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YOUR MONEY AND MINE

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YOUR MONEY AND MINE

by

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NOTE TO THE SECOND EDITION

THIS book was written when the war of 1939–45 was reaching its climax, and its pages are sprinkled with references to "the present war." They are happily now out of date; but to change them would not affect the argument of the book, for the problems with which it deals are still with us, and are most clearly seen in a war-time context. So I have let them stand, as also certain illustrative figures which are no longer the latest available; but the latest figures for income-tax rates and the like have been inserted. The demand for a second edition prompts me to hope that the little book has been proved useful.

BARNARD ELLINGER

December 1945

FOREWORD

MR. ELLINGER is an economist of a type which was commoner in the nineteenth century than to-day—the man of affairs who took a liberal interest in the social and scientific aspect of his own activities. He prepared himself for his writings on money and credit by a practical experience extending over many years in the export of English textiles to the East. The account he gave, in his *Credit and International Trade*, of the monetary and credit arrangements involved has for this reason the liveliness of a first-rate book of travels. He has now used his gift for clothing abstractions in concrete form to show how much money and credit enter into the everyday experience of the humblest members of the economic community. Readers who find the chief attraction of monetary theory in its obscurity and difficulties may not recognize in his domestic chronicle the subject-matter of their self-torturing studies; but it is all there. It succeeds in setting forth fundamental truths of currency and credit without any technical language; incidentally, under its deceptive appearance of artless simplicity it undermines and outflanks a good many of the wild notions on the subject current to-day.

There is much to be said for his approach; it provides safeguards against partial and exaggerated views that are a danger of an analytical approach. The ordinary people whose affairs form his theme know from experience that lending is not confined to banks; that bank deposits are not the property of the banks to utilize at their will, but liabilities for which the banks have to account; that interest rates have only a limited influence on saving and expenditure; that Government debts arise from a deficiency of income in relation to need, like other debts, and do not provide Governments with anything useful unless someone else goes without it. The need is to make them examine, reflect on, and understand their own experience, to which end Mr. Ellinger has written his story. There is a special need at the present time, when the Government is apparently achieving miracles in the way of financing expenditure. Mr. Ellinger makes clear the conditions which make this achievement possible, and so helps his reader to judge how far it can be repeated in peace.

I hope this simple guide will be read by young people, but not by young people only. It is elementary in the sense of providing a first approach to its subject, but also in the sense of dealing with at any rate some of the fundamental elements of its subject. There is a vast literature on the subject of Money and Credit to which readers can proceed subsequently; they will get more from their subsequent reading if they have first been induced by Mr. Ellinger to reflect on their own everyday experience.

HENRY CLAY

1st August 1944

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Part One

MONEY—BANK-NOTES AND COIN

Chapter I

WHY MONEY?

I HAVE forgotten who it was, but somebody once said that there are in England three very old and very great families whose interests are sometimes neglected and whose importance and influence are often underrated. These families are the Smiths, Browns, and Robinsons, and it is to them that this little book is addressed. But to them must be added the family of Jones in Wales and Mackintosh in Scotland. These people have many things in common, but this book deals only with their common interest in money and their common necessity for it.

We use the term money in two senses: first, "How much money have you in your pocket?" that means "How many bank-notes and how much coin?" and second, "How much money did he leave?" that means in biblical terms, "What was the size of flocks and herds of which he died possessed?" or in modern society, "What was the value of his land and house, furniture, and savings?" The savings might be either in the form of stocks of goods or of investments, *e.g.* stocks, shares, bonds, or National Savings Certificates, or money to his credit in his bank or in the savings bank, all of which could at will be turned into purchasing power in the shape of money.

The first part of this little book will deal with money, consisting of bank-notes and coin; the second part will deal with money in the sense of possessions which can be turned into purchasing power—both with those possessions which we have and use ourselves, and with those which we lend to or borrow from others (which is what we mean when we talk of " credit ").

Whenever mankind has emerged from a condition of savagery he has found something which he could use as money—in the first instance as a standard of value or exchange. As he became more civilized he wanted more things, and a simple system of barter became too difficult because ex-savage A wanted the thing which ex-savage B had, while B did not want what A possessed but what ex-savage C possessed. and it therefore became necessary to find something which A could give to B and B could pass on to C ; so a medium, as well as a standard, became necessary. (This is the second use of money.) Many kinds of money have been used, from cowrie shells to metallic coins.

As life became still more complex, ex-savage A found a third use for money. Sometimes he had a surplus of things which were exchangeable over and above what he required to satisfy his immediate desires, and he wanted a means of conveniently saving up this surplus until he desired to use it. Perhaps the thing which he had was too bulky to save conveniently, or perhaps it would go bad if saved, or the surplus which he had was not sufficient to buy the piece of cloth which he wanted, and he found that the money which he was using as a medium of exchange could be saved up and could act as a store of value, that is, as a convenient means of saving up his power of exchange, or, as we should call it, his purchasing power.

Later, as the number of commodities grew, he found the first use of money, *i.e.* as a standard, grew in importance. It provided a convenient means of measuring the extent of preference which he had for one commodity over another. Ex-savage A would have asked himself whether he should exchange the fish which he had caught for eggs, or for beads, or for cloth, or for birds' feathers or for coco-nuts. Gradually as the Smiths, Browns, and Robinsons of the day became accustomed to using money as a medium of exchange, Mr. ex-savage Smith formed the habit of stating how many cowrie shells (or whatever the money was) he would take for the thing which he had to exchange. Instead of saying he would take for his piece of cloth so many eggs, or so many beads, or so many coco-nuts, or so many feathers, he said how many cowrie shells he would take, knowing that he could change his cowrie shells later on for any of these commodities which he desired. On the other hand, Mrs. ex-savage Brown got into the habit of saying how many cowrie shells she would give for the article she was anxious to have. And as things grew still more complicated with the arrival of traders who had many articles to offer, it became customary for the trader to say the number of cowrie shells which he would take for each of the articles which he had to sell, and Mrs. ex-savage Brown could then easily know which of them she preferred to buy at the price stated. In other words money came to be used as a common denominator of values, enabling the buyer to make comparisons between one thing and another and measure his wants.

Some people say that money is an evil thing and has been a curse, and they want to abolish it. Their idea seems to be that even if money were necessary as we emerged from a condition of savagery, this was a long time ago, and now in the twentieth century other means should be found for exchanging what we have for what we desire, which would do away with the abuses which they believe have arisen from the use of money.

I once went to the cinema and saw a picture which described a country, the people of which had to revert to barter as the country had been drained of all money. It described how an old gentleman went to a restaurant, had a good dinner, called for his bill, and in order to pay for it, opened his bag and handed the waiter a hen. The waiter returned with his change, which consisted of a chick and two eggs. The old gentleman handed back one of the eggs as his tip. On the screen it worked quite well, but it would have been very awkward if the restaurant had already too many hens but was short of ducks, or if the waiter's wife was tired of eggs.

The abolition of money has been tried seriously in the twentieth century at the time of the Russian Revolution, and has failed. An attempt was made to abolish money, but five years after the outbreak of the revolution it was found necessary to create a money which was called the "chervonetz," to have a banking system, and to have methods by which people could save up their money and invest it in Government bonds on which they received 8 per cent. interest per annum.

