing by offering advances for three days only. (*Economist*, March 1st, 1890.)

³ *Economist*, July 12th and 19th, 1890.

⁴ *Economist*, August 30th, September 13th and 27th, 1890.

Russian authorities were talking of withdrawing some of their balances from London. Bank Rate was raised to 4 per cent., which began to draw gold. The Bank was not satisfied, however, and the Advances Rate was raised to 1 per cent. above Bank Rate, the latter being itself raised again on the following Thursday.¹ The next instance of a change shows that even at that time the Bank felt a double allegiance. At the end of 1891 the Bank, with its eye on the external situation, had been borrowing in the market to keep market rates close to Bank Rate. The gold reserve being increased by these measures, it relaxed its control.² Market Rate fell away quickly, and on December 10th Bank Rate was reduced to $3\frac{1}{2}$ per cent. The three months' Market Rate, however, went down to $1\frac{3}{4}$ per cent., and gold began to go out. In view of the general foreign situation, this collapse of rates was unwelcome to the Bank. Owing to the year-end money market movements it was unnecessary for the Bank to take steps to force the market to borrow from it. The significant point for us here is that the Bank, instead of raising Bank Rate, forced a recovery of rates at the end of the year by charging 5 per cent. ($1\frac{1}{2}$ per cent. above Bank Rate) for the ten-day advances which covered the year-end. The market complained, but the *Economist* approved.³ When the Australian crisis caused a spasm of precaution in London the Bank raised its official rate to 4 per cent., but its

¹ *Economist*, May 9th and 16th, 1891.

² At the beginning of December

³ January 2nd, 1892.

Advances Rate to $4\frac{1}{2}$ per cent. At the end of that year the Bank again succeeded in causing a hardening of market rates by raising its Advances Rate to $\frac{1}{2}$ per cent. above Bank Rate,¹ and on this occasion that rule was maintained (apparently as part of an effort to sustain market rates) until the middle of February, 1894.²

Throughout the cheap money period the Bank maintained an equality between Bank Rate and the Advances Rate. In the autumn of 1896, and again at the end of 1897, the Bank occasionally reverted to the rule, Advances Rate $\frac{1}{2}$ per cent. above Bank Rate, solely for the purpose of stiffening market rates.³ On all these occasions the market was in the Bank, either for seasonal reasons or because the Bank had forced it in, and the higher charge for short-term advances was designed to make that borrowing have more effect on market rates. The bill market did not like it ; but the Bank achieved its end. In the following years it sometimes raised the Advances Rate more than $\frac{1}{2}$ per cent. above Bank Rate. At the end of 1897 the Bank charged 1 per cent. above Bank Rate for Advances,⁴ but it soon dropped the Advances Rate back to Bank Rate. In the summer of 1899, when trade activity combined with apprehension of the South African War to make things difficult, the Bank's first step was to raise the

¹ This was throughout December, 1893. There was "a good deal of grumbling" in the market.

² *Economist*, February 17th, 1894.

³ *Economist*, October 31st, 1896 (when there was again "grumbling"), November 14th and 28th, and December 26th, 1896, January 2nd and December 25th, 1897.

⁴ *Economist*, January 1st, 1898.

Advances Rate from 3 per cent. (Bank Rate) to $3\frac{1}{2}$ per cent. A week later Bank Rate followed to $3\frac{1}{2}$.¹ A few weeks later the Advances Rate was raised to $4\frac{1}{2}$ per cent.,² though Bank Rate remained at $3\frac{1}{2}$ per cent., and as it restricted its rediscounting facilities at the same time,³ Market Rates rose above Bank Rate.

In the spring of 1900 the Advances Rate was raised in unusual circumstances.⁴ Much pressure was occasioned in the market in consequence of a large instalment of War Loan subscriptions falling due. The Bank discounted freely at the official rate (4 per cent.), but charged 5 per cent. for advances. "To this latter charge," the *Economist* wrote, "strong objections have been made, and it is certainly unusual for the directors to take advantage of a scarcity, caused by the payment of Government money into the Bank, thus to raise their rates against borrowers. Having arranged, too, to facilitate subscriptions to the loan, it is held to be all the more invidious for them now to squeeze the market when a payment in connection with it has to be made, and perhaps it would have been wiser policy not to have done so. For it is not as if the advance were necessary in order to protect the reserve." Certainly the gold position was fairly strong, and there appears to have been no justification for the Bank's action in forcing Market Rate up above Bank Rate. This high level was main-

¹ *Economist*, July 8th and 15th, 1899.

² *Economist*, September 2nd, 1899.

³ See below, p. 65.

⁴ *Economist*, April 14th, 1900.

tained, however, for at least three weeks.¹ The incident can only be accounted for, I think, as one among many indications of nervousness on the part of the Bank. The position abroad was extremely uncertain. Trade booms in the United States and Germany had had their usual effects, and the American currency position was being very much strained by Treasury operations.² Home demands for gold were unusually large, though mainly because of the activity of trade.³ In view of this last, the Bank might have been expected to raise Bank Rate if there were difficulties. But raising Bank Rate would have serious effects on the Government's borrowing operations. In any case, the Bank appears to have been so bewildered by the temporary ebbs and flows of tension abroad that it could not make up its mind to any such drastic action. It raised its prices for gold,⁴ after it had forced up Market Rate, then a few weeks later it was reducing Bank Rate. The situation was certainly complicated, and in view of the Government's borrowing programme the Bank may well have been unable to make up its mind to any drastic raising of rates.

Consideration of the effect of Bank Rate movements on the Government's loan operations was again probably behind the operations of the Bank at the beginning of 1901. The turn of the year had seen the culmination of a serious drain of gold which, coming at a time when the internal demand was

¹ *Economist*, May 5th, 1900. Cf. *Statist*, May 12th, 1900.

² *Economist*, April 28th, 1900.

³ *Economist*, May 5th and 26th, and June 9th, 1900.

⁴ See below, p. 92.

seasonally great, reduced the Bank's gold stock to £28,500,000. This gold efflux was effectually stopped by raising Bank Rate to 5 per cent. With the return of coin from circulation at home Market Rates soon dropped away, but the Bank took steps to keep the market temporarily in the Bank. In February, though it was still needing to draw in gold from abroad, the Bank reduced Bank Rate from 5 to $4\frac{1}{2}$ per cent. and then to 4 per cent. By this time the normal revenue collections were keeping the market close to the Bank, which was therefore able to stop its borrowing in the market. But by charging sometimes as much as 1 per cent. above Bank Rate for advances it was able to prevent Market Rates from falling much, so, though it had reduced Bank Rate by 1 per cent., gold began coming in from abroad and its reserve was quickly replenished.

For a time thereafter the Bank maintained the Advances Rate equal to Bank Rate, but about 1903-04 the Bank's practice was changed. In December, 1902, the Bank began what subsequently became its general practice of making advances at $\frac{1}{2}$ per cent. above Bank Rate. On the same occasion it charged $\frac{1}{2}$ per cent. above Bank Rate for short discounts, although longer-dated paper was taken at Bank Rate.¹ In the first year (1903) of the new practice the Bank on three occasions kept the Advances Rate equal to Bank Rate, those occasions being the end of June and two month-end occasions of borrowing.² Thereafter no such exceptions were

¹ *Economist*, December 27th, 1903.

² *Economist*, January 31st, June 27th and August 1st, 1903.

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made, the Bank habitually charging $\frac{1}{2}$ per cent. over Bank Rate for advances to the market. These advances were almost invariably made for one week at a time.

From the new practice the Bank did during the difficult years 1905-07 occasionally depart in order to strengthen Market Rates, by raising its Advances Rate to 1 per cent. above Bank Rate. In December, 1905, the first of these occasions, the *Economist* discussed the resentment expressed in the market, and remarked that the Bank's action was efficacious in the market and therefore on the foreign exchanges, while disturbing internal trade less than would a comparable rise in Bank Rate.¹ A similar situation arose, in a more acute form, in the following autumn, and in the second half of September, 1906, the Bank for a time maintained its Advances Rate at 1 per cent. above Bank Rate.² The Bank then returned to its usual practice, and does not appear to have relied at all on this expedient when the final crisis came in the autumn of 1907.

(3) RESTRICTING THE ELIGIBILITY OF BILLS

(a) *By Reducing their Currency*

As has been stated above,³ the Bank in 1890 announced that it was willing to rediscount for the market bills not having more than fifteen days to

¹ December 16th and 23rd, 1905 (See also February 10th, 1906, where the whole subject is discussed in an article "The Bank of England and the Money Market.")

² *Economist*, September 22nd and 29th, 1906.

³ Pp. 21-22.

run to maturity. But as the Bank developed its contacts with the market it gradually extended the currency of eligible bills. In 1897 the limit of currency became three months,¹ and in the first decade of the new century it was further extended. In the "Interview with the National Monetary Commission" the "maximum length of time to run" was given as "four months, exceptionally six."² The *average* length of time of "bills discounted" was given as "forty to fifty days"; but as these "bills discounted" presumably included those discounted directly for customers, the average for bills rediscounted for the market was probably much less. The Bank did not, however, have an invariable rule on the subject. The National Monetary Commission was told: "The *currency* of bills accepted for discount is from time to time regulated by resolutions of the court of directors, and varies constantly (within the limits so laid down) at the discretion of the Governor, who is guided by the existing conditions of the market."³ The Bank, in fact, used this power of variation to help to stiffen market rates while keeping Bank Rate unchanged. Once it had become its general practice to take two- or three-months' bills at Bank Rate, it could always (when the market was much in the Bank) raise Market Rate further by refusing for a time to rediscount any bills having more than say fifteen or thirty days to run. The expedient was not,

¹ *Economist*, September 11th, 1897.

² P. 20.

³ P. 22.

however, used very often. For, although the Bank had so much extended the currency of eligible bills, it always (in order to maximise its own control)¹ maintained its preference for short bills, so that anything but a most drastic shortening of the currency eligible would have no effect except when the market was in the Bank on a quite abnormal scale. But there were some such occasions, which we shall now detail.

In September, 1899, the Bank refused to take three months' bills at Bank Rate, not, it seems, with a view to protecting the home situation from the consequence of the external situation, but in order to avoid any hindrance to its power of making a higher Bank Rate effective. It was expected that Bank Rate would rise.² If the Bank took many long bills from the market before the rate rose it would have to take so much more money off the market in order to make a higher rate effective a week or so later. The Market Rate for three months' bills thereupon rose far above Bank Rate. In July, 1900, the Bank refused to take bills of more than two months' currency as part of its efforts to force higher rates without raising Bank Rate.³ The same course was taken as a prelude to a rise in Bank Rate in 1902.⁴ The power proved in earlier years may have been used in the autumn of 1903. At that time the American situation was making the

¹ The maturing of the bills it held automatically reducing market funds.

² *Economist*, September 30th, 1899, *cf.* above, p. 60.

³ *Statist*, July 28th, 1900.

⁴ *Statist*, September 27th, 1902.

general gold position very uncertain, while the failure of home trade to recover as quickly as had been hoped after the end of the Boer War made the Bank unwilling to resort to a rise in Bank Rate beyond 4 per cent. The Bank took care, by borrowing in the market, to keep Market Rates up well, and there is some evidence of its having, at the end of November, shortened the currency of eligible bills to about five weeks. But the case is not clear.¹ Somewhat similar conditions recurred at the end of 1904. The Bank had managed to get Bank Rate down to 3 per cent., but difficulties in Berlin and the repercussions of the Russo-Japanese War were straining the gold position. Recovery at home was barely susceptible. Under the stimulus of cheap money, however, it did seem to be incipient at last. Under these circumstances the Bank was naturally inclined to take measures to strengthen itself without raising Bank Rate, and one of the measures it took was the refusal "to make advances on bills having more than sixty days to run, while at the same time increasing the margin of security for all advances on bills to 10 per cent."² This step appeared to the *Economist* to be a justifiable step, because it would "curtail somewhat the facilities afforded to certain dealers in money which are often used to beat down market rates at the very time the Bank feels itself called upon to make every effort to maintain them."³ In February, 1906, the Bank refused to

¹ See *Economist*, November 28th, 1903.

² December 31st, 1904.

³ In spite of this step, rates did fall away quickly in the New Year,

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take any except short bills at Bank Rate, in order that the maturity of such bills should keep the market under control.¹

In the autumn of 1906 the Bank, as has already been seen, modified its lending policy in order to protect internal trade as far as possible from the repercussions of the American difficulties. At the beginning of October Bank Rate stood at 4 per cent. The actual rediscount rate, after standing for a time at $4\frac{1}{2}$ per cent., was reduced to 4 per cent. on October 4th. But at the same time "some of the less regular customers were given to understand that any bills running beyond the end of the year would not be taken at 4 per cent." ² In the following year the American demand for gold again forced action on the Bank. After Bank Rate had been raised to $4\frac{1}{2}$ per cent. on August 15th, the Bank for a time relied on other measures. Among the latter was the absolute refusal to take bills from the market of more than thirty days' duration.³ Again in the autumn the Bank, in its efforts to stave off an extreme movement in Bank Rate, refused to take any but "short-dated paper."⁴ In the depth of the subsequent slump the Bank had in the autumn of 1908 to endeavour to maintain market rates without raising Bank Rate. On this occasion we

¹ *Economist*, October 6th, 1906. Either from its more regular customers, or at a rate higher than 4 per cent, the Bank *did* take some such bills (See *Economist*, October 13th, 1906)

² *Statist*, February 10th, 1906 The Bank's action was taken with a view particularly to making a renewal of its borrowing from the joint-stock banks unnecessary (see p 37, above)

³ *Economist*, August 24th, 1907.

⁴ *Economist*, November 2nd, 1907.

are told of a "preference of the Bank for very short bills,"¹ though not of the way in which it expressed that "preference."²

(b) Restricting the Nature of Eligible Bills

In 1910 the Bank stated that "as regards the class of bills accepted, no particular change has taken place of late years." But on one extreme occasion not long before this, it had endeavoured to achieve its ends partly by discriminating against a certain class of bills which it would ordinarily have taken. In the autumn of 1906 London was subject to a great demand for gold for the United States proximately because London houses were taking up, at the high rate which could be earned, large amounts of American paper. The Bank of England, in "its evident desire to avoid, if possible, a further advance in rates," discriminated against American bills.³ Much further back, on the eve of the Baring crisis, the Bank had discriminated against "bills having the appearance of being offered with a view to gold exports,"⁴ but this is more akin to the operations examined in Chapter IV.

In the development of this technique of market control the Bank was obviously looking, on many occasions, simply to its end of keeping the market

¹ *Economist*, November 28th, 1908.

² In August, 1912, the currency of bills eligible for discount was drastically reduced; but this was apparently merely to prevent the market securing independence before the official rate was raised. (See *Economist*, August 31st, 1912.)

³ *Economist*, September 22nd, 1906.

⁴ *Statist*, October 4th, 1890.

close to its own rate in order to give some reality to the latter's control of the foreign exchanges. But in doing this it had learned that, to some limited extent, Market Rate and Bank Rate could be looked upon as independent weapons. Once this was realised the Bank could to some extent meet the public demand¹ that it should resort to the method of raising Bank Rate as sparingly as possible. First perhaps out of consideration for the Government's borrowing operations, and subsequently out of tenderness for home trade, the Bank often endeavoured to avoid raising Bank Rate, or at least to keep the movements within narrow limits, by resorting to these other devices for raising Market Rates.

But the importance of Bank Rate as an *index*, upon which the full light of publicity was thrown, could not be forgotten. We have seen² how in the early days of the period the Bank sometimes underrated its own power, when it decided to let Bank Rate follow the market. Although the market was working in complete independence of the Bank, a reduction in Bank Rate was the signal for a further fall in Market Rate. Conversely, although the Bank might wish to deal with a foreign situation by operating on Market Rate and leaving its official rate alone, it might be worth raising Bank Rate because that would be more spectacular. If the worst came to the worst, Bank Rate would be raised as a piece of "shock tactics." It was its "shock value" which, after all, was the basis of the

¹ On which see below.

² P. 6, fn. 3.

tradition that, for the purpose of influencing the foreign exchanges, Bank Rate should not be raised by less than 1 per cent. at a time. The shock effect was felt in the London market and so raised Market Rates, even if the supply of funds in the market did not appear to force the market to follow the Bank. There would then be direct, as well as indirect, effects on the international gold market. A clear example of the efficiency of "shock tactics" in such circumstances was in the autumn of 1899, when on the prospect of outbreak of war, the Bank raised Bank Rate twice in a week—from $3\frac{1}{2}$ to $4\frac{1}{2}$ per cent. on the Tuesday, then to 5 per cent. on the Thursday.¹ An even clearer example of the "shock" effect, of an unusual movement of Bank Rate, directly on the foreign situation, was that of October, 1906. On Thursday, the 18th, Bank Rate was unchanged, but on Friday, the 19th, it was raised from 5 to 6 per cent.² The next letter of the New York correspondent of the *Economist* stated that the fact that the Rate was raised on a Friday much enhanced its "shock" effect and brought about a collapse in Wall Street,³ thereby easing the monetary stringency which was proving so embarrassing to London. The contrast between Bank Rate as the controller of the internal situation and Market Rate as the controller of the external situation remained as true as ever, but the power of the Bank was so widely respected that a sharp rise in Bank Rate could itself do much to protect the Bank's gold reserve.

¹ *Economist*, October 7th, 1899.

² *Economist*, October 20th, 1906.

³ *Economist*, November 3rd, 1906

CHAPTER IV

DIRECT OPERATIONS ON THE GOLD MARKET

I

WE pass now to an entirely different part of the Bank's armoury. So far we have been concerned with showing the various ways in which the Bank, by operating directly and indirectly on Market Rate of discount in London, changed the relative attractiveness of London and other centres for the holding or borrowing of funds. But the profitability of such transfers would depend not only on relative interest rates, but also on the possible movements of the foreign exchange rates, and therefore on the terms upon which gold could be transferred from one centre to another. In other centres the authorities were able to remove and replace obstacles in the way of gold exports, facilitate gold imports, charge a premium on gold and so forth. To overcome the effects of such changes the Bank of England might be obliged to raise Market Rate to a level far above rates abroad. To avoid these extreme movements in Bank Rate the Bank itself had recourse to weapons similar to those used in other centres. Its powers of this kind were, of course, far more restricted than those enjoyed by

some of the foreign authorities. The Bank of France, for example, derived a large measure of protection from its option to redeem its notes in standard silver coin.¹ The relevant statutory obligations of the Bank of England were (1) the obligation to pay out sovereigns in exchange for notes at par ;² and (2) the obligation to issue notes in exchange for bar gold at the price of £3 17s. 9d. per standard ounce.³ These two obligations were sufficient to set limits for the gold points.⁴ But there was nothing to prevent the Bank paying more for bar gold if it chose. And there was nothing to regulate the prices at which it would deal in foreign gold coin, save that it would be futile to offer a price lower than that at which it would pay dealers to have foreign coin converted into bars, and equally futile to charge so much that it would pay them to take gold from the Bank in sovereigns.⁵ Within this range the Bank could make a considerable difference to the foreign exchange markets by altering its prices for bar gold, American eagles, German coin, Japanese coin, and so forth.

In addition to these manipulations of its prices for gold in various forms, the Bank could help to attract gold by giving advances free of interest to

¹ Cf. Withers, "Meaning of Money," p. 220.

² Under the Resumption Act of 1819.

³ Under the Bank Charter Act of 1844.

⁴ Given transport, insurance and interest costs (the last of which was susceptible to influence by the Bank).

⁵ These limits were recognised by the Bank, which would generally prefer to part with foreign coin rather than sovereigns. It was therefore careful to restrict its raising of the prices of foreign coin *within* the limits set. (Cf. p 77, fn 4.)

importers of gold to cover the time which was spent in transit. This device was used by the French, German and American authorities¹ very frequently, and was on certain occasions also adopted by the Bank of England.

Both these expedients were officially admitted by the Bank in the "Interview with the National Monetary Commission," in the following general terms²:

Q. Do you take other steps in addition to raising the Bank Rate to protect gold in times of crisis?

A. Yes.

Q. Is it customary at such times to advance money without interest to importers of gold to cover the time required in transportation?

A. At such a time facilities for bringing gold have been given in the shape of free advances during transit, adequate security having been lodged.

Q. Does the Bank under some conditions advance its rate for gold purchases?

A. Yes.

Q. Under what circumstances and to what extent does the Bank charge a premium for gold bullion or foreign coin?

A. When there is a demand for either gold bullion or foreign coin for export to another country the Bank follows the same rule as the seller of any ordinary commodity.

In the following paragraphs the actual use of these expedients by the Bank will be detailed. It should be borne in mind throughout that there was

¹ The Bank of France, the Reichsbank and the United States Treasury respectively.

² Pp. 28-29.

normally a supply of new bar gold coming into the market every week from South Africa. The bars were sold usually on the Monday, and they formed the " front-line " supply.¹ Any bars not wanted by other buyers at 77s. 9d. or more per standard ounce automatically went to the Bank, which was under statutory obligation to buy all offered at that price. If the Bank wanted, on a Monday, to replenish its gold reserve, as it would sometimes after a drain in the previous week, it could and would offer a price higher than 77s. 9d. for the Monday bars, and so prevent them going to other buyers.

II

ADOPTION AND EARLY USE OF THE " GOLD DEVICES "

The use of these weapons by the Bank of England was apparently quite new at the beginning of the period with which we are concerned. The acute problem of the 'eighties and early 'nineties was how the Bank should protect its gold stock when it found itself unable to control the discount market except at great cost. A " gold policy " was, in some degree, a substitute for a " Bank Rate policy." As such the matter was raised by the *Economist* in 1885.² Years before that date the Bank had

¹ Except that, at certain prices, it would pay gold exporters to take from the Bank gold coin of the country of destination, rather than take the Monday bars and bear minting charges at the destination.

² February 14th, 1885 The article in the issue of that date was the result of some previous correspondence

voluntarily notified its willingness to buy foreign gold coin. It then fixed its prices for these foreign gold coins on the assumption that they would all have to be melted down into bars for coinage at the Mint. Prices which, on that assumption, would not involve the Bank in any loss were naturally insufficient to exercise any special attraction. The assumption on which the pricing was based was, however, unjustified. If gold was wanted for export to Germany, it was obviously an advantage to the exporter if he could secure German gold coin at the Bank, since that was worth more than bars or sovereigns in Germany.¹ The Bank could therefore afford to pay for foreign gold coins a price practically equivalent² to its price for bars. Offering a more attractive price for gold might at times, the *Economist* thought, have decided advantages over the alternative line of policy. “. . . in a time of gold scarcity, such as that through which we have been passing, it is certainly much better for the trade of the country, and probably, on the whole, better for the Bank also, that it should seek to attract gold by raising its price of gold coin than by raising its price of discount. Both measures may be necessary, but certainly the former is less disturbing to business than the latter, and it is not unlikely to be less costly to the Bank itself than the efforts it has made to lift the Market Rates up nearer to its own level. The balance of argument

¹ Cf *Economist*, February 25th, 1905

² Not quite equivalent, since there was a slight risk that it might for some years face demands for other countries and not the particular country whose coins it was buying.

appears, therefore, decidedly in favour of a revision by the Bank of its prices for gold coin, so as to bring them on a level with what other national banks find it profitable to pay."

Precisely when the Bank first exploited this possibility I do not know. But at the beginning of 1890, when the problem of Bank control over the market was exceedingly acute, the Bank carried the logic of the argument a little further and raised its price for bar gold. At the beginning of January, 1890, Bank Rate had been raised to 6 per cent. without much effect in attracting gold. Its lack of success had been largely due to its ineffectiveness in the London market. In the middle of February, the 6 per cent. rate remaining ineffective, the Bank raised its buying price for bar gold from 77s. 9d. to 77s. 9½d. an ounce. "Something more than the usual price" had already been paid for gold which came from Paris. These steps were then described by the *Economist* as "exceptional methods" of strengthening the attraction of the 6 per cent. Bank Rate.¹ Gold then came in in increasing amounts, and, with the prospect of being able to make its rate effective, the Bank reduced Bank Rate to 5 per cent. on the following Thursday. That the Bank was impressed with the possibility of attracting gold directly when it was unable to make its rate effective may be deduced from the fact that in the following month it announced that henceforward it would not, as it had in the past, oblige importers of large bars to bear the charge of smelting. This

¹ February 15th, 1890.

change made the Bank permanently more attractive to bars and at the same time increased the efficacy of any future small rise in its offered price for bars.

In the same year the Bank did also manipulate the prices of foreign gold coin, these operations also being hailed as "exceptional" in a way which suggests that they were also novel. In April, 1890, the Bank, meeting a demand for napoleons for export, raised its selling price at once.¹ In October the Bank attracted some Russian gold coin from Paris by offering 76s. 4½*d.* per ounce instead of its usual price of 76s. 4*d.*² The following week the German exchange stood at a point which indicated an efflux of gold bars. The Bank refused to sell bars, and the exchange continued to fall until it became profitable to take sovereigns.³ In December, when £900,000 was taken out of the Bank for New York, the Bank charged as high a price as it could for the eagles.⁴

In 1891, a year in which the inability of the Bank to control the market was "more marked than ever,"⁵ the Bank consistently manipulated its prices for gold, both bars and coin, as a definite supplement to its Bank Rate policy. Throughout May and June the buying prices for coin and bars

¹ *Statist*, April 26th, 1890.

² *Statist*, October 11th, 1890.