The money affairs of the people of this country are looked after by many different institutions : the Treasury, the Bank of England, deposit banks, savings banks, and various other organizations, forming between them a machine all the parts of which interlock and work together. This machine should be working in our interests—yours and mine—directly or indirectly. If it is not doing so, and particularly if it is doing anything which is contrary to our interests, we should see to it that it is altered. But in order to be quite certain that some alteration is necessary, and to have some idea of the kind of alteration which is desirable, it is essential that we should understand what the machine does and why it does it, and this little book endeavours to explain *what* it does and *why* it does it rather than *how* it does it.

CHAPTER II

NOTES AND COIN

BEFORE going further, let me make you acquainted with my friends Smith, Brown, Robinson, Jones, and Mackintosh. Jack Robinson is a self-made man who started in a very small way as a manufacturer of certain chemicals, including colours for wall-paper, material for white enamelling of writing paper, refining oils (for which purpose he uses Norwegian fish oil), while he also makes industrial castor oil. His largest business perhaps is in gums for all kinds of purposes—among others, sauces and sweets. A good deal of this gum he sends abroad. He has been constantly enlarging his business, and now employs about 200 people, including Tom Smith and his daughter Janet. Charlie Brown is the local butcher, David Jones is the representative of a large building society, and his son Ivor is a collector for an industrial insurance company. Ian Mackintosh is the local branch manager of one of the most important banks which has more than 2,000 branches spread up and down throughout the country.

Now that we know each other, we can consider how far the system of notes and coin performs for us and our friends the services which we expect from money as outlined in Chapter I, or in what respects it fails to do so.

The first question is " Do our notes and coins provide an adequate means of payment or medium of exchange ? " Are Tom Smith and Janet willing to accept notes and coin in payment of wages ? Will Charlie Brown sell Mrs. Robinson meat for them ? Can Mrs. Smith pay her weekly life insurance money to Ivor Jones in them ? We know from our experience that the answer is " yes." Some of us would find some difficulty in explaining why we accept them One reason is that they are legal tender ; that means that according to law people can pay all their debts in bank-notes and coin. No one is obliged to accept more than a shilling in copper coin or £2 in silver coin, but must accept any amount in bank-notes. Although bank-notes and coin must be accepted in payment for goods once sold, no one is obliged to sell their goods if they do not like the money which they will get for them. But you will say shopkeepers always want to sell their goods. Well, they did not want to sell them in the great inflation in Germany in 1923. Shopkeepers tried to sell as little as possible because money was daily losing its value or, to put it the other way round, prices were rising so rapidly that the shopkeepers who sold goods on Monday and were paid in notes or coin, found on Tuesday that prices had already risen so much that for the money received they could not even buy the quantity of goods which they had sold on Monday. German money t that time was a very bad medium of exchange, in spite s being legal tender, because the Germans had lost lence in it. Germany is under the suspicion that her rnment permitted a runaway inflation in order to get of the great national debts which had arisen during the war. In this country we have sufficient confidence in Government and Parliament to believe not only that y would never adopt such methods but also that they uld never allow matters, even during this war, to get out of hand that there would be danger of a runaway flation.

Smith, Jones, Robinson, and Brown accept our money freely as a medium of exchange, first, because it is legal tender, and secondly, because they have sufficient confidence that their Government will not abuse the power it has to give consent to the creation of currency. If they had not that confidence—legal tender or no—they would not accept the money. They would try to revert to a system of barter. Smith would insist that Robinson paid him his wages in food, clothing, and house room. Charlie Brown would want Mrs. Smith to do some charring for the meat which he sold her, and there would be no question of Ivor Jones receiving premiums for his insurance company, because no one would insure as they would have no faith that they would ultimately be paid anything worth having.

In order to accept money freely, moreover, we must be satisfied that it is good ; that is, that there is practically no risk of forged notes and coin being planted on us. Of course such things do exist, but the risk in this country is very small as adequate precautions are taken to prevent fraud. Personally, during a long life, I have on one or two occasions been given a bad florin or a bad half-crown, but I have never, so far as I know, been given a forged bank-note, and I imagine that must be the experience of most people.

In order that notes and coin should pass freely from hand to hand, it is also necessary that they should be in a convenient form. In the island of Yap in the Pacific the natives still use as money large circular discs of stone with a hole in the centre. But the stately Mrs. Robinson would not like to carry about with her things like that, or a sack of cowrie shells, or a bar of iron or lead, or lead a bullock along when she does her shopping, all of which have been used as a standard of value at some time in the world's history. Charlie Brown would not like coins which were so small or so thin that they were apt to fall through the little hole in his trousers pocket.

There are possibly some small inconveniences in our coins. In the dark it is sometimes difficult to distinguish a farthing from a sixpenny piece ; but although farthings circulate in London, they do not circulate as freely in the north of England where none of the shops seem to give a farthing change. There, it is evidently an unnecessary medium of exchange. The new threepenny piece, although it was not at first liked, is certainly a more convenient coin than the old threepenny bit, and we can only congratulate ourselves that the old fourpenny bit, which existed some years ago and was much too near in size to the threepenny bit, has been abolished. Many people would like to see the florin done away with, as it is inconveniently near to the half-crown in size. But none of these small inconveniences impede the free circulation of our coins.

Our bank-notes, too, are convenient. They do not tear easily ; they do not stick together (as did the old Bradburys at the beginning of the last war) ; and although now during the present war they are sometimes not as clean as we should like, in normal times they are quite clean. Even now, compared with notes which circulate in many other countries, there is nothing to grumble at. But if they ever became so dirty that people disliked handling them because they were frightened of disease, the Smiths, Joneses, Robinsons, and Browns of the world would avoid them as much as possible however much our branch manager Ian Mackintosh might try to induce them to take them.

To come back to the German inflation, money there—apart from everything else—broke down as a medium of exchange on account of its inconvenience. At one time it took a bagful of notes to pay a taxi, and Frau Schmidt had to carry a quite inconvenient amount of them in her handbag even to pay her tram fare. German bank-notes sank so much in value that it has been said that Swiss brewers found that it paid them to use them as labels on beer bottles.

The next point which we have to consider is whether our notes and coin are a convenient store of value. There are two tests : first, "Will it keep ?" (eggs would obviously be a bad store of value except for the Chinese) and secondly, "If kept for some time, will it retain its value, that is, its purchasing power?" In other words, "Will it buy as much when it comes to be spent as it would have done when it was first saved?"

Our money is a good store of value as regards keeping. The coins will not easily deteriorate, and it is possible to obtain new notes for old. Once, when Charlie Brown had some notes partly burnt he took them to Ian Mackintosh, who sent them up to London and had them replaced by new notes from the Bank of England. During the blitz in 1940 *The Times* reported that charred fragments of paper were being handed in at some Post Offices, being all that was left of Bank of England notes recovered from premises destroyed in the fire-bomb raid on the city. If more than half the note was left and the whole of the sentence "I promise to pay the Bearer on Demand the sum of One Pound (or Ten Shillings)," and at least one-third of the Chief Cashier's signature at the foot of the note was readable, the Post Office branch to which the charred notes were brought would replace the charred notes; but if these conditions were not fulfilled, the notes were passed on by the Post Office branch to the Bank of England for a decision.