³ *Statist*, October 18th and 25th, 1890

⁴ "The Bank asked 76s 8½*d.*, as compared with the usual price of 76s 6*d.* At first the Bank asked 76s 9*d.*, but exporters showed a disposition to take sovereigns rather than pay the price, and the Bank consequently reduced its charge ½*d.* per ounce." (*Statist*, December 13th, 1890)

⁵ *Economist*, "Commercial History and Review of 1891"

were held at a higher level than usual.¹ In July a gold efflux was stopped by the Bank placing "difficulties in the way of withdrawing anything but sovereigns" after all its German coin had been taken.²

In the autumn of 1892 again the policy of raising the price of gold was adopted before Bank Rate was raised. There was an important demand for gold for Austria and Russia at a time when the Bank could ill afford to lose much. Bank Rate had been as low as 2 per cent. all the summer, Market Rates being far below. The first change made by the Bank was not a rise in Bank Rate, but a rise in its selling price for bar gold.³ The efflux persisted, the market went into the Bank, and Bank Rate went up. In the following month, when the Bank by its own action was keeping Market Rates up well,⁴ the Bank, rather than raise Bank Rate above 3 per cent., raised its selling price for fine bars to 78s. 1d.⁵ When in January, 1893, Bank Rate stood at 3 per cent. but was quite ineffective, the Bank, on meeting a demand for gold, sold foreign coin at "advanced prices."⁶ The Bank even went some way towards meeting Market Rate by reducing Bank Rate to 2½ per cent., after which it refused to sell bars, and charged high prices for French and

¹ Eagles at 76s 5d and bars at 77s. 9½d (*Economist*, May 23rd and June 20th, *Statist*, May 9th and June 27th, 1891)

² *Statist*, July 25th, 1891.

³ *Economist*, October, 1892.

⁴ *Economist*, November 5th and 19th, 1892.

⁵ *Economist*, November 5th, 1892.

⁶ *Statist*, January 21st, 1893.

Russian coin.¹ In August, 1893, the Bank's steps to meet a foreign drain were the raising of Bank Rate to 4 per cent. (from 3), a refusal to sell gold bars, and raising its selling price for foreign coin.² So far, then, the Bank had resorted to these measures not in extraordinary circumstances when a very high Bank Rate had been reached, but as an alternative to raising Bank Rate at all, or because it was easier or cheaper than attempting to make Bank Rate effective.

Throughout the cheap money period of the middle 'nineties there was, of course, no need for any such weapons. The Bank was flooded with gold. But these devices were not forgotten. When strains arose at any time during the years 1896-1910 the Bank was prepared to resort to the method of attracting gold, or preventing an efflux, otherwise than by operating on discount rates. The rationale of the Bank's frequent use, during those fifteen years, of these "gold devices" would appear to have been this: other monetary authorities (including the United States Treasury as well as the leading Continental banks) were continually doing the same thing; consequently the Bank could only protect itself by most extreme movements of Bank Rate, if it relied on that weapon alone; the period was one of extraordinary foreign movements, partly owing to wars, but more owing to the extremes of American and German speculation; it was unfair to penalise

¹ 76s. 9½d. for Napoleons and 76s. 9d. for Imperials. (*Statist.*, February 4th, 1893)

² *Statist.*, August 12th, 1893.

English business on such accounts, especially in the many years when English business was relatively slack; therefore movements in Bank Rate should be minimised. But it is difficult to generalise, and some of the outstanding cases are detailed below.

The rapid elaboration of these devices in the later 'nineties is somewhat difficult to follow because they soon became such an everyday part of the Bank's armoury that they were not always the subject of particular remark. This is most true of the manipulation of the prices of foreign gold coin. Although there had been several previous references in the *Statist*, there is no mention in the *Economist* of this particular practice before September, 1896,¹ when one of the Bank's first steps was to raise its selling price for eagles (American gold coin), its selling price for bars having been raised on the previous day.² After that date there are occasional references to the Bank raising its price for eagles and reducing the price after the strain had passed. But these references are so casual³ that we may assume that the Bank was in fact continually changing its prices for foreign gold coin, and particularly for eagles.⁴ The *Statist* is more informative, but the wording of its references also betrays acceptance of these methods as everyday practices.

¹ But see above, p. 77

² September 12th, 1896.

³ Often (as, e.g., May 5th, 1900, and April 30th, 1910) the first change remarked was the downward revision of prices after the strain was over.

⁴ In January, 1907, when the difficulties of the autumn of 1906 had been overcome, prices for eagles became "a matter of negotiation." (*Economist*, January 26th, 1907)

Changes in the price of bars can more easily be traced, as there was usually some comment on what had happened in the open market each Monday, when the Cape bars were sold. That was when any rise in the Bank's buying price would be manifested, and it was normally the subject of remark by the *Statist*¹ and the *Economist*. In the earlier part of the period the price offered by the Bank for these bars rarely rose above 77s. 9½*d.* As compared with the statutory price of 77s. 9*d.*, this represented a bigger advance than appears at first sight, since the Bank would have to pay brokers' charges² when it entered the market, whereas when fulfilling its statutory duty, of accepting any gold *offered to it*, it would not have to do so. In 1903, however, the price offered rose above 77s. 10*d.*, and in the next five years 77s. 9½*d.* was frequently exceeded. On two occasions in 1910 the Bank satisfied its requirements by paying the statutory price *plus* the brokers' charges.³ •

Besides replenishing its reserve by offering a higher price for the Cape or other bars, the Bank could do something to protect its reserve in time of a threatened or actual gold export by raising its *selling* price for bars. As the Bank appeared to be

¹ The Bank's buying price for bars became more obscure when in 1899 the Bank for a time adopted the method of buying privately through a broker, instead of openly announcing its price. (See, *e.g.*, *Statist*, March 4th, 1899)

² In 1907 the *Statist* referred to the charges as "¼*d.* or ⅓*d.*" (May 25th, 1907), and in 1909 as ⅓*d.* (October 30th, 1909). Cf. *Economist*, July 23rd, 1910.

³ March 12th and October 8th, 1910. This may also have been done on other occasions, but it was not recorded in the *Economist* or the *Statist*.

unwilling to raise its offer for the Cape bars beyond 77s. 10½*d.* at the utmost, those bars would be the first sought by any operators wanting bars for export. But the bars in the market might be insufficient; then resort would be made to the Bank. What was the Bank's normal selling price I have been unable to ascertain. Indeed, in the 'nineties the Bank does not appear to have had a "normal" selling price at all, for it would stand for months on end at any one price, which might be as low as 77s. 10½*d.* or as high as 78s. The minimum recorded was 77s. 10½*d.*, and there is a further strong presumption that that price would in fact be the Bank's minimum.¹ The maximum price recorded was 78s. 1*d.*,² charged in November, 1892, and September, 1906. The Bank thus moved its prices for bars over a range of 4*d.* between the extreme points of the minimum buying price and the maximum selling price. When this range is compared with the 1925-31 range of 1½*d.* imposed by statute,³ it will be realised how much freer the Bank was to act upon the gold points before the war than it has been since.

The next weapon adopted by the Bank was that

¹ This presumption is based on the facts (a) that the Bank never raised its *buying* price for bars above 77s. 10½*d.*, and (b) that it was obliged to sell sovereigns at 77s. 10½*d.*

² It should be remembered that a limit to the price which people would pay was set by the possibility of securing sovereigns at the Bank.

³ The obligation to purchase all bars offered at £3 17s. 9*d.* imposed in the Act of 1844 (7 & 8 Vict. c. 32, s. 4) remained, while the obligation to sell bars on demand at £3 17s. 10½*d.* was imposed by the Gold Standard Act, 1925 (15 & 16 Geo. V. c. 29, s. 1, subs (2)).

of facilitating gold imports by giving advances free of interest on condition that they were repaid in gold within a certain number of days. Use of this device was alleged in the *Statist* in 1891, when it was said that the Bank "paid for the gold immediately it was shipped and before it arrived here, reserving stock as security for the advance, which stock was taken back by the importing houses as the gold was sent into the Bank."¹ In April, 1898, some gold was received from abroad "partly as a result," said the *Economist*, "of a special arrangement by the Bank, which has made advances for a few days—of course on security but free of charge—on condition that they should be repaid in coin. Under this arrangement upwards of £250,000 of German gold coin has already been obtained, and about half a million more will be paid in during the next few days. This is an exceptional operation, and one which is not likely to be carried out to more than a limited extent, but it has been effected opportunely. . . ." ² The *Economist* considered that this measure (which was continued during the following week) "obviated the necessity" for a rise of Bank Rate beyond 4 per cent. The weapon was again employed in June, 1899, when Bank Rate was 3 per cent.,³ and at the end of 1899, when Bank Rate was 6 per cent.,⁴ on one occasion during the South

¹ June 6th, 1891

² April 23rd, 1898, and *Statist*, April 30th, 1898 It will be noted that the operation was described as "exceptional"; but not as an innovation

³ *Statist*, June 24th, 1899. On this particular incident, see below (p. 90)

⁴ *Economist*, December 16th, 1899.

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African War,¹ and in 1906 and 1907.² After that there was no instance recorded, though in the interview with the U.S.A. National Monetary Commission in 1910 the Bank admitted employing this particular weapon, in terms³ which leave the impression that the Bank had not entirely discarded it.

Another of the Bank's "gold devices" was explained to the U.S.A. National Monetary Commission not by the Bank of England representatives but by Lord Swaythling.⁴ It will be recalled that the power of the Bank to influence the situation by raising its selling prices for bars and foreign gold coin was effectively limited by its obligation to pay out sovereigns at par, which would imply the statutory price of £3 17s. 10½*d.* per standard ounce. According to Lord Swaythling, the Bank was able to stretch this limit somewhat by exploiting its effective monopoly of coins for export in that it would sift out minimum legal weight coins for sale to the exporters.

The *Statist* recorded this method as having been used with effect at the end of 1900.⁵ There was also an example of it in 1904, but it is doubtful whether

¹ *Economist*, August 11th, and *Statist*, August 25th, 1900.

² *Statist*, February 3rd, 1906, and June 29th, 1907

³ Quoted above, p 73

⁴ Interviews, p. 98.

⁵ "Under ordinary circumstances a Paris exchange of 25.07½ would have enabled gold to be taken from the Bank of England for shipment to Paris at a handsome profit, but in view of the difference between the value of money in Paris and in London, and also of the action of the Bank of England in giving out as light sovereigns as possible consistent with the law, it does not make gold shipments profitable as an exchange operation." (December 22nd, 1900. Cf December 29th, 1900)

on that occasion the Bank paid out light coin with the deliberate intention of checking the export of gold.¹

On one occasion the Chancellor of the Exchequer deliberately helped the Bank of England to avoid a 6 per cent. Bank Rate. The allotment of an issue of Exchequer Bonds in 1900 was arranged in such a manner that New York applicants had to find a large proportion of the money.² The Bank's discrimination, in 1890, against bills suspected of being designed to finance gold exports must also be mentioned in this analysis of the various methods which the Bank adopted in order to check gold losses or to encourage gold imports.³

III

SUBSEQUENT OCCASIONS OF THE USE OF THE "GOLD DEVICES"

We have seen how, at the beginning of the 'nineties, the Bank adopted operations directly in the gold market when it was unable, or unwilling, to make a higher Bank Rate effective. We now proceed to examine the occasions when, in the subsequent years, the Bank again so operated.

It is notable that when, in the early autumn of

¹ On that occasion it was stated (*Statist*, October 29th, 1904) that the withdrawal of sovereigns from the Bank was not so large as it would have been "had the exporters been able to rely upon getting heavy coin," but it appears that the Bank's stock was exceptionally low at that time.

² *Statist*, August 11th and 25th, and particularly (for the Chancellor's open avowal) October 27th, 1900.

³ *Statist*, October 4th, 1890.

1896, the London gold plethora came to an end, the Bank immediately, without awaiting any strain, resorted to direct operation on the gold market. Gold had been going to New York for three weeks, but the Bank still had an amount of gold far in excess of its earlier average.¹ In the second week of September, when the market, owing to the previous plethora of funds, was still working far below the Bank, the latter took the unusual step of raising the rate by $\frac{1}{2}$ per cent. and raising its selling prices for eagles and bars.² These steps did not prove sufficient to stop the drain, and the Bank, after much hesitation,³ raised its rate to 3 and then to 4 per cent. The hesitation appears to have been caused by doubt of the market following a rise at a time when money was so abundant.⁴ Eventually the Bank took various steps to make its higher rate effective in the market, and the gold efflux was stopped.⁵ Regarded as a whole, the events of this phase suggest that when the gold efflux began the Bank preferred working on the gold price directly

¹ But when comparing the 1896 gold stock with that of 1891-93, it must be remembered that in 1896 the Japanese Government's deposit amounted to about £11,000,000.

² The drain at first consisted of bars, which the Bank was willing to sell at 77s. 10½d. The Bank then decided that it would prefer to lose eagles and, to divert the demand, it *reduced* the selling price for eagles to 76s. 7½d., then to 76s. 7d., and raised the price for bars to 77s. 11d. The drain then becoming more serious, the Bank *raised* the selling price for eagles to 76s. 7½d., and that for bars to 78s. (*Statist.*, August 15th to September 12th, 1896).

³ The Courts which decided on the rises were exceptionally prolonged.

⁴ *Economist*, October 17th, 1896.

⁵ There had been a temporary check after Bank Rate rose to 3, but shipments were soon renewed.

and giving market rates a lead upwards by raising its ineffective official rate from 2 to $2\frac{1}{2}$ per cent. to forcing a high rate on the market. When, with the raising of Continental rates,¹ the drain continued, it adopted the latter policy. Making Bank Rate effective had by that time become much easier, since the gold drain had much reduced funds in the market. The "gold operations" of 1896 were therefore similar to those of 1890-92 in that they were dictated by the weak position of the Bank in the money market.

In the following autumn the Bank was well in control of the market when the gold began to go out. As the gold efflux was not expected to be serious, the rate was raised from 2 to $2\frac{1}{2}$ per cent. only. The drain being scarcely interrupted, Bank Rate was raised on October 14th to 3 per cent., and on the same day the bar gold and eagle prices were raised by $\frac{1}{2}d.$ per ounce.² These steps stopped the efflux of gold. The Bank throughout that autumn was taking steps to control the market, and succeeded in keeping market rates continuously close to its own. There can be no question, therefore, of the step of raising the price of gold being the result of the Bank's powerlessness in the market. This time the gold price was raised clearly because the Bank did not wish to raise interest rates with undue severity.

In the few years following this, years which were

¹ *Economist*, October 17th, 1896.

² Bars to 78s. $0\frac{1}{2}d.$ (the price having apparently stood at 78s. since 1896), and eagles to 76s. $7\frac{1}{2}d.$ (*Statist.*, October 23rd, 1897). The price of bars was maintained at 78s. $0\frac{1}{2}d.$ for the remainder of the year.

in many ways peculiar, the Bank frequently used these various gold devices in this last way, *i.e.*, as an alternative to higher interest rates which *could* have been enforced. In the spring of 1898, when the Spanish-American War opened up the prospect of dearer money in the United States, the Bank, with the market well under control, was faced with a relatively small loss of gold. In view of the possible development of the American situation, it set about strengthening its reserve at once by raising Bank Rate from 3 to 4 per cent., by giving free advances to importers of gold, by buying bars in the market at 77s. 9 $\frac{3}{4}$ d., and by offering higher prices for foreign coin.¹ With these auxiliary weapons gold was attracted in large quantities without the Bank being obliged to raise Bank Rate any further. There are some points about the situation on this occasion which render the Bank's behaviour particularly interesting. The immediate origin of the need for action was the prospect of war in another hemisphere, a war with which this country would have no direct concern. Therefore, it may have been argued, the Bank was right in obviating (by its advances on gold imports, etc.) the need for any further rise in Bank Rate, a rise which would have oppressed home trade. But the need for strengthening the Bank's gold reserve was increased by the activity of home trade (particularly shipbuilding) which was drawing gold into the country on an unusual scale.² Unless the Bank

¹ *Statist*, April 30th, 1898.

² *Economist*, April 23rd, 1898.

had entirely lost sight of the principles of 1844, it should not have been so tender in its Bank Rate policy. The same suggestion arises from the consideration of the large foreign loans then being issued in London. There are various possible explanations of the Bank's choice of weapons: (1) Bank Rate was anyway raised to 4 per cent., which might be considered as great a rise as home trade could stand, while the uncertainty of the situation would tend to check new foreign issues; or (2) the alternative to gold operations would be a very steep rise in Bank Rate, such as could not be considered; or (3) the Bank should do nothing to damp down prosperity at home while there was not a manifestly unhealthy speculative boom; or (4) the Bank wanted to gain time while it made up its mind about higher interest rates.¹ Broadly, either the Bank doubted the power of any extravagantly high rates of interest in London, or it wanted to avoid any upsetting of home trade, even should it be booming, or it wanted just to gain time. Which of these thoughts predominated in the minds of the Directors we have no means of knowing.

In the autumn of 1898 the Bank again charged 78s. 0½*d.* for bars, over a period of ten weeks or more, which covered a drain to America, the Fashoda incident and the development of strain in the Berlin money market. At the outset Bank Rate stood at 2½ per cent., but this was raised to 3 per cent. on the American drain. At the end of October, after the Fashoda incident and the raising of Bank

¹ These explanations are not, of course, mutually exclusive.

Rate to 4 per cent., the Bank paid a premium for bars.¹

The operations of 1899 hardly lend themselves to generalisation. At the New Year the gold reserve had touched its lowest point since the cheap money period. Bank Rate was maintained at 4 per cent. for the first four weeks of the year, but was quite ineffective. The Bank eventually followed Market Rate, the official rate going down by two stages to 3 per cent. The Bank in February, March and early April endeavoured to add to its reserve by offering a premium for bars.² But the gold reserve failed to keep up, and at the end of May was again below £30,000,000. For this state of affairs the Bank's own operations were largely responsible, for, while maintaining Bank Rate at 3 per cent., it had, by its exceptionally large releases of cash in exchange for bills and securities, allowed the Market Rate to remain well below that figure.³ In June it resorted to the expedients of giving free advances on gold imports and paying higher prices for bars and eagles, later raising its buying prices for French and Russian coin.⁴ At the same time the Bank, perhaps sensitive to criticism, suddenly adopted a vigorous policy of

¹ *Statist*, September 24th, October 29th and December 3rd, 1898.

² Ranging up to ½*d.* and possibly more. (*Statist*, February 4th to April 15th, 1899.)

³ The Bank was "increasing its purely banking business," probably with the idea of acquiring greater influence over the market eventually (*Statist*, June 3rd and 17th, 1899). This particular short period happened, however, to be an unfortunate one for the Bank's initiation of a new long-run policy.

⁴ *Statist*, June 24th and July 15th and 22nd, 1899

market control,¹ and by the end of the summer was in a strong position. In October, after raising rates sharply to check an efflux of gold, it felt strong enough to discourage gold imports which might strain New York by reducing its buying price for eagles.² But at the close of the year the position again became very strained. The recent stoppage of the South African supply by the Boer War³ undermined the Bank's capacity to meet any drain. Gold was going out in large amounts to South America, and at the end of November Bank Rate had been raised to 6 per cent., and the market was working close to the Bank. In December, the drain continuing, the Bank raised its prices for eagles and bars and made free advances to gold importers,⁴ clearly in an effort to spare the trade and business of the country the burden of a 7 per cent. rate. The movement was successful; gold came in in large quantities and discount rates were soon allowed to fall away, while the Bank's prices for bars and foreign coin were reduced at the end of January.⁵

In 1900 the situation was dominated by the Government's needs for the Boer War. The Government was continually issuing war loans and it was having to take gold for circulation in South Africa. Acute stringency in the Berlin money market was

¹ It sold securities, borrowed in the market, and charged unusually high rates for advances, etc

² *Statist*, October 21st, 1899. This was a fortnight after the sharp rise in Bank Rate.

³ *Economist*, October 7th, 1899

⁴ *Economist*, December 16th, 1899.

⁵ *Economist*, January 27th, 1900. Further reductions were made in February and March, and were at first criticised by the *Statist* (February 24th and March 31st, 1900).

also important for a short time.¹ In May the Bank, when its rate was 4 per cent., endeavoured to divert to London American gold that was going to Paris by advancing its buying price for eagles. At the end of July the position became much more difficult. The gold reserve was very low,² and Bank Rate was raised from 3 to 4 per cent. on July 19th. This prevented the situation from becoming worse, but at that season a strengthening of the reserve was clearly needed. Action of the Bank combined with the fears of the market to keep market rates close to Bank Rate, and even above. Further action was needed at a time when a raising of Bank Rate would clearly have been effective. But apparently the Bank was unwilling to take such a course on the eve of a fresh Government loan operation. At the end of July it was exhorted by the *Economist* "to attract gold by offering higher prices for foreign coin, and those other inducements to import the metal which it at times holds out." Within a fortnight the Bank was following that advice, raising its prices for foreign gold coin and offering free advances for six to nine days on condition that these should be repaid in gold. The gold tide turned, and later in the month gold was actually coming in in millions.³

By this time the use of these weapons by the Bank of England was sufficiently well established to be

¹ See *Economist*, June 23rd, 1900.

² At £31,500,000, a lower figure for July than had been touched since 1893.

³ For the entire phase see *Economist* and *Statist*, July 21st and 28th, August 4th, 11th and 18th, 1900.

regarded as a normal part of the Bank's armoury. For in the early nineteen-hundreds the *Statist* and the *Economist* were almost as ready to suggest that the Bank should advance its prices for gold as it was to suggest that the Bank should advance its official rate, and the alternative of manipulating gold prices was shown to have the advantage of leaving home trade unhurt.¹ In this the journals were apparently reflecting correctly the attitude of the London money market.² It was felt that the Bank was at times unduly hesitant about the employment of such weapons on account of the consequent reduction in its profits. Whether or not the opinion was justified, the Bank had not yet obtained that reputation, which it has certainly had ever since the Great War, of considering the public interest alone, to the entire exclusion of possible effects on its own profits.

When the general economic conditions of the first five years of the century are considered, it is hardly surprising that the Bank made much use of these weapons. For English trade in the years 1901-05 was most disappointing. Not until the second half of 1904 did the long expected revival occur. Meanwhile conditions abroad, particularly the endemic monetary disorders in the United States, prevented London from enjoying anything comparable to the cheap money period which had characterised the previous depression. There was much to be said

¹ See *Economist*, July 28th and August 4th, 1900, January 12th, 1901, February 21st, 1903, May 23rd, 1903, and February 25th, 1905, and *Statist*, February 28th, 1903, and especially its tone in the spring of 1900.

² See *Economist*, February 21st, 1903

for meeting the recurrent difficulties, originating from foreign centres, by action which would not disturb internal trade. The Bank did take such action on a considerable scale. Through the greater part of 1901 the Bank, still perhaps bearing in mind the Government's financial needs,¹ was paying a small premium for bar gold, and when a minor crisis occurred in the United States in the autumn the Bank raised its selling price for eagles to 76s. 9*d.* as soon as a gold movement was threatened.² In 1902 the Bank felt stronger, but even so it frequently bought bars at a fractional premium during the first half of the year.³ Throughout the spring of 1903 the Bank was endeavouring to avert a rise in its official discount rate by paying high prices for German gold coin and by bidding actively for the bars arriving in London. The price paid for the latter was generally 77s. 9½*d.* from February until the beginning of May. The danger of large foreign withdrawals being then passed and the scene set for the great Transvaal loan, the Bank relaxed its efforts, and for a few weeks paid prices ranging from 77s. 9¼*d.* to 77s. 9¾*d.*⁴ In October and December, 1903, in an effort to avert a 5 per cent. Bank Rate, the Bank paid 77s. 10*d.* and more—perhaps as much as 77s. 10½*d.*⁵ In the spring and summer of 1904 the Bank was wanting to build up a larger

¹ *Statist*, February 9th, 1901

² *Statist*, September 14th, 1901.

³ *Statist*, May 10th and June 14th, 1902.

⁴ See the *Statist* every week from February 28th to June 20th, 1903.

⁵ *Statist*, weekly from October 3rd to November 7th, and December 19th and 26th, 1903.

reserve, in view of the possibility of large foreign needs in the autumn and the uncertainty of the international political situation. In the circumstances of the moment, making higher rates effective would have been an expensive business, and in any case the Bank was probably unwilling to embark on a high rate policy while home trade was so slack. It therefore endeavoured—with some success—to snatch the gold arrivals from the market whenever there was a slackening in French bids. In March it made an effective bid, probably 77s. 9½*d.*,¹ and thenceforward it continued for some months willing to pay high prices—77s. 9¾*d.* being recorded in June and 77s. 9½*d.* in July.² In the autumn of 1904 there was, it appears, an extraordinary attempt by foreign interests to force dear money in London,³ the Bank was charging such a high price for foreign coin that sovereigns were being taken, though the Bank eventually preferred to part with foreign coin.⁴ In the autumn of 1905, when there was a large drain of gold to America, the Bank secured some of the market bars by paying prices ranging from 77s. 9¼*d.* to “over 77s. 10*d.*,”⁵ thereby averting a 5 per cent. Bank Rate.⁶

¹ *Statist*, March 5th, 1904.

² *Statist*, June 18th and July 23rd, 1904.

³ There was “a very general impression in well-informed quarters” that the withdrawals had been engineered in order to cause the failure of a Japanese loan issue in London (Japan and Russia then being at war) (*Statist*, November 12th, 1904.)

⁴ The Bank’s selling price for eagles stood at 76s. 9*d.*, but on its stock of sovereigns being much reduced, it reduced the price of eagles to 76s. 8*d.* (*Statist*, October 29th, 1904.)

⁵ The *Statist* recorded the premiums paid by the Bank every week from October 14th to December 9th (except October 28th).

⁶ Cf. *Statist*, November 25th, 1905.