If carefully kept, notes and coin should not be lost, but if kept under the mattress they might be burgled. In these days, however, there is no reason why they should be kept under the mattress. The smallest sums can be deposited with the Post Office or Trustee Savings Banks, and any amount can be deposited with the banks. Smith, who has no bank account, puts his savings into the Post Office Savings Bank from which he can draw them out whenever he likes, and meanwhile they earn $2\frac{1}{2}$ per cent. interest per annum (or 6d. in the £). His money is as safe as the Government itself, as it is all lent by the Post Office Savings Bank to the Government, and earns from the Government for its loans sufficient interest to pay Smith his $2\frac{1}{2}$ per cent.

So much for the question as to whether our notes and coin are a convenient store of value. The other question which we have to answer is " Will they buy as much when they come to be spent as they would have done when they were first saved ? "

The purchasing power of money varies from time to time. For example, Smith saved £3 in 1914, and put it in the Post Office Savings Bank instead of buying a gramophone. To-day this £3 with accumulated interest amounts to £6, but the price of the same gramophone has risen to £6. But this is a very exaggerated case, because we are comparing a time of peace (July 1914) with a time of war. If we made a comparison with the money which Smith saved and put in the Savings Bank in the war year 1918 and now, we should find that there was little alteration in the purchasing power of money ; Smith could buy as much to-day as he could then, and his money would have nearly doubled through the accumulated interest. And for the money which he saved in 1919, 1920, and 1921 he could buy more to-day because prices are lower now than they were in those years, and he could not only buy more now than he could then, but have all the interest to the good. It can be fairly said that our money is a good store of value, particularly when we remember that we have had two major wars in twenty-five years which have been the chief causes of the ups and downs in the purchasing power of our money. Nor must we grumble too much when we remember what happened to the money of other countries engaged in the Great War of 1914–18 when the French franc instead of falling from the equivalent of 20s. to 12s. 8d. in purchasing power between 1914 and 1938 (as was the case with us), fell to the equivalent of 3s. 6d., while the value of the German money and the Russian money had disappeared by 1923, so that the whole of the savings of the Smiths of those countries were entirely lost.

Of course there are other means of saving money besides keeping notes and coin under the mattress or putting it in the Post Office Savings Bank ; for instance, investment in Government bonds, or industrial or other debentures, preference or ordinary shares. Charlie Brown used these other ways to some extent and so did David Jones and Ivor Jones, and Jack Robinson still more, and we shall have something to say about them later on when we come to talk about savings generally. All these other methods are affected by changes in the purchasing power of money, just as were the savings of Smith.

In Chapter I we said that money acted as a common denominator. Is it a good common denominator for the purposes of our friends ? It is quite satisfactory, because by it the value of everything which they desire to buy can be expressed in terms of our money. Value expressed in terms of money is what we call the price. Our money is so sub-divided that all prices up to a £ can be expressed in it, and beyond that any multiples of a £. Money is a common denominator for the price of Mrs. Smith's half-pint of milk at 2¼d., and for the price of the factory which Robinson bought for £15,500. I do not know of any single, item which can be bought for a farthing unless children can buy a farthing's worth of sweets, but Janet Smith likes articles which would otherwise cost 2s. to be priced at 1s. 11¾d. It makes her feel less extravagant.

CHAPTER III

WHY BANKING?

TOM SMITH, his wife, and his daughter Janet all have Post Office Savings accounts, so do Ivor Jones and his father David Jones, Charlie Brown, and Jack Robinson, who started his when he was a struggling young man. It is only Mrs. Jack Robinson who has no account with the Post Office Savings Bank; she thinks it rather beneath her dignity; but she and all the others, except the Smiths, also have a banking account in the bank of which Ian Mackintosh is the local manager.

Banks perform many services which touch the daily lives of all the Smiths, Joneses, Browns, and Robinsons in the country. Some of these will be dealt with in Part II of this little book, but here we are only concerned with the services that they render as the source from which all the coin and notes which are required for carrying on our daily transactions are obtained.

Although the Smiths have no bank account, they benefit indirectly from its services, because it enables Jack Robinson to pay the wages of Tom Smith and Janet every Friday. Jack Robinson has money to his credit with the bank, and every Friday he writes out a cheque instructing the bank to pay the bearer (who is his cashier) £500. This is the amount which Jack Robinson requires to pay wages and to use for petty cash. Every Friday afternoon the cashier pays this money to the people employed by the firm.

Let us follow the money which Tom Smith and Janet take home. Tom Smith keeps a little for beer and a little for tobacco, and Janet keeps part of her money for dress and pocket money. The remaining money of both of them is handed over to Mrs. Smith for housekeeping. As Tom Smith spends his beer and tobacco money it finds its way back from the pub and the tobacconist into Ian Mackintosh's bank. Mrs. Smith pays the rent and does her weekly shopping on Saturday. This money, and that which Janet spends and the money which the family spends on cinemas and other things, comes back from the landlord, the shops, and the cinema into Ian Mackintosh's bank, usually in the first two or three days in the week.

The others—the Joneses, Browns, and Robinsons—are doing the same as the Smiths. Mrs. Robinson, for instance, settles her books every Saturday morning with some of her trades-people.

By the time the next Friday comes round and Jack Robinson wants another £500 from the bank for that week's wages, most of the previous week's wages have come back into the bank through the shops, cinemas, pubs, and so on. All the money which has been spent during the week, however, has not come back because part of it has gone into the Post Office Savings Bank as savings, and into the Post Office in various other ways. These are some of the other ways. First there are all the stamps which have been bought during the week, not only by the Smiths but also by Jack Robinson's business for his large correspondence, also telegrams, money orders, and postal orders; second, there are the stamps for Health Insurance and Unemployment Insurance; third, our little community have wireless sets and have to pay 10s. a year into the Post Office for their licences, so have Janet and Ivor Jones for their dogs; finally, the money either collected by National Savings Groups or paid directly into the Post Office for National Savings Certificates.

All this money, however, is not lost to the till of Ian Mackintosh's bank, because part of it is paid out every week by the Post Office to some members of our little community in various ways: money orders and postal orders which are cashed; money which is withdrawn from the Post Office Savings Bank; National Savings Certificates which are cashed in small amounts in order to meet some current emergency; Old Age Pensions; wages to the Post Office staff, and probably some other items which I may have overlooked. This money paid out by the Post Office will also be spent in the shops and cinemas, for rent, for fares, and so on, and will find its way back into Ian Mackintosh's bank. The Post Office will pay any surplus notes and coin which it receives above its requirements into Ian Mackintosh's bank, and that bank pays this money to the Bank of England to the credit of the Post Office.