In the extremely difficult years 1906 and 1907 it was widely felt that the London market and English trade were being upset simply by the extravagant speculative boom in America. The experience of the earlier nineteen-hundreds was being repeated in an aggravated form. The Bank was therefore anxious to minimise the disturbance.¹ Early in 1906 the Bank paid 77s. 9½*d.* for bars, and, it was supposed, gave "other facilities" to gold importers.² At the end of August, 1906, on a fall in the exchange on New York and a consequent expectation of a gold movement, the Bank raised its selling price for eagles to 76s. 8½*d.*, a "very high price."³ The following week eagles were taken at that price. The stock of eagles having been exhausted, the Bank raised its selling price for bars to 78s. 1*d.*⁴ Apparently throughout the autumn the Bank worked to a special schedule of prices for foreign coin.⁵ Throughout the first three-quarters of 1907 the Bank, in an endeavour to build up a strong reserve, again and again secured bars in the market by bidding prices ranging from 77s. 9¼*d.* to 77s. 10¼*d.* per ounce. The occasions included practically weekly bids during the summer, when Bank Rate was 4 per cent., and the situation was not immediately strained. When

¹ When in September Bank Rate was raised from 3½ to 4 per cent., the *Statist* thought the avoidance of 4½ per cent. had been "based upon the wish not to disturb trade." (September 15th, 1906. Cf., October 13th, 1906)

² *Statist*, February 3rd, 1906.

³ *Statist*, September 1st and 8th, 1906.

⁴ *Statist*, September 8th, and *Economist*, September 22nd, 1906.

⁵ *Economist*, January 26th, 1907

Bank Rate went to $4\frac{1}{2}$ per cent. in August the Bank raised its bids. Thenceforward until the crisis was almost overcome, in December, the Bank made no further efforts in the gold market, but raised Bank Rate to 7 per cent. Then, after it had satisfied the most urgent demands of America at the expense of allowing its gold stock to fall below £30,000,000, it secured some of the Cape bars one week by offering 77s. 10 $\frac{1}{8}$ d., and at the turn of the year it paid 77s. 9 $\frac{1}{2}$ d. and 77s. 9 $\frac{1}{8}$ d.¹

By April, 1908, the situation had been radically changed. The American crisis was over, and the Bank, with its official rate standing at 3 per cent., had a gold reserve of £40,000,000. Nevertheless, the Bank thought it necessary to secure gold against Continental competition by paying 77s. 9 $\frac{7}{8}$ d. for bars.² The Bank was probably stimulated to make this effort by the strained situation in Berlin, where the crisis was by no means over, while the Bank of France still held the power to draw about a million pounds in gold from London.³ In such circumstances an increase in the gold reserve appeared desirable, but with depression at home becoming every day more serious the Bank would naturally have been most unwilling to raise Bank Rate.

In 1910 came a curious repetition of the occasional circumstances of the early 'nineties. Owing to the

¹ *Statist*, January 4th and 11th, 1908. The following week it was able to secure bars at the statutory minimum.

² *Statist*, April 4th, 1908.

³ See Chapter V., p. 110

Budget controversy there was in March, 1910, the most unusual phenomenon of an empty Exchequer. At a time when the Bank could usually rely on revenue collection to make its rates effective, it found itself unable to maintain rates, even after some gold had gone out. How far its efforts to make Bank Rate effective were carried is not known. In the second week of March, as an alternative to raising discount rates, it resorted to the expedient of procuring gold by paying brokers' charges in excess of the statutory price.¹ It then raised Bank Rate, and the higher rate became effective. The effect on the foreign exchanges was disappointing, however, and the Bank competed actively in the gold market in the following weeks.² The Bank also attracted a large amount of gold from New York by offering a higher price for eagles.³ Probably the Bank preferred to avoid any drastic Bank Rate policy while the market was so liable to disturbance by the extraordinary state of the Exchequer. In the autumn of the same year, when the Bank was raising rates and had the market well under control, it again, for one week, paid brokers' charges in order to secure some of the Cape bars.⁴ Between that date and mid-1914 neither the *Economist* nor the *Statist* recorded any further operations of the kind.

¹ *Economist* and *Statist*, March 12th, 1910.

² The net price paid by the Bank rose to 77s. 9½d. (*Statist*, March 19th and 26th, 1910.)

³ *Statist*, April 9th, 1910. Reduction of the price for eagles to 76s. 5d. was recorded in the issue of April 30th, 1910.

⁴ October 8th, 1910.

IV

CONCLUSION

Once the Bank had adopted these measures as alternatives to the orthodox method of raising interest rates, it appears to have employed them, not on extraordinary occasions and with great hesitation, but with a readiness which suggests that the Bank had itself come to regard them as orthodox measures. This readiness on the part of the Bank may, however, be explained in another way. In the early years at least, when the Bank had difficulty in controlling the market, the Directors may well have been the more ready to use these gold devices because they were likely to have results more certainly and quickly than a somewhat problematical forcing up of interest rates. And even in the later years, when opinion expressed in this country was generally hostile to continual fluctuations in Bank Rate,¹ the Directors would be ready to use some weapon other than Bank Rate for dealing with a situation regarded as ephemeral.

Much of the interest of the Bank's use of these gold devices lies, indeed, in the light which it throws on the general position of the Bank and its ideas about policy. Used in the early 'nineties as a substitute for a Bank Rate policy which the Bank doubted its power to enforce, the gold devices naturally came to be regarded as a substitute for a

¹ Cf. pp. 125-126, below, and Palgrave, "Bank Rate and the Money Market," *passim*.

high Bank Rate, when, for one reason or another, that was considered undesirable. At the end of the 'nineties the burden on home trade of a 7 per cent. Bank Rate was avoided. In the Boer War Government war finance was facilitated by avoiding a rise in Bank Rate. Then again throughout the first decade of the century the Bank was ready to resort to devices which would not interfere with home trade. In these various ways we see how far the Bank had moved from the principles of 1844. The way in which the Bank gradually dropped the use of the gold devices has a similar indirect interest. So far as we know, the device of giving free advances to gold importers was not used after 1907. Although in the years of strain, 1906 and 1907, the Bank was frequently raising its prices for gold, when the climax of the strain came in November, 1907, the Bank relied almost exclusively on the Bank Rate method.¹ In the spring of 1908, when the crisis was scarcely over, the Bank once again, in quite exceptional circumstances, bid a high price for bars. After that, there were only the two occasions in 1910, one of which was a "throwback" to the practice of the early 'nineties and was in most unusual circumstances in the money market. In the difficult years which immediately preceded the outbreak of the war the Bank appears to have relied entirely on the Bank Rate method. The rapid fall into disuse of the gold devices after the crisis of 1907 was perhaps the result of the success of the Bank Rate method on that occasion. For

¹ The sole exception is mentioned above (p. 97).

long afterwards the experience of the Bank on that occasion was cited as an illustration of its power to control the situation by Bank Rate methods.¹ It is likely therefore that the Governors of the immediately pre-war years would tend to rely exclusively on that weapon which had acquired such a reputation, despite the frequent analogy of circumstances to those which had been held to justify other methods in earlier years. The confidence in the Bank Rate method which the Bank of England expressed to the United States Monetary Commission would have been unthinkable ten years earlier. Even four years earlier the tone would have been more doubtful.² Yet so striking was the success of its action at the end of 1907 that the Bank just before the war was exercising its power with a confidence which pushed the gold devices into the lumber-room as the doubtful expedients of a temporising adolescence.

¹ See, *e g.*, the works of Hartley Withers, the *Economist*, January 25th, 1908, and "U.S.A. National Monetary Commission," pp. 26-27

² *Cf.* *Economist*, November 17th, 1906

CHAPTER V

SUPPOSED CONTINENTAL SUPPORT OF THE BANK

DESPITE the lack of any support from English writers, it has been persistently stated, especially by Continental writers,¹ that the Bank of England was able to manage successive crises only with the gratuitous aid of the Bank of France. The subject was not reviewed by the National Monetary Commission in its English interviews. In the absence of any authoritative support for such statements, it is necessary to consider what basis there is in contemporary literature.

There has never been any doubt about the incident of the Baring crisis in 1890. The facts were thus reported in the *Economist*²: "Early in the week it was announced that arrangements had been made by which its stock of gold would be increased by £3,500,000. Of this amount £1,500,000 has been obtained by the sale to the Russian Government of Treasury Bonds held by the Bank, while through the good offices of Lord Rothschild, the

¹ *Vide, e.g.*, R. J. Lemoiné, "The Banking System of France" (in "Foreign Banking Systems"), Ansiaux, "Principes de la politique régulatrice des changes", M. Patron, "The Bank of France in its Relation to National and International Credit," and H. D. White, "French International Accounts."

² November 15th, 1890.

Bank of France has agreed to lend the Bank of England £2,000,000 of gold for a certain definite time. The transaction with the Bank of France is supposed to have taken this shape because that institution is debarred by its statutes from buying securities in the same way as the Russian Ministry of Finance has done ; but, be that as it may, the French institution has manifested an accommodating disposition in regard to the loan, which has been made on very reasonable terms." Later it became known that Treasury Bonds had been pledged with the Bank of France. The French loan was repaid in February, 1891,¹ and the Russian loan probably about the same time.²

The supposed incidents of 1906 and 1907, on the other hand, were not the subject of any official announcement. This very contrast with the 1890 incident should make us sceptical of these suggestions. The evidence must therefore be most carefully examined. There were three of these alleged incidents in the two years : May, 1906, the late autumn of 1906, and the late autumn of 1907. All three of these incidents are mentioned by Maurice Patron in his memorandum, "The Bank of France in its Relation to National and International Credit," prepared for the U.S.A. National Monetary Commission. All three were mentioned by H. D. White

¹ *Economist*, February 14th, 1891. According to Patron (*op. cit.*, p. 143) : "It seems that these 75 million francs not only returned to the Bank of France with seals unbroken, but that they did not even cross the Channel."

² Since Russia was drawing much gold from England in the spring of 1891.

in "The French International Accounts." He relies, it appears, on the previous Continental sources,¹ so that his statements cannot be regarded as corroborative.²

At the beginning of May, 1906, the monetary situation in the United States was straining London and causing great anxiety. The "excessive trading and speculation" in the States generally were checked by the great San Francisco earthquake and fire, which occasioned a bout of liquidation in New York. By borrowing largely on finance bills in London, America was in a position to draw the needed gold from London. London, with a gold stock which fell rapidly from £38,000,000 to £31,000,000, had none to spare; Paris, on the other hand, always in these years had an enormous stock. There was an obvious case for some extraordinary operation, but the evidence of such an operation is not conclusive.

Patron says³ quite definitely: "In the first days of May, 1906, it [*v.e.*, the Bank of France] loaned 40 million francs to the Bank of England in order that the latter might avoid raising the discount rate." White repeats the statement.⁴ In the *Economist* and the *Statist* there was no mention of it in the ordinary way, although it was noted that the Bank of France was releasing gold more freely than usual.⁵ It is particularly noteworthy that,

¹ Among them Ansiaux, which I have been unable to consult.

² The vague reference in Lemoine, *op. cit.*, p. 56, must be similarly dismissed.

³ *Op. cit.*, p. 145.

⁴ *Op. cit.*, p. 194.

⁵ May 12th, 1906.

though the *Statist* devoted a leading article to "The Lesson of the Gold Scare," no mention was made of any extraordinary transaction. But in the Berlin letter appearing in the *Economist* of May 19th there was incidental mention of "the assistance extended to the London money market by Paris." Whether the writer of the money market paragraphs ever noticed this we cannot tell; if he did so, he did not even trouble to discount or confirm it. And, after all, the statement is quite vague. Paris could "assist" London by releasing gold in response to demand in the ordinary way. There is no trace in the Bank of France returns of any special transaction. Mr Hartley Withers does not mention any such transaction, even when he is discussing the alleged incident of the autumn of 1907.

About the events of the autumn of 1906 the facts are very much clearer. There had been rumours all the autumn about the Bank of France helping the Bank of England to cope with the American demand for gold. In mid-September the *Economist*¹ reported: "There has been some talk during the week of the Bank of England obtaining some millions of gold from the Bank of France in order to meet the demand upon it, but it is not for a moment to be supposed that the Bank would really put itself in so humiliating a position merely in order to permit American speculators getting gold here on easy terms. It is understood, however, that the Bank of France is willing to part with a million or so of its stock of the metal at a premium."

¹ September 15th, 1906.

After that the Bank of France kept a very tight hand on its gold until far into November. On November 24th the *Economist* reported that the Bank of France had released £900,000 in U.S.A. gold coin for the Bank of England. This release was supposed to have been actuated partly "by a desire to ward off an advance in the discount rate of the Bank of England, *which would probably compel it to raise its own rate.*"¹

↓ The culminating incident in December, 1906, is that which has received much publicity on the Continent. According to Patron,² "The Bank of France did not hesitate to furnish it [the Bank of England] with 75 million francs in gold by discounting English commercial paper. It also brought indirect aid by releasing £200,000 for shipment to Egypt." White, apparently relying on Ansiaux, makes a similar statement.³ The *Economist's* version ran thus⁴: "The Bank of France has indirectly come to the relief of this market by agreeing to discount English bills. The story in Paris is that this discounting has been on the behalf of the Bank of England, but so far as we have been able to ascertain that is not the case, and it is ordinary three months' paper that has been dealt with. We believe, too, that the Bank of France has let it be known that if a fresh American demand for gold should be experienced here it will be ready to part with more gold, as it is anxious to

¹ My italics.

² *Op. cit.*, p. 143.

³ *Op. cit.*, pp. 194-195.