If Ian Mackintosh's bank is short of notes and coin, he will ask his head office in London or a branch of the Bank of England, if more convenient, to send him a further supply from the credit held at the Bank of England; while if for any reason he has a surplus, he will send it up to his head office, or sometimes direct to the Bank of England. Whether a branch bank will generally have a surplus of notes and coin or a deficiency really depends on the nature of the business within the town in which it is situated. A branch bank situated in a shopping centre will, as a general rule, have surpluses to send up to the head office, while a branch bank in an adjacent industrial centre with factories paying out large sums for wages every week will have to draw notes and coin from the head office or the Bank of England, because part of the wages will be spent in the adjacent shopping centre. So here the notes and coin are not circulating as in our little community from the branch bank to the factory, from the factory to the wage-earner, from the wage-earner to the shops, and from the shops back again to the branch bank in the same town, but the notes and coin are circulating between two towns in a similar way, but some part of the notes and coin circulate through the intermediary of the bank's head office in London or through the Bank of England. It would be quite wrong, however, to imagine that all the notes and coin in the country are constantly circulating in and out of the pockets of the people through the banks. This is not so. A vast amount of notes and coin are always carried about by people or are kept in their little private hoards. Further, shops keep a minimum amount of till money overnight and business firms keep a certain amount as petty cash in their safes, and this money and other similar sums are not circulating through the banks. It is when the amount of this money held by the public is increased—perhaps because trade is better and more people are employed, or perhaps because people are uneasy and are hoarding more—that more notes and coin are required by the banks in order to supply this increased demand.

This is possibly the time to say something about inflation in order to get clear in our minds what inflation really is, for there is a connection between inflation and the quantity of notes and coin which are supplied by the banks to the public and their circulation as described above. The old farmer really explained it very well. "If I takes two pigs to market and there be only one buyer, pigs is cheap. But if I takes one pig to market and there be two buyers, pigs is dear." It is when there are more buyers in the market willing to pay current prices or more than current prices than there are pigs for sale at current prices (and money is forthcoming to enable them to pay these prices), that we have inflation in the price of pigs. But if what we have said about pigs applies to buyers and sellers of *all* commodities, then we have general inflation.

If trade is very good and people are spending money lavishly in buying goods which are being lavishly produced, there need be no rise in prices, that is, no inflation, because there is a sufficiently increased supply to meet the increased demand. On the other hand, if during a time of war when an abnormal part of production is directed to making munitions and a smaller part than usual in making what the Smiths, Joneses, Robinsons, and Browns buy, and if at the same time, owing to the large Government expenditure, the Smiths, Joneses, Robinsons, and Browns have a much larger amount to spend and are trying to spend it on the reduced quantity of goods offering, prices will go up, and that is what we call inflation. It is not the fact that Smith, Jones, Robinson, and Brown are earning more money that causes inflation, but the fact that they are trying to *spend* more money, and therefore increasing competition for the limited stock of goods which are on sale. During this war, the Government has tried with success to prevent inflation by price control and rationing.

If Smith, Jones, Brown, and Robinson hoard their money or carry more about in their pockets or keep more change overnight in their shops, that money is for the moment dead, and consequently has no effect on prices. It is only the money which they are spending to buy the reduced quantity of things which exist that raises prices, and however much the prices are increased, they cannot get more of the things because all our energies are bent on making armaments. The consequence is that if Mrs. Robinson, because she is richer, can afford to pay the high prices which the shopkeepers are asking for the smaller quantity of fully-fashioned stockings which exist, although they are very limited in supply, Janet Smith, who is poorer, has to do without fully-fashioned stockings. In normal times, of course, the fact that prices were going up would induce manufacturers to make more fully-fashioned stockings, and as they came on the market for sale, prices would stop rising and would very likely fall when the demand was satisfied. But under war conditions no more fully-fashioned stockings can be made however much Mrs. Robinson is willing to pay for a pair, and consequently somebody in the general community has to go without them. If Janet Smith and Mrs. Robinson do not spend their money but put it in a savings bank, there need be no rise in prices.

The Government tries by other means to prevent a rise in prices taking place. Our money, which it is spending for us on armaments, is paid out by the Government either in the form of wages or as remuneration to the manufacturers of the armaments. In both cases there is more money for the wage-earner and for his employer to spend on the limited amount of goods. In order to prevent inflation, the Government tries by increased taxation and by encouraging every form of saving to get this extra money back into its hands and thus reduce the spending power.

Any alteration in the relationship between the quantity of money which is being spent and the quantity of goods which can be bought affects prices. It is not only the amount of money that matters. The speed with which the money circulates, that is, the amount of work which every note or coin does, is also of great importance in affecting prices.

Littlehampton has grown out of all recognition. When I first spent a holiday there a very long time ago, it was hardly more than a village, and I can recollect only one shop, but even then there was a troupe of pierrots which performed every day on the beach. The visitors on their way down in the morning from the village to the beach called at the shop, changed their sixpences and shillings for coppers, which they gave to the pierrots during the morning. In the evening the pierrots came up to the village, handed all their coppers to the village shop in exchange for silver coins, and when they had had a good day even for half-sovereigns and sovereigns, because in those halcyon days those of us who could afford it carried about gold coins in our pockets as there were no 10s. or £1 notes—in fact, no bank-notes under £5. My experience in Littlehampton was, I think, the first illustration to me of the circulation of money, and brought home to my mind the fact that if the pierrots had only returned the coppers to the village shop every other day instead of every day there would have been fewer coppers to give to them, that is, their takings would have been reduced or, in other words, the price of their services would have fallen. It would be deflation caused not by a reduction in the quantity of money available to be spent (for the quantity of money in the whole village was still the same), but caused by the fact that it was doing less work, that is, circulating less quickly because the pierrots were keeping it in their pockets twenty-four hours instead of twelve hours.

Inflation and deflation both cause a considerable amount of suffering and injustice. During and after the last war the country suffered severely from both. Although it still remains to be seen if it will be so, there is good reason for hoping that the experience gained by those who are responsible for managing our monetary system will enable the country to get through the present war with a smaller amount of dislocation arising from monetary instability than was the case during and after the Great War of 1914–18.

CHAPTER IV

WHERE DOES THE MONEY COME FROM?

ROBINSON has a son and two daughters; the elder girl, Betty, is seventeen, and says when she leaves school next year she expects Uncle Mac to give her a job in his bank if the war is over. Ian Mackintosh frequently drops in at the Robinsons for a chat or a game of chess in the evening. Both girls are very fond of him. Strange as it may seem to all the Smiths, Browns, Joneses, and Robinsons, particularly to those who have overdrafts, bankers are really quite human in their home life.

One night when Mackintosh called, Mrs. Robinson told him that there seemed a considerable shortage of shillings. She had noticed it at Charlie Brown's and at some of the other shops, and Robinson said last time he was in London there also seemed to be a shortage of coppers because at the tube station there was a notice up, "No Coppers," and when he gave a shilling for his 7d. fare, they asked him if he had not got a penny, so that they need only give him a 6d. bit change. Mackintosh said they had experienced a shortage of shillings at his bank. He thought that one of the reasons was that the gas and electric light companies, who like everybody else were understaffed on account of the war, were not emptying the shillings in the slot meters as frequently as usual. It was extraordinary how many shillings were used for gas and electric light meters. He said he knew that the Mint had at one time stopped coining pennies to try and save metal, and because it was thought that any shortage could be made good by people circulating the coins more rapidly.

Robinson remarked that evidently there was a considerable attempt being made to make the public take to the new 3d. bits which they did not like, and he wondered if the idea was to keep the public short of pennies so that they would be obliged to use more 3d. bits, which would be a considerable saving because the weight of metal in a 3d. bit is far less than in three pennies.

Mackintosh said that a great many people who were in the habit of paying in a large amount of coppers into the banks in paper bags did not like the 3d. bits, because they were awkward to parcel, but special bags were being made to overcome this difficulty.

Mrs. Robinson declared that she hated the things, as they were so thick that if you had two or three they were very inconvenient in your bag.

Betty asked, " When were coins first made, and how does the Mint know how much new coin to make ? " and Uncle Mac, who loved explaining things, told her that as man became more civilized, he found it inconvenient to use types of money like cowrie shells, which were always varying in size and quality and which only circulated by the force of custom. So he made efforts to standardize and to create coins which would all have the same amount of metal in them, and bear some stamp to show that they did conform to a standard which had been set. The oldest mint of which we are told was in Lydia about 800 years B.C., and in this country there were mints before the Romans came, and after the Norman Conquest there were, owing to difficulties of communication, about seventy mints in England, more than there are in the whole of the world to-day. Minting coins became the prerogative of the sovereign, and at one time our kings used to set up a mint wherever they were in residence. It was about 1180 that Government officials were appointed to supervise the coinage, but up to the middle of the nineteenth century the minting of coin was contracted out. Sir Isaac Newton made a fortune out of it as Master of the Mint and Contractor for the Coinage, but after 1850 the Mint was handed over to the control of civil servants and all the profit went to the Government.

In answer to Betty's second question as to how the Mint knew how much new coin to make, Mackintosh said that the Bank of England gives a frequent estimate to the Mint of what they think the public will require in the way of silver coin, based on the public demand for silver coin as experienced by the banks all over the country (but the Mint judges the amount of copper coin itself). Mackintosh said that the amount of coins in circulation, including what the banks had, was equal to about £2 per every man, woman, and child in the country.

When Uncle Mac was asked how the banks got the notes and coin which they wanted, he explained that they got the notes and silver coin from the Bank of England, but the copper coin direct from the Mint, and thus cut out an extra journey in order to save expense, as it was so cumbersome to move. When the banks had too much money they sent up the notes and silver coins to the Bank of England and worn copper coins to the Mint. "In our little town here," he said, "we continually have to obtain new supplies of notes and coin, because there are several factories in the place which take a lot of money from my bank every week for wages, but a considerable part of these wages are not spent in the town, because a great many people go to shop in the large town nearby. Before I came here," Mackintosh told them, "I was at a branch in an agricultural district. There we usually had too much money, because the farmers sold their cattle and produce in the neighbouring town and brought home the notes and coin and paid them into my branch, and in our little place there was not much opportunity for spending money. And for some time I was in a branch at Worthing, and there, like in all the coastal towns, the local banks accumulate a great surplus of notes and coin by the end of the season."

"We don't, as a rule," continued Mackintosh, "send our notes and coin up to our bank's head office in London or draw from it if we are short, because redistributing them between our hundreds of branches would involve it in an enormous amount of work, and so the head office find it much simpler to use the Bank of England as a kind of clearing house."

Betty asked why it was that if the money was always circulating between the factories and the banks and the shops and the cinemas, as he had explained to them once before, the Mint required to make new coins.

Partly, Uncle Mac told her, because light coins or worn coins when they went back to the Mint were not reissued, but new coins were made to replace them. The Mint bore the loss involved in this, but it would not bear the loss for defaced coins—for instance, coins which had had a hole made in them so that they could be hung on watch-chains. But that was not the only reason why new coins (and the same thing applied to notes) were required. If trade improved and more people were employed, or wages increased or prices generally were higher, more money was required to do the country's work, and of course as the population increased (which it was now doing very slightly) more money was required. On the other hand, if trade were bad and fewer things were being bought, the money found its way back from the shops, cinemas, and so on into the banks, and from the banks into the Bank of England.

The banks can, if they want, draw notes and coin out of the Bank of England or pay them into the Bank of England every working day of the week, but as most employers of labour draw the money they require for wages out of the banks on Fridays or Saturdays, by Monday the banks may be short of notes and coin, and this accounts for the fact that more money is drawn by the banks from the Bank of England on Mondays than on any other day. During the week the money comes back from the shops, cinemas, and so on, and finds its way from the banks to the Bank of England on Thursdays and Fridays.

The Bank of England performs various services for the banks in connection with the coin. It sorts the coin as it comes in, taking out any foreign or counterfeit coins, and it counts the coins, making them up into bags either of mixed coins or all shillings or all half-crowns as the banks may desire to have them. This counting and sorting is done by very ingenious machines.

One evening the following week Robinson went across to see Mackintosh. He said he came for a quiet chat alone with Mackintosh, as he did not want to expose his ignorance before his girls.

"I want you to tell me if the Bank of England has power to print as many notes as it likes. I was at a meeting the other day of our Employers' Association, where somebody said that the Bank could create as much money as it wanted to do, and that such a power ought not to be given to any private institution, and the Bank was nothing but a private corporation owned by its shareholders. I don't understand anything at all about these matters, and want you to explain it to me as far as you can."

Mackintosh said, "There is really no very great mystery about it. When I entered the bank over thirty years ago (as you will remember) there were no such things in England as £1 and 10s. notes. There were only £5 notes, and people walked about with golden sovereigns and 10s. pieces in their pockets—at least the people who were sufficiently rich to have them. And if you went into the Bank of England you could shove a £5 note over the counter and ask for five golden sovereigns in exchange for it, and the Bank was obliged to give them, so that the total worth of notes it could issue was restricted by the amount of gold which it held. (There was a small amount of notes not backed by gold, the greater part of which was an old debt owing by the Government to the Bank.) But the Great War of 1914–18 changed all that. Sovereigns went out of circulation then and never came back again; we have now £1 and 10s. notes instead. And although the notes say, 'I promise to pay the Bearer on Demand the sum of One Pound,' it is very difficult to know what it really means, because if you go to the Bank of England and ask them to carry out that promise, all you'll get in exchange is another £1 note for the one you hand over.

"I need not remind you how we left the gold standard during the last war, and then came back on it in 1925, and came off it again in 1931. All that is old history; you can read it up if you want to know about it. What happened at the outbreak of the present war was that although we were not on the gold standard, the Bank of England had a considerable amount of gold in its vaults, and all this gold was handed over by the Bank to a fund which the Government has set up which was called the Exchange Equalisation Account, and in return the Government gave the Bank Government securities. The Government wanted all the gold it could get to pay for its purchases from America which had to be made in order to carry on the war.