⁴ December 15th, 1906.

avoid the disturbing effect in Paris of a 7 per cent. rate in London.”¹ The *Statist's* account was almost identical.² The Paris letter in the same issue noted the inclusion in the Bank of France return of an entry of 22,682,279 francs (£907,291) which represented the English bills discounted. The fact that such an item now appeared and had not appeared in May suggests that the alleged May incident was at least different in kind from that of December.

The entry of “Foreign Bills” in the Bank of France return increased in subsequent weeks as more gold was released for London. The magnitude and timing of the entire transaction is shown in the following series of entries “Foreign Bills discounted,” extracted from the Bank of France returns shown in the *Economist* of the dates indicated.³

	Francs.
December 8th, 1906 . . .	nil.
December 15th, 1906 . . .	22,682,279
January 5th, 1907 . . .	58,720,336
February 2nd, 1907 . . .	58,874,331
March 16th, 1907 . . .	63,485,614
March 23rd, 1907 . . .	65,557,988
April 6th, 1907 . . .	65,603,731
April 13th, 1907 . . .	65,647,870

¹ The Governor of the Bank of France, in his speech to the annual meeting, referred to the discounting of English bills as an effort to avert monetary tension which might have forced a rise in bank rates. (*Economist*, February 9th, 1907.)

² The *Statist* referred to the action of the Bank of France in its issue of December 22nd, 1906, but its fullest comment on the operation is to be found in its issue of July 6th, 1907.

³ Fractions of a franc have been excluded.

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	Francs.
April 20th, 1907. . . .	60,597,500
April 27th, 1907. . . .	53,155,509
May 18th, 1907	45,730,214
May 25th, 1907	33,974,598
June 1st, 1907	22,776,496
June 8th, 1907	11,276,157
June 15th, 1907. . . .	9,455,633
July 6th, 1907	nil.

The bills originally discounted mostly fell due in February and March, 1907, but they were renewed as they fell due ¹ and apparently supplemented by new bills. The maximum outstanding was reached in April, at 65,647,870 francs (about £2,600,000).

In the autumn of 1907, when the pressure from New York again became acute, there was a similar transaction. According to Patron,² "In answer to a mere telegram it [the Bank of France] forwarded to London 80 million francs in gold eagles of the United States."³ The passage implies that the "mere telegram" came from the Bank of England. The *Economist* files show very little to support this statement. The most categorical statement again appeared in the weekly Berlin letter,⁴ where it was said quite definitely that "the Bank of France has agreed to advance to the English institution £3,000,000 of gold." The Paris letter of the following week spoke definitely of a consignment of gold "on account of the loan of £3,000,000 to the Bank of

¹ *Economist*, February 2nd, 1907.

² *Op. cit.*, p. 144

³ *Cf. White, op. cit.*, p. 195.

⁴ In the issue of November 9th, 1907.

England.”¹ Yet the money market paragraphs contained no such explicit reference. On November 16th it was recorded that there was an improvement in the reserve, for which “Paris is mainly responsible.” The *Statist*, in referring to the operation, was most definite: “It is clearly to be understood that the Bank of France has acted without communication with the Bank of England.”²

The most authoritative evidence is to be found in a statement made by the Governor of the Bank of France at the annual meeting early in February, 1908.³ After referring vaguely to the discounting of bills for England at the end of 1906, he stated that in 1907 “the Bank of France decided on placing immediately at the disposal of the Bank of England resources still more important than in the preceding year . . . we placed at the disposal of the London market a sum of 80 million francs (£3,200,000) in American gold coin.” It will be noted that two phrases have been used here, apparently interchangeably: (1) “at the disposal of the Bank of England”; and (2) “at the disposal of the London market.” This can hardly be taken as conclusive evidence that the transaction was directly and exclusively with the Bank of England, but it perhaps encourages the Continental notion that the Bank of England had some say in the matter, either in suggesting or facilitating it.

Little is to be gleaned from the Bank of France

¹ Cf. also the Paris letter in the *Economist* of November 23rd, 1907.

² September 28th, 1907

³ *Vide Economist*, February 8th, 1908.

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returns. The following amounts of "foreign bills discounted" were shown in the returns reproduced in the *Economists* of the dates given.¹

	Francs.
November 2nd, 1907 . . .	nil.
November 9th, 1907 . . .	19,159,986
November 16th, 1907 . . .	81,629,713
November 23rd, 1907 . . .	81,808,775
November 30th, 1907 . . .	81,808,775
January 4th, 1908 . . .	81,821,065
January 18th, 1908 . . .	76,142,455
January 25th, 1908 . . .	75,036,278
February 1st, 1908 . . .	60,472,012
February 8th, 1908 . . .	36,289,468
February 15th, 1908 . . .	40,355,573
February 29th, 1908 . . .	41,794,685
March 21st, 1908 . . .	38,362,716
March 28th, 1908 . . .	35,298,109
April 4th, 1908 . . .	25,084,774
April 11th, 1908. . . .	17,987,905
April 25th, 1908. . . .	10,010,566
May 2nd, 1908	5,421,709
May 9th, 1908	nil.

The amount quickly rose above 81 millions in mid-November, 1907, was practically halved between mid-January and mid-February, 1908, then fell steadily after the middle of March, 1908, the transaction being closed at the beginning of May. But there is one feature of the figures, as of those of the earlier transaction,² which is significant: the continual changes, some small, some great, in the figures. If the transaction had been a direct one

¹ Fractions of a franc have been excluded.

² P. 107, above.

with the Bank of England the amounts might have risen to the maximum quickly, as they did, but such an irregular decline would be most unlikely. The *temporary* rise in February, 1908, is particularly significant. For the Bank of England was at that time in a strong position and subject to no extraordinary demands.¹ It certainly looks as though the Bank of England had very little to do with the detailed carrying-through of the transaction.²

Let us now see what is said about this transaction by Mr. Hartley Withers, who was at that time City Editor of *The Times*. His version appears on p. 221 of "The Meaning of Money": "The determination which it [the Bank of England] showed finally compelled the Bank of France to take some share in the international burden and to send three millions of its gold, not to America but to London, whence it knew that it could rely on getting it back. It has been commonly stated that the Bank of England asked it to carry out this operation, but this is quite untrue. The whole arrangement was made outside

¹ The Danish crisis had only very limited effects on London.

² This view is supported by the following extracts from the *Economist* :—

(a) The rise of the Bank of France "foreign bills discounted" could, it was said (February 15th, 1908), "only be explained by the supposition that while, as is reported, a not inconsiderable part of the foreign bills held by the Bank [of France] ran off and were paid in English gold, a still greater sum of new foreign paper was taken in."

(b) (February 22nd, 1908) "An unexpected relief has been afforded by the hardening process earlier in the month [due primarily to revenue collections], for it has enabled the Bank of France to renew the remainder of its bills profitably until after the end of the quarter, so that the £1,500,000 or thereabouts of gold in which the London market is still indebted to Paris will not be withdrawn at present."

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the Bank of England, which approved of but by no means asked for it. The Bank of France made an excellent and profitable investment in sterling bills, and helped to mitigate a storm which threatened the French monetary community with unpleasant consequences. And at the same time it was enabled to pose very gracefully as fairy godmother to the world at large, and superficial observers cried out that there must be something in its management that enabled it to play this pretty part." This version is entirely consistent with the Bank of France's returns, which form the only precise official evidence of the transaction. Only the vague statements of Continental writers can be considered as in any way inconsistent with it. These Continental statements may be based on no more than the vague claim of the Governor of the Bank of France that the latter had "placed at the disposal of the Bank of England" the 80 million francs of gold. That statement may have been so worded in order to magnify the apparent graciousness of the Bank of France's action.

Lastly, let us consider the Bank of England's own attitude, so far as we know anything about it. In 1890, when the Bank of England did borrow directly from the Bank of France, there was no secrecy about it. But in 1906-08 there was no announcement of any kind. Nor was there any reference to any such borrowing in the interview with the National Monetary Commission in 1910. Indeed, before that Commission great stress was laid on the efficiency of Bank Rate in the crisis of 1907. This does not

look much as though the Bank of England had to seek help—or even accept direct help—from the Bank of France.

In the light of all this evidence, and in the absence of any authoritarian statement, we can endeavour to reconstruct the alleged incidents. For that of May, 1906, there is least support. It seems probable that the Bank of France for the moment relaxed its customary tight hand and allowed gold to flow out to meet demands elsewhere. The incidents of the autumns of 1906 and 1907, however, were more important. The Bank of France could, to a limited extent, ignore rises in the Bank of England's discount rate and market rates generally in London. But this power, based on the gold premium system, was limited.¹ It could not therefore view with equanimity continual rises, to extreme heights, in the London Bank Rate. When London went to 6 per cent. in the autumn of 1906 and to 7 per cent. in the autumn of 1907 the Paris authorities evidently thought that that was as much as their system (which included an almost stationary Bank Rate²) could stand. Any further rise would disturb the Paris money market. Therefore, the French authorities apparently argued, let us step in to

¹ The *Statist* was at times inclined to stress the Bank of England's dependence on the favour of the Bank of France (see, *e.g.*, July 28th, 1906); but when it came to refer explicitly to the facts it had to admit that the power of London to make Paris uncomfortable was in fact the stimulus to French action (see, *e.g.*, September 8th and November 24th, 1906).

² The Paris rate did occasionally go to $3\frac{1}{2}$ or 4 per cent., but the avowed aim was to keep it as long as possible at 3 per cent. It was in fact maintained at 3 per cent. from 1900 until 1907 without a break. In the autumn of 1907 it stood at 4 per cent.

make a further rise in London unnecessary. The Bank of France declared (perhaps actually to the Bank of England¹) that it was willing to take English bills under certain conditions. In this way it made gold available for London, exchanging gold in its own vaults for absolutely safe claims, at very short date, on gold in London. The Bank of France saved itself from having to raise rates in Paris, it made a profit on the transaction, and it could be masqueraded as the saviour of the monetary systems of the world.

If this hypothetical account of the incidents is broadly true, it means that the Bank of England could, if it wished, induce the Bank of France to disgorge gold. So long as the premium which the Bank of France was willing to charge for gold remained small, so that France was effectively on the gold standard, the Bank of England could oblige the Bank of France to choose between releasing gold and raising interest rates.² As the French system was working in 1906-07, a gap of 3 per cent. between the official rates of London and Paris was about as wide as Paris could bear. That Paris decided to give in before London exercised all the necessary power means that the Bank of France, like the Bank of England, recognised a duty to minimise the international effects of the

¹ Which might then have informed the leading London houses.

² The Bank of France could, of course, refuse absolutely to release gold—and it frequently did refuse. But the Paris financial houses could always, at a price, collect gold coin from circulation, and this possibility and its implications had to be faced by the Bank of France.

American crisis, but it does not justify the picture of a decrepit Bank of England propped up by a fairy godmother, the Bank of France. Rather the incident justifies the confidence in the Bank Rate weapon which the Bank of England showed in the interview with the National Monetary Commission.

CHAPTER VI

THE AIMS OF BANK POLICY

IN examining the various weapons in the Bank's armoury we have had occasion here and there to make some reference to the Bank's objects in using particular methods. In this chapter we shall make a more systematic survey of those objects. In this part of our study we are necessarily upon much more uncertain ground than in the preceding chapters, for while an analysis of the methods used by the Bank can be in a large part a survey of its recorded actions, we can only conjecture what objects were in the minds of the Bank's governors. But there are some grounds on which we can base our conjectures; there are the recorded results of the Bank's actions and inactions. There are also occasional references in the *Economist* and the *Statist* which we may presume to have been based on contemporary informed gossip, or at least to have reflected correctly the opinions which were currently entertained in high quarters in the City.

I

Of the Bank's main motives there can be no doubt whatever. First and foremost the Bank considered

itself obliged to provide for the convertibility of the pound into gold by taking appropriate action to maintain the gold reserve. Any large or persistent drain of gold was bound sooner or later to lead to drastic action by the Bank. In this object of maintaining the convertibility of sterling the Bank succeeded. Yet its actions were by no means automatic. How far it ignored the principles of 1844 can only be realised by watching the great irregularities, year after year, in the movements of the Proportion, the Gold Stock and the Securities held in the Banking Department. There were every year the regular seasonal increases in Securities at the end of the year and the half-year. The gold stock always went to a very low point at Christmas (the internal circulation being maximised then) without the Bank concerning itself at all. But, apart from these regular movements, there were many others of which the Bank obviously took no account, even if it did not "offset" them. There are even indications that it sometimes did adopt "offsetting" action.