"You asked me," continued Mackintosh, "if the Bank of England can create as many notes as it likes. The answer is that it cannot, for its issue of notes is regulated by Act of Parliament, and can be increased only with the consent of the Government. There is now practically no gold backing behind these notes, but the Bank of England must hold an equivalent amount in value of Government securities for the amount of notes which it issues, and the whole of the note issue therefore is now what is called a 'fiduciary issue'; it rests on the people's faith in the Government—

hence the term 'fiduciary.' It is interesting to look back on the changes which the people of this country have seen regarding the backing of the issue of notes from a time when the Bank of England was obliged to pay golden sovereigns in exchange for them to the limited gold bullion standard which existed after 1925, when it was only obliged to give gold bars and for amounts of not less than about £1,600, till after the 1931 crisis, when it was not obliged to give gold at all, but the Bank still held considerable quantities of gold, until now when the Bank has practically no gold, and only gives a clean note for a dirty one. All this has happened within one generation, and the people accept the bank-notes with the same confidence as they have always done, as their trust in the Government and the Bank of England and the banks has remained unabated. Since the outbreak of the present war the amount of notes has proved insufficient, because more and more people are employed, and the Government has to pay more money to the troops, and so on. Provision, however, has been made so that if the Bank thinks it necessary to issue more notes, it can do so if the Treasury consents, but the Treasury is obliged to inform Parliament of the amount of the increased issue to which it has consented, and if this issue is outstanding for a period of two years, the sanction of Parliament becomes necessary. It is therefore quite clear that it is Parliament, either direct by legislation or working through the Treasury, which fixes the amount of notes which the Bank of England is allowed to issue. Besides, I would remind you that the Bank of England has no incentive to increase the amount of notes which it issues, because it doesn't get any profit by doing so, as all the profits arising from the issue of notes —that is, the profits of what is known as the Issue Department—belong to the Government, and if there should be any loss it would have to be borne by the Government."

"You talk," said Robinson, "shaking your finger and with 'I would remind you,' as if you were addressing the House of Commons. Tell me this. You told us the other evening that the Mint issues the coin and is a Government department, and all the profits go to the Government. The Bank of England issues the notes, and is a corporation owned by members of the public, but all the profits of the note issue go to the Government, as do those of the Mint. Would it make any difference to us, the common people—the Smiths, Browns, and Robinsons—if the Mint issued the notes instead of the Bank of England, or would it be better if the right were taken away from the Bank of England, and all you banks could issue your own notes?"

"To answer your second question first," replied Mackintosh. "In former days banks issued their own notes before the sole right was given to the Bank of England, and it didn't work satisfactorily. Haven't you ever read the description in *Cranford* of the results of a bank failure? Of course the banks in Scotland do still issue their own notes of £1 and upwards, but for a hundred years now the way they do it has been regulated by Act of Parliament to protect the public. As a matter of fact, for every extra note of their own which they issue they have to keep a Bank of England note or actual coin in reserve, so it comes to much the same thing in the end.

"As regards your first question, I don't think it would be any improvement if the Mint issued the notes instead of the Bank of England. It would doubtless be done on the advice of the Bank, just as the amount of silver coin is regulated by estimates which the Bank of England gives to the Mint. The fact that the notes are issued by the Bank of England and not by the Government provides an additional check against any possible Government temptation to get rid of its financial difficulties by an over-issue of notes, because under the present system any increased issue can only be brought about through the suggestion of the

Bank of England and with the consent of the Treasury, Parliament being informed."

"It seems to be," said Robinson, "one of those illogical arrangements of which we are so fond in this country, because, however illogical they appear, they work."

"Yes," said Mackintosh. "And it provides checks and balances like those on which our constitution is built up. It is true that they result at times in affairs being slowed down, sometimes possibly in progress being retarded, but they have all arisen as a result of lessons which we have learnt from bad experiences which we have had in the past."

As Robinson got up to go he said, "You know your stuff, Mac, don't you?"

Mackintosh thought a minute and then replied, "Being in a bank can be the dullest job in the world. When I was a youngster I took all my exams for the Bankers' Institute, and then sat back and was bored stiff. I used to think that I was only a cog in a machine, and would have to do the same daily grind for the rest of my life. Then one day I made up my mind that I would find out something about the machine. I started to study again, and the more I learnt the more I realized that I was a cog in a very wonderful machine that is always changing with the changing times and, I believe, that is always improving. It gave me an entirely fresh outlook. Now, although I am growing old, I am still learning, and instead of finding banking dull, I find it a most fascinating occupation, and I wouldn't change my job for any other nor leave this town if I could help it. I like my job here. I've seen the place grow, and I feel I've helped to make the place grow, and I know all the people. Good-night."

Part Two

MONEY—SAVINGS AND CREDIT

Chapter V

BORROWERS AND LENDERS

The word " credit " is derived from the Latin " credere," which means to " believe." One of the essentials of credit is belief, faith, or confidence in the ability of the borrower to return to the lender the thing which he has borrowed, or its equivalent. But this confidence alone is not sufficient to explain the existence of credit, which always involves payment at some future time. Therefore the lender must have confidence that the borrower will and can repay the loan at the future time agreed upon.

It is quite wrong to consider credit merely as a question of banking. There is a vast amount of credit being given every day by and to individuals which does not touch the banking system at all. A well-known banker said : " The main credit system of the country, the gigantic amount carried by trade in the form of capital or capital debts is independent of the banks altogether. The banks deal in fact only with the bare fringe of this great mass of credit."

Practically every adult in this country gives and receives credit—that is to say, lends and borrows. Borrowing or receiving credit is getting into debt. Getting into debt is sometimes beneficial to the person who does it and sometimes harmful. It is beneficial to the farmer, for instance, who borrows money to buy seed which is going to produce a crop out of which he can repay the price of the seed which he has borrowed. It is harmful to the man who chalks up his drinks at the public house, because, quite apart from the question whether the drink is harmful or not, there is nothing in his borrowing to enable him to repay ; rather the reverse.

In *Hamlet* the advice that Polonius gives to his son is :

> Neither a borrower nor a lender be ;
> For loan oft loses both itself and friend,
> And borrowing dulls the edge of husbandry.

If loans lose themselves, it is usually because the borrower is not creditworthy—that is to say, does not have the means of repayment, or the loan in itself is not for a purpose which will provide him with the means of repayment, and where the loan loses a friend, it is usually for that reason. Further, if borrowing " dulls the edge of husbandry," it is bad borrowing or unwise borrowing ; wise borrowing sharpens the edge of husbandry.

The giving and receiving of credit is not confined to the more well-to-do people ; it exists throughout the community. Janet Smith is both a lender and a borrower. When she puts her money into the Post Office Savings Bank she is lending her money to the savings bank. The savings bank in its turn lends all the money to the Government. Janet Smith puts the money into the savings bank because she has confidence that it will be repaid at any time when she wants it. When she pays her weekly contribution for " Health and Pensions " and for her unemployment insurance, she is lending her money to the Government in the full confidence that it will be repaid if she is ill or unemployed, or, in the case of pensions, when she reaches the age of sixty. She is employed by Robinson, and the firm pays her at the end of a week's work, so that under modern factory conditions she is giving them a week's service on credit. Janet belongs to a " draw " club for clothing. She and all the other nineteen members of the club pay a 1s. a week for twenty weeks. Every week they have a draw, and the girl who wins is entitled to draw £1 straight away although she may have only paid her first subscription. If Janet Smith does not succeed in the first draw, but only draws her £1 at some later period, she is giving credit to all the other girls in the confidence that they will continue to pay their 1s. a week. On the other hand, if she draws her £1 before the twentieth week, the other girls are giving her credit for her remaining payments. This is a very usual way of buying clothes. In fact, half the clothing sold by many of the retail co-operative stores is sold by the club method, either a "draw" club or what is called a "mutuality" club, where members can even obtain credit up to £5.

Mrs. Smith and Mrs. Brown are members of co-operative societies, in fact one person out of every five in the country is a member of some co-operative society, from which they receive on an average nearly £1 credit. That this credit system is not an undue burden on the less well-to-do housewife is shown by the fact that the bad debts of the co-operative societies are only a 1d. in £10, whereas in the case of some of the large departmental stores which cater for the more wealthy they are a 1d. in every £3.

Apart from her clothing, Janet Smith receives other credit too. She has bought her wireless set on the instalment plan. Some firm sold her the set in the confidence that she would pay all the future instalments as they fell due. Janet is also getting credit from her mother, who provides her with board and lodging for a contribution of £1 a week, which Janet only pays at the end of the week.

Mrs. Smith (Janet's mother) gives credit to young Ivor Jones's industrial insurance company, in which she has insured the life of her husband in the confidence that when he dies she will draw his insurance money. She also gives credit to her "ladies," for whom she does daily cleaning, and who only pay her at the end of a week's work. But Mrs. Smith also gets credit, for she has bought her mangle on the instalment plan, and once when her husband was ill and another time when he was out of work she got credit from the grocer and from Charlie Brown, and she always gets a week's credit for her bread and for her milk. (Small shops for small people usually give credit when times are bad, while large shops who serve wealthy people endeavour in bad times to restrict their credit.)

Tom Smith gives credit, like Janet, for his Post Office savings to the Government and to Robinson for a week's work, and like his wife to young Jones's insurance company with whom he has insured her life. He receives credit for a week's rent from his landlord, and although Tom is a sober man, by Thursday he is possibly getting a drink or two on tick.

Ivor Jones, the insurance agent, gives credit to his insurance company because he only draws his commission every three months. He gets credit from the people from whom he bought his Austin Seven on the instalment plan, which, owing to the war, he has had to lay up, and he takes credit from the garage to whom he owes money as he does to his dentist. His father, David Jones, the agent for the building society, receives credit from the firm from whom he bought new furniture on the instalment plan, and he gives credit, among other items, to the building society for his monthly salary, to the Government for his investments in War Loan, and to the railway company for his three-monthly season ticket which he pays for in advance. He gets credit from the newsagent, from the plumber, and the electric and gas companies.

As regards Charlie Brown, the butcher, he once offered to buy his wife a vacuum cleaner on the instalment plan, but she said she wouldn't have one of those new-fangled things in the house; they couldn't get the dust out of the corners, and she liked her house spick and span. Charlie Brown, however, gives a lot of credit to his customers and takes credit from his wholesale meat suppliers. Before the war. he never had an overdraft from his bank except to carry him over the Christmas trade. Since the war he says that with all this rationing, there is no Christmas trade. Now he always has a credit balance with his bank, and therefore is giving credit to the bank for the money which they owe him. As regards his telephone, he has to pay £1, 15s. 6d. in advance for his rental, for which he gives credit to the Postmaster-General. On the other hand he has so many outgoing calls that his bill is usually £4 or £5 a quarter, and the Postmaster-General is giving him credit for the calls. He also receives credit from the building society from whom he is buying his house on the instalment plan.

Robinson sells his chemicals to his customers on credit, varying from ten days to four months for goods which he sends abroad. On the other hand he receives credit from his British wholesale suppliers and also for raw materials which he imports direct from overseas. These two forms of credit far exceed any credit he receives of a domestic nature ; but his wife has credit for her monthly household bills, from her dressmaker, from the gardener and the maids for their wages, as they are paid at the end of the week. Robinson is also giving credit to the school for his children's education, as their school fees are payable in advance.

Finally, even our banker, Ian Mackintosh, in his private capacity both gives and receives credit. He receives credit from his doctor, tailor, his butcher and baker, and also receives credit from his candlestick maker—gas, coal, and electricity. He gives credit for his library and golf club subscriptions which he pays in advance, and to David Jones's building society in which he has deposited some money, and to the Government for his investments in War Loan.

Except for the credit which Charlie Brown and Robinson receive from their wholesalers, a very large part of the other credit items which have been enumerated are in the nature of consumer's credit, about which so much is being written as if it were something which had never heretofore existed.

CHAPTER VI

WHAT IS JANET TO THE CITY OR THE CITY TO JANET?

IT is Janet's wireless set which she bought on the hire purchase system which brings her into contact with the City. Mugglethorpe, the retailer, from whom she bought the wireless set, could not afford to be out of his money until Janet's instalments were finally paid off. So he, in his turn, obtained credit through financial organizations.

It is not only Janet among our friends who is concerned with hire purchase and instalment buying; her mother had bought her mangle in the same way, and Ivor Jones had bought his little runabout car on these terms before the outbreak of war; David Jones, his father, when he went into a bigger house bought a lot of new furniture on the hire purchase plan. Jack Robinson recently bought some new machinery for his factory in the same way. A farmer, who is a customer of Ian Mackintosh, told him that he had bought a calving cow on the hire purchase plan, and was making arrangements to get some fencing and draining done by means of instalment payments. Charlie Brown is buying his house on the instalment plan, but this is not financed in the manner which we shall describe but directly with the building societies, who obtain their money by deposits from the public or from the public buying shares in their societies.

Through insurance companies, like the one of which Ivor Jones is agent, we even bury our dead on the instalment plan. In some working-class budgets given in B. Seebohm Rowntree's book *Poverty and Progress* there is one of an unemployed man with a wife and three children whose total income was 38s. a week. Of this the family spent 2s. 3½d. a week on clothing and 2s. 6d. on burial insurance. It cost them more for shrouds and coffins for the dead than for shoes and clothing for the living. But burial insurance is different from other instalment buying, because we do not get our coffins till we are dead while Janet got her wireless set directly she paid the first instalment. How is it all done?

Hire purchase and instalment buying is a very big business. By both methods payments are made by instalments. There is, however, this difference, that under a hire purchase contract the commodity purchased does not belong to the purchaser until all the instalments are paid, and if they are not paid the seller can take the commodity back (within certain limitations imposed by a recent Act), whereas in instalment buying, the thing purchased belongs from the start to the buyer, and if he fails to pay his instalments, the seller's only remedy is to sue him for them.

Out of every ten wireless sets which are sold, eight are bought on the instalment plan, while seven out of ten motor-cars are bought by the same means. Although it now takes a very important place in retail trade, some people have still the feeling that it is wrong to buy and enjoy things like wireless sets, gramophones, fur coats, bicycles, and so on, until the purchaser has saved up enough money to pay for them. They might even think that it is wrong to buy furniture in this way. But fewer people would think it wrong to acquire their house on the instalment plan, or to use it for purposes which enable them to carry on their businesses. It is of great benefit to farmers. Doctors and dentists can buy their equipment by these means. Railway wagons, machinery for factories, plant for collieries, refrigerators, X-ray equipment, central-heating installations, and a large number of other commodities can be bought on the hire purchase or instalment buying methods. It is all made possible by the means of credit, and it works like this.