In departing in these ways from the purely automatic system, the Bank was not, on the whole, departing from its main principle of concentrating on the external situation. It is true that it rarely raised its official rate unless gold was flowing out, but the magnitude of flow necessary to make the Bank act varied very much according to the particular circumstances of London and the foreign centres at the time. Similarly, an influx of gold would usually lead to a relaxation of rates by the

Bank—but not always. Before it acted the Bank took into account numerous circumstances which were obviously relevant. Some of these circumstances would be known to well-informed people in the market as well as to the Bank. Such would be the prospects of the American monetary position—the activity of speculation in the States, the action or prospective action of the Secretary of the American Treasury, and so forth. The attitude of the Bank of France, whether it was or was not willing to release gold for export, was also relevant. There were large funds under the control of foreign governments which might be shifted from one centre to another, or taken home in gold. The large balances of the Russian Government, said at one time to amount to £20,000,000,¹ were liable to be moved from one centre to another without any apparent reason.² More immediately under the Bank's own eye were the balances of the governments (particularly that of Japan) which banked with it. Her two wars and the indemnities which followed them, besides the government's borrowing in London, caused Japan's balance in London to run to eight figures at times,³ at other times being much smaller. By the end of the period the practice of holding sterling bills by foreign central banks

¹ *Economist*, May 9th, 1891.

² "The market has learned by experience that the balances of the Russian Government are moved about in a perplexingly capricious way, and are liable to be withdrawn at inopportune times." (*Economist*, November 17th, 1894 Cf. June 28th, 1890, and April 18th, 1891.)

³ *Economist*, September 18th, 1897, and February 10th, 1906. Cf. *Statist*, February 10th, 1906, for a more detailed discussion.

was widespread,¹ even the Bank of France holding important and very variable amounts of sterling bills from 1909 onwards.²

A few examples of particular incidents may serve to show to what extent the Bank was exercising its discretion in working on an external situation which was complicated by these factors. In July, 1890, the Argentine crisis was just beginning to look serious. The Bank had raised its official rate to 4 per cent. at the end of June and made that rate fully effective, so stopping the efflux of gold. With that the Bank was not satisfied. The South American situation looked very threatening, and the Bank's gold stock, at just over £20,000,000, did not look sufficient to stand a crisis. The Bank therefore raised the official rate to 5 per cent., compelling the market to follow it most of the way. At a time when gold was actually flowing in in appreciable quantities the rise to 5 per cent. took the market by surprise, but it was approved by the *Economist* as a "wise measure of precaution."³

In April, 1891, the Bank had managed to stave off a demand for gold (mainly for Portugal, which then drew on Paris) by raising its rate to 3½ per cent., and making that rate effective by borrowing in the market. At the beginning of May, however, it raised its rate to 4 per cent., owing to the fear of Russian balances being withdrawn. The 4 per cent.

¹ See the interview of the National Monetary Commission with Lord Swaythling, *passim*.

² On these operations of the Bank of France see particularly *Economist*, November 20th, 1909.

³ August 2nd, 1890.

rate began to attract gold, yet the following week the rate was raised to 5 per cent. This step was apparently taken owing to the very uncertain situation in most European centres, and the necessity of extreme caution about the movement of Russian balances.¹ The Bank proceeded to reinforce the effect of higher interest rates by offering an advanced price for gold,² and the gold stock was raised by more than £7,000,000. Bank Rate was reduced to 4 per cent. early in June, then to 3 and 2½ per cent., despite the realisation of some of the Russian gold withdrawals which had been threatened earlier. The acquiescence of the market in the Bank's judgment of such situations is seen in a remark by the *Economist* later in the same year, when the Bank watched gold go out for weeks before it took any action: "The directors of the Bank of England appear to regard the continued efflux of gold with equanimity, and they have such special sources of information as to the probable movements of bullion that outsiders are naturally disposed to acquiesce in their judgment."³

The Bank's action when the cheap money period ended in the autumn of 1896 was by no means the result of rule-of-thumb methods. Its gold stock had increased in 1894-96 almost to £50,000,000, roughly double what it had been in the early 'nineties. In 1894 when an autumnal drain to America had helped to bring down the gold stock from near

¹ *Economist*, May 16th, 1891.

² Cf. p. 118, above.

³ October 24th, 1891.

£40,000,000 to about £32,000,000, the Bank had not thought it necessary to act. In August, 1896, the gold stock was over £47,000,000. Gold then began to be taken, in small amounts, for New York. In the last week of August a million went out and in the first weeks of September two millions. This was not sufficient to create any stringency in London,¹ and it left the Bank's "Reserve" £10,000,000 higher than it had been when Bank Rate went down to 2 per cent. Yet the Bank raised its rate from 2 to 2½ per cent., causing much surprise and some criticism. The *Economist* thought that something was to be said for giving the market "an early note of warning by the unusual means of a rise from 2 to 2½ per cent." instead of waiting a few weeks, then raising the rate from 2 to 3 per cent.² Gold continued to go out, and the Bank raised its rate as quickly as it felt able to lead the market upwards.³ The Bank's foresight was abundantly justified by the course of events during the remainder of the year.

In the autumn of 1898 the Bank again anticipated events rather than waiting for action to be forced upon it. Near the end of September £1,000,000 in gold went out to America, and the Bank, after taking

¹ The impact effect on the London market was a trifling rise in discount rates, from below to above 1 per cent. The rise was no more rapid because that slight advance "increased the supply of credit by 'tapping' stores which could not be touched at a lower rate than 1 per cent" (*Economist*, September 5th, 1896.) On the elasticity of market supplies, *cf.* pp. 44-47, above.

² *Economist*, September 12th, 1896.

³ September 26th and October 24th, 1896. The Bank also resorted to other expedients for protecting its reserve (*cf.* pp. 86-87, above).

money off the market, raised its rate from $2\frac{1}{2}$ to 3 per cent. Under ordinary circumstances that would have been considered sufficient, for in the next three weeks less than £600,000 in all went out, a small amount for the season. Nevertheless, at the end of those three weeks the Fashoda incident and the threatening appearance of German financial conditions induced the Bank, to the surprise of the market, to raise Bank Rate to 4 per cent., forcing the market to follow it.¹ That rate was maintained for the remainder of the year, despite the strength of the Bank's position.

Its action when the South African War was imminent exemplifies the Bank's forethought. Seasonal requirements were reducing the Bank's reserves, it is true, but the Bank return was not, for the season, by any means unsatisfactory. But the Bank took the unusual step of raising Bank Rate on a Tuesday from $3\frac{1}{2}$ to $4\frac{1}{2}$ per cent., then on the Thursday to 5 per cent. These changes were justified by the *Economist* in the following terms²: "In ordinary circumstances there would have been nothing in the position of the Bank to call for further measures of precaution. . . . [But if war] breaks out, it will entail further withdrawals of gold from the Bank, while already the supplies of gold from South Africa have been stopped, and there will therefore be much greater difficulty in replenishing the Bank's stock of the metal if it be further depleted. As a measure of prudence, therefore, and in order

¹ *Economist*, October 15th, 1896.

² October 7th, 1899.

that the Bank may be in a position to meet the wants of the Government, it is desirable to seek to attract gold hither from abroad, and it is mainly with that object in view that the advance to 5 per cent. has been made, although of course the stringency of the New York and Berlin markets constitutes an additional reason for the step." ¹

There was considerable argument about the propriety of the reduction of Bank Rate from 4 to 3 per cent. (in two stages) in June, 1900. The Bank's position was superficially strong and gold was coming in in small amounts. Against this it was urged that there were still difficulties in German financial circles,² the prospects of big withdrawals of French money ("bad money") which was being held in London, and the probability of a gold flow to the United States in the autumn. But the Bank decided to take the risk, the deciding factor apparently being that the Bank of France was paying out gold freely and was expected to continue to do so, having more gold than it wished to hold.³

At the beginning of 1904 Bank Rate stood at 4 per cent., a high rate for a time when trade at home and abroad was depressed. The position of the Bank was, for the season, so strong that in ordinary

¹ The advance of Bank Rate from 3 to 4 per cent. in July, 1900, was a similar precautionary measure. (*Economist*, July 21st, 1900.)

² The Leipziger Bank failed at the end of June

³ *Economist*, June 8th and 15th, 1901. The statutory maximum of the French note issue made the Bank of France unwilling to add indefinitely to its gold, at least in a short period. Paris did, that autumn, do much to meet the American demand, though London's Bank Rate was raised to 4 per cent. as "a prudent measure of precaution." (*Economist*, November 2nd, 1901.)

circumstances a reduction in Bank Rate would have been certain. But the rate was maintained in case war should break out between Russia and Japan, as it did at the beginning of February. The first effect of the war was to turn the Continental exchanges in our favour, largely because the Russian and Japanese Governments transferred balances to London in prevision for payments for coal and stores, but the caution of the Bank was justified when the war very quickly began to have reactions in Paris, which was largely responsible for supporting Russia's finances, and which had then been holding large balances in London.¹

Early in 1906 the Bank's action was much criticised in the market. It had lost some gold to abroad in the first weeks of the year, but the tide soon turned. Then, despite the apparently strong position of the Bank, it refused to reduce Bank Rate and drained the market of funds² in order to keep rates up as the gold came in. The *Economist* saw justification for this in the reaction which Russian internal difficulties were bound to exert on certain Continental centres, and in the uncertainties of the Algenciras Conference. In addition, the Bank had to consider the fact that Japan's London balances amounted to between £20,000,000 and £25,000,000 and the annual drains, to Egypt

¹ *Economist*, January 30th, February 13th and 20th, 1904. French balances in London were estimated at as much as £40,000,000. (*Economist*, May 21st, 1904.)

² The reduction in the Bank's securities understated the magnitude of the Bank's borrowing, as some was reborrowed by the market (but *at the Bank's price*). For the method used, see pp. 36-37, above

and South America in particular, were showing a tendency to increase with the rising boom.¹

In the other years of the period there were several other instances of the same kind as these. Some cases (such as the precipitant drops in Bank Rate at the beginning of 1910) are not easy to explain. The Bank possibly acted on its "special knowledge." Others are adequately explained by the rises or falls in Continental bank rates—the Bank of England taking parallel action, not waiting for gold movements to begin. And throughout the years down to 1914 the Bank had to take account of the perpetual major and minor international political crises.

II

While, however, the Bank's primary aim was to protect the gold reserve, it showed an occasional tendency to avoid action which would be detrimental to the activity of home trade. In the early days of this century there was a disposition, among chambers of commerce and such bodies, to make invidious comparisons between the Bank of England and the Bank of France.² The latter institution, they said (quite correctly), rarely changed its Bank Rate. French Bank Rate remained for years at 3 or 4 per cent. On the other hand, the Bank of England's rate was sensitive to every breeze from across the

¹ *Economist*, February 10th, 1906. The Bank acted in a somewhat similar way early in 1905. (*Economist*, February 25th, 1905.)

² See, e.g., the Report of the Banking and Currency Committee of the Chambers of Commerce, published early in 1909.

Atlantic, and every major bankruptcy in Berlin or Hamburg. 'Up and down it raced, from 2 per cent. to 6,¹ and back again. The English traders felt themselves quite unnecessarily disturbed when they found their bank overdraft charges rising for such obscure reasons. As is well known,² the Bank of France was able to avoid these great fluctuations in its discount rate by employing various devices which made its gold reserve insensitive to the needs of the outside world. Because it was the only free gold market in the world, the entire brunt of any disturbance was liable to fall on the Bank of England.

Already before 1900 the Bank of England was doing something to meet this criticism. Within narrower limits it was imitating the methods of the Bank of France and other authorities in order to lessen the sensitiveness of the gold reserve to differences in interest rates in the different centres. These methods have been discussed in Chapter IV. The Bank was also, as we have seen in Chapter III., able to protect the home situation to some extent by forcing market rate up beyond its usual relationship with Bank Rate. The outstanding cases of the Bank demonstrating such an attitude have been mentioned in those chapters. Here it suffices to say that the Bank's concern had most marked effects on its operations in the extremely difficult years 1906 and 1907, but its readiness to reduce

¹ In 1907 alone did it go to 7 per cent.

² *Vide* Keynes, "Treatise on Money," Vol. II., pp. 320-321, and Withers, *op. cit.*, pp. 219-222.

Bank Rate to stimulate home trade was the subject of remark on other occasions outside those years.¹

That this tenderness for home trade was subordinate to the primary object of protecting the gold reserve is undoubtedly true. But it made Bank Rate history in those years very different from what it would have been had the Bank pursued with single-mindedness its primary aim. In the absence of such tenderness for home trade, the account which this book gives of the Bank's operations would have been much shorter and simpler. And had the Bank followed the strict principles of 1844, waiting for gold to go out or come in before it acted, this study would hardly have amounted to a book at all—or it would have been concerned to show, not how the system worked, but why it failed.

¹ *E.g.*, *Statist*, March 15th, 1890, and *Economist*, May 23rd, 1903.

CHAPTER VII

CONCLUSION

I

FROM the mass of detail which has been the subject of the last five chapters certain conclusions emerge. First, the Bank had, in an extremely hesitating and not very consistent manner, solved its problem of controlling Market Rate by adopting a number of devices for reducing the supply of money in the market (Chapter II.), and by curtailing from time to time the loan and rediscount facilities which it allowed to the market (Chapter III.). This problem solved, it could make any Bank Rate "effective" in the pursuit of its primary aim of protecting the gold reserve. In the pursuit of this aim the Bank did not necessarily wait until action was forced upon it; it was willing to "precautionary" action upon occasion (Chapter VI.). If it chose to take money off the market to a sufficient extent (which implied bearing interest costs) it could make any rate effective in the market. By making a sufficiently high rate effective it could draw in gold in sufficient quantities even in times of acute crises. The efficacy of high rates of interest was not dependent on the good graces of any foreign institution—the incidents of 1906 and 1907 were

tributes to the power of a Bank of England threat rather than a testimony to the graciousness of the Bank of France (Chapter V.).

Yet the solution of this problem was piecemeal rather than systematic, and in many ways it was unsatisfactory. The diversity of methods employed by the Bank alone suggests that it was not very happy about any of them. The margin of market funds was sometimes so large that the Bank found difficulty in making arrangements for a sufficiently large amount to be absorbed. Further, there was always the question of cost, which some governors seemed loath to incur.¹ The support which the market gave to such measures was sometimes very disappointing.² There was the hampering tradition, from which the Bank hardly ever broke, that while it was permissible for it to take measures to make Bank Rate effective when gold was going out, such measures should be avoided at other times.³ The resort which the Bank had to entirely different methods for attracting gold in 1910,⁴ when the Bank had been staring the problem of rate control in the face for twenty years and more, gives some indication of the imperfection of the pre-war solution. When compared with the perfection of the post-war system of market control by the Bank, the imperfection of the pre-war system must be described as one of the outstanding failures of the pre-war Bank of England.

¹ Cf. *Economist*, October 31st, 1891, January 12th, 1901, and February 21st, 1903.

² Cf. p. 46, above.

³ Cf. p. 47, above.

⁴ Cf. p. 97, above.

As an alternative or supplement to the policy of conserving the gold reserve by regulating an effective Bank Rate, the Bank employed methods which operated directly on the gold market (Chapter IV.). Use of these methods was sometimes a confession of lack of faith in the Bank's ability to make a high Bank Rate effective. At other times they were employed in an attempt to protect the internal economic situation from the consequences of an external drain. Although the Bank did not in pre-war days do as much "offsetting" of gold movements as it has done in post-war days, it did far more, apart from regulating interest rates, to hinder gold movements than it has ever been able to do in the post-war gold standard period.

The Bank employed other devices sometimes to support "Bank Rate policy" and sometimes as an alternative to it (Chapter III.). The use of these devices as an alternative to "Bank Rate policy" was based on the fact that, while Bank Rate regulated interest rates at home, the rate which influenced the foreign exchanges was Market Rate. If, therefore, the Bank wished to insulate the home from the external situation, it could do something towards it by forcing Market Rate up beyond its normal relationship with Bank Rate. And at times during this period the Bank *did* apparently seek to avert from home traders the extreme consequences of our adherence to an international standard.

There is, however, a *prima facie* weakness in the argument that, by influencing Market Rate independently of Bank Rate, the Bank could insulate

the internal situation. For, except in extreme cases, forcing up Market Rate necessitated, as a preliminary at least, a reduction of the Bank's assets—*i.e.*, "open market operations."¹ This reduction in the cash basis would naturally induce the commercial banks to reduce their liabilities. Hence, it may be argued, the banks would tend to cut down advances to traders. No advance in charges (which would remain steady with Bank Rate) would be necessary in order to force such a contraction of credit. The banks would merely be more discriminating, so increasing the "unsatisfied fringe" of borrowers.² The open market operations of the Bank of England would thus be forcing credit contraction at home, quite independently of Bank Rate. But, while it is true that this would be a long-run result, it seems unlikely that the commercial banks would be so quick to reduce their most profitable assets. Rather the banks would, on finding their cash reduced, redress their balance sheets by calling in loans to the money market. Indeed, the Bank's power to work on Market Rate quickly was based on the assumption that the banks would act in the latter way. The commercial bank's regulation of the amount of advances to traders would not, one would suppose, be subjected to such rapid changes as would reflect every passing

¹ This was true of any gold drain of ordinary magnitude, except in the "tax-collecting season." Had it been allowed to persist, a gold drain would eventually, of course, have exhausted the market's margin. But the Bank generally preferred to act earlier

² Cf. Keynes, "Treatise on Money," Vol. II., pp 364-367

change in money market conditions. In extreme instances, of course, it is possible that the Bank of England's open market operations would result in some reduction in the willingness of commercial banks to allow ordinary overdraft facilities. It is noteworthy that the one occasion in twenty-five years when such an effect was remarked in the *Economist* was at a time when the Bank of England had reduced the cash basis by a most unusually large amount.¹ The *Economist* was generally in the habit of reiterating comment on any apparent defect in the system. The fact that in this instance remark was only made on one occasion, and that an extreme case, supports the view that the Bank could to some extent insulate the internal situation by adopting methods other than that of changing the official Bank Rate.

II

One other matter which has not yet received any attention in this study must be mentioned in this general conclusion. The autumnal drain of gold from the Bank of England was fully analysed by

¹ The occasion referred to was in the autumn of 1909. The market had been little inclined to support the efforts of the Bank to maintain a high rate. The Bank therefore acted on a drastic scale, reducing its securities by about £6,000,000 in six weeks. The Bank's usual scale of operations was two millions or so. The *Economist* remarked on the energy with which the **Bank** was carrying out its policy, and added. "We cannot, however, resist the thought that a device which involves a great artificial restriction of credit in order that the market may follow the Bank is not a satisfactory arrangement either for trade or for finance" (November 20th, 1909) I have no direct evidence that the commercial banks were restricting advances to traders.

Inglis Palgrave, in the succession of studies which received their final embodiment in his "Bank Rate and the Money Market."¹ There is no need to repeat here what has been said in that book. The conclusion is clear enough: the Bank of England was subjected to an internal drain (especially to Scotland) and to an external drain every autumn for purely seasonal reasons. This autumnal drain was in large part responsible for the fact that Bank Rate was, on the average, higher in the autumn and winter months than in the summer. On this phenomenon among others Palgrave based his criticism of the Act of 1844. Yet it is clear that these seasonal drains were not allowed to affect the Bank's operations as non-seasonal drains would have done. Unless it happened to coincide with an exceptionally low reserve, the periodic drain to Scotland would be ignored.² Internal drains occasioned by a bank scare in Yorkshire³ and the run on the Birkbeck Bank⁴ caused no disturbance of the Bank's policy. The Governor of the Bank might boast a rule-of-thumb, but it was soon proved that when the reserve was low for seasonal reasons that rule-of-thumb was ignored.⁵ Despite these

¹ See particularly Chapter XIV. thereof. Jevons had given the subject some attention much earlier.

² *Economist*, December 26th, 1903; *Statist*, September 13th, 1890.

³ In November, 1911.

⁴ In September, 1892. On the other hand, temporary internal circulation needs appear to have kept Bank Rate up at $3\frac{1}{2}$ per cent. at Whitsun, 1903.

⁵ In 1900 the Governor of the Bank spoke of £20,000,000 as the point below which the Reserve should not fall; but at the end of that year the Bank failed to take any action when the Reserve fell below that figure. (*Economist*, December 15th, 1900.)

evidences of the Bank's disposition to ignore seasonal drains, Palgrave's statement that "on an average, for the years 1846-1900, the rate of discount charged by the Bank of England was higher during the autumn months" would be equally true for the period 1890-1914.

The reason for the effect which seasonal movements did thus have, despite some exercise of the Bank's discretion, on Bank Rate is to be ascribed largely to the uncertainty and great variability of some elements in the autumnal drain. A table in Palgrave¹ shows this variation, for the years 1881-1900, to have been enormous. The following table shows that the variability in the external drain continued during the early years of the present century.²

GOLD WITHDRAWALS FROM THE BANK OF ENGLAND
SEPTEMBER, OCTOBER AND NOVEMBER
(in thousands of pounds sterling)

For export to	1900	1901	1902	1903	1904	1905
Egypt	1,783	1,285	2,482	4,025	3,020	1,520
S. America	85	289	2,020	351	1,483	1,543
Germany	1,105	1,510	—	807	1,358	—
Other destinations	1,408	1,900	495	904	391	742
Total	4,381	4,984	4,997	6,087	6,252	3,805

However, when everything possible has been said in mitigation of the Bank's treatment of the seasonal

¹ *Op. cit.*, p. 138.

² The table deliberately stops short of the crisis years, 1906-07.

drain, it does remain as a deficiency on the part of the Bank.¹ Occurring as it did year after year, the Bank's failure to adopt some system of positive action to insulate the English banking system from all consequences of this seasonal drain must be accounted as a serious blot on its record.

III

We conclude, then, that the Bank had, despite the bonds of ~~1844~~, moved a long way in the development of modern central banking. The outstanding failures, in the period with which this study is concerned, were two: first, the deficiencies in the Bank's control of the market; and second, the reactions which seasonal movements were allowed to cause. If we wish to seek the cause of these two failures we must find it, in all probability, in the constitution of the Bank. The Bank was singularly free of all legislative restriction of its operations. The power of daily executive control—to which open market operations particularly would be subject—lay in the hands of the Governor. The *Statist* in 1907 went so far as to say that "the power of the Governor during his term of office is very nearly absolute."² The Governor would always be a director of long standing, but normally one who had not, until he became Deputy-Governor,

¹ Cf. Keynes, "Treatise on Money," Vol. II, pp. 230-231.

² September 28th, 1907. Cf. October 21st, 1905: "It is notorious that the junior members of the Court are discouraged from meddling much in the management. . . . And it is the Governor's decision which rules everything."

have been a member of the Committee of Treasury—a Committee which, it is generally understood, has far more power than the full Court of Directors. After holding office for two years, the Governor would give place to his deputy, who had himself served as such for two years. Under this system it is hardly surprising that the major technical problems were not rapidly solved. No Governor was in power long enough to develop and consolidate a really satisfactory system. Further, it is not surprising that in some years the Bank appeared to be acting much more confidently than in others.

Evidence in support of these opinions ¹ does not lend itself to quotation, but to one who has studied the money market reports for every week of those twenty-five years the conclusions are inescapable. Temporising is sometimes the correct line for a central bank to take; sometimes when it is not in the correct line the fault is in the bank's diagnosis, and not in its method of handling the situation. But the hesitancy of the pre-war Bank of England was not hesitancy over policy. Rather it was the hesitancy of an imperfect technique, subject sometimes to weaker and sometimes to stronger hands, but always to hands which were newly set to the plough. Bagehot ² and Palgrave ³ were both putting their fingers on a weak spot in the Bank's

¹ These conclusions are, of course, no more than opinions.

² "Lombard Street," Chapter VIII.

³ "Bank Rate and the Money Market," Chapter VI. The *Statist* was before the war continually attacking the system as unsatisfactory.

constitution when they urged the desirability of some permanence in the government of the Bank. In this at least the constitutional conventions of the Bank of England since the war represent a definite improvement over the pre-war system.

IV

It will be readily perceived that the picture which this book has drawn of the pre-war operations of the Bank is not, in its details at least, entirely consistent with the broad description given in the First Interim Report of the Cunliffe Committee.¹ The reason is not, I think, difficult to find. Mr. Walter Cunliffe (later, as Lord Cunliffe, Chairman of the Committee) did not become Deputy-Governor of the Bank until 1911, succeeding to the Governorship in 1913. His notions on the pre-war system would therefore be highly coloured by the practices and events of the last three or four years before the outbreak of war. The ideas of his colleagues on the Committee would naturally also be coloured mainly by the events of the immediately pre-war years. Now it so happened that, during those last three years or so before the war, the Bank's operations had been, to a quite unprecedented extent, standardised and automatic. The sustained activity of trade, the "record" volume of British overseas lending, the Government's financial operations and the disposition of the great joint-stock banks to

¹ Committee on Currency and Foreign Exchanges after the War. (August, 1918); particularly paragraphs 2-7 inclusive.

help the Bank of England ; all these factors helped to facilitate a straightforward Bank Rate policy. The Bank's success in 1907 led it naturally in that direction. Consequently the Bank did not, in those last years, have resort to special devices for influencing gold movements. The Advances Rate remained fixed at $\frac{1}{2}$ per cent. above Bank Rate. The Bank felt more free than it had in the first decade of the century to raise Bank Rate to high points, and when it did so it more easily took Market Rate up with Bank Rate, and it was this somewhat extraordinary period which had left the most vivid impression on the minds of the Cunliffe Report, which in its turn has probably helped to shape general post-war thought on the pre-war monetary system.

In its endeavour to give a complete analysis of the Bank's operations over the quarter of a century, this book has, I hope, done something to correct the unduly simplified version in the Cunliffe Report. For in the decades following the Baring crisis the Bank's operations could hardly be described as the functioning of a perfect machine. In some ways, it is true, the Old Lady of Threadneedle Street had long ago reached years of discretion. That the Bank's Banking Department was little more than an ordinary bank had long ceased to be the fashionable view, although the *Statist* could complain that the Governor of the day was behaving as though the Bank was a purely private institution.¹ But, though the Bank had realised its public duties, it

¹ June 3rd, 1899.

had hardly developed a complete and consistent system for carrying out those duties. Old the Old Lady was, yet in her varied technique she showed the ingenuity, and in her divided allegiance the susceptibility, of youth. The mastery of technique which is the mark of maturity had yet to be achieved.

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