Let us take Janet's wireless set as an example. Mugglethorpe, the retailer, from whom she buys it asks her to sign a paper promising to pay her instalments, not to him but to a finance company, whom we will call the Hire Purchase and Finance Company. (Sometimes, however, the retailer collects the instalments on behalf of the finance company.) Janet pays the first instalment when she gets the wireless set. With her written promise in hand, Mugglethorpe goes to the Hire Purchase and Finance Company, who pay him straight away the whole of the price of the set, less the first instalment which he has received from Janet and less a sum which represents the interest which the company charges for the time they have to wait until Janet completes her instalments. The interest which Janet pays is included in Mugglethorpe's price, which is therefore higher than if she bought it outright.

Mugglethorpe, who sold the set, guarantees to the Hire Purchase and Finance Company that Janet will carry out her bargain and pay the instalments. Up to now, then, Janet has obtained credit from Mugglethorpe, who sold the wireless set, and he in his turn obtained credit from the Hire Purchase and Finance Company. Janet is thus in direct touch with Mugglethorpe and with the Hire Purchase and Finance Company in the City (if it collects the instalments).

So many customers come to the Hire Purchase and Finance Company with similar business that the company in its turn has not sufficient money of its own to do all the business offered to it, so the company borrows from other people. But as it can borrow more cheaply from these other people than the rate of interest it charges Mugglethorpe, it can make an extra profit by doing more business, even although it has to borrow money to enable it to do extra business. The rate of interest which is charged for lending money increases or decreases with the degree of risk that it will not be repaid. The Hire Purchase and Finance Company in lending the money to Mugglethorpe has only his guarantee and Janet's that the money will be repaid. But the people from whom the Hire Purchase and Finance Company borrow the money have the additional guarantee of that company. The risk is therefore less, and the rate of interest which the Hire Purchase and Finance Company has to pay is lower. But the Hire Purchase and Finance Company has to bear the risk of Mugglethorpe and Janet not being able to pay. It therefore covers itself for this risk by charging Mugglethorpe a higher rate for the money than the rate it has to pay for borrowing it. Still, the cheaper it can borrow its money, the less interest it will charge Mugglethorpe, the retailer, and the lower will be the price at which Mugglethorpe will be able to sell his wireless sets.

The Hire Purchase and Finance Company, then, wanting to borrow money, does it in two ways. First, and this is the more general way, it borrows the money from a bank, guaranteeing the bank, of course, that it will repay as the instalments from Janet are received. If the bank is satisfied with the way in which the Hire Purchase and Finance Company is conducting its business, and that it has some resources of its own sufficient to fill the gap if Janet fails to pay her instalments, then it will be content to lend the money; Janet is now in touch directly with Mugglethorpe and the Hire Purchase and Finance Company (again if it collects the instalments from Janet), and indirectly in touch with the bank.

But the Hire Purchase and Finance Company wants to obtain its money at the lowest possible rate of interest, and has another idea. It thinks, "For the money which the bank is willing to lend me it has only my guarantee that I will repay it backed by Janet's and Mugglethorpe's guarantees to me. If I can get somebody else of good reputation and with plenty of capital to guarantee also, then whoever lends the money will have an additional guarantee and should be willing to lend it more cheaply."

There are firms in London part of whose business it is to give this additional guarantee. They do not always themselves lend money, but they enable their customers to obtain it more cheaply by the extra guarantee which they are willing to provide by lending their good name. They are called accepting houses. The word "acceptance" to Janet implies the acceptance of an invitation or, in her wildest moments, the acceptance of a proposal of marriage; but people accept responsibility, and that is part of the business of accepting houses.

The Hire Purchase and Finance Company having arranged to obtain the guarantee from the accepting house, it may be said that Janet is now in direct touch with Mugglethorpe, the Hire Purchase and Finance Company, and indirectly with the accepting house in the City.

With the additional guarantee of the accepting house the Hire Purchase and Finance Company can go to another firm called a discount house, and that firm will give it cash, relying on the two guarantees (from the Hire Purchase and Finance Company and the accepting house) that the amount will be repaid to them at the time agreed upon. They will, of course, charge interest for the time for which they are out of pocket. Janet thus may be said to be directly in touch with Mugglethorpe and the Hire Purchase and Finance Company, and indirectly with the banks, or with an accepting house and a discount house in the City.

If Janet ever reads this, three things may strike her. First, what an extraordinary chain of transactions has been set up by her purchase of a wireless set on the hire purchase plan; secondly, how much depends on people's belief in her honesty that she will pay the instalments as promised (this is a very pregnant thought, because all credit depends on confidence, confidence not only that the lender has in the honesty of the borrower, but also in his ability to repay the money which he has borrowed); and thirdly, that but for the existence of these various financial organizations in the City, Janet would not have been able to buy her wireless set on the hire purchase system and thus would not have enjoyed it until the time when she had saved up enough money to pay for it in full. She may also realize that every additional link in the chain has reduced the risk which the ultimate lender of the money runs, has enabled the Hire Purchase and Finance Company to borrow more cheaply (even after allowing for the commission which has to be paid to the accepting house for its services), and to charge less to Mugglethorpe, who in his turn was able to sell more wireless sets on credit and more cheaply than he otherwise could have done.

Bad debts under this system of hire purchase finance are very small—less than 1 per cent. One large company has never had bad debts of more than one-tenth of 1 per cent., or 2s. in every £100.

Chapter VII

WHY SAVINGS?

When we talk of savings, the first idea that springs to our minds is the saving of money; but the saving of money is only useful in so far as it enables us to buy commodities which are in stock, *i.e.* which have been saved or which are in process of being made. Even if there were no money there could, of course, be saving. The squirrel has no money, but it saves the nuts gathered in the autumn for its food in the winter. Bees have no money, but they save the honey made in the summer for use later on. Benjamin Hogge, the farmer, a customer of Ian Mackintosh, sometimes saves potatoes as seed for planting the next year out of the potatoes which he grows (but not every year, as he sometimes uses the potatoes saved by another farmer).

All saving arises—like the squirrels', and the bees', and Benjamin Hogge's—from not using immediately some stock which they possess but keeping it or part of it for use by them or by somebody else at some later period. This applies also to money savings. Money that you have not spent immediately but have kept for use at some future time is money saved, whether it is the 6d. a week which Janet Smith puts into her Post Office money-box or whether it is the several hundred pounds or thousands of pounds which Robinson has saved out of his profits in order to spend them at some future time on replacing his machinery or expanding the size of his factory buildings. There is, however, this difference between the saving of commodities and the saving of money. The former is always saved for a definite use, while the latter (that is, money) can be used to buy any commodity which the saver chooses, and at any time when he chooses to spend his money.

Why do people save ? One of the reasons is because they want to buy something for which they have not enough money in one lump sum at the time, and therefore gradually save up sufficient to buy what they want. Dick Robinson and his sister Betty are saving something every week in order to buy a small sailing boat. Charlie Brown, the butcher, is saving up for another reason : he wants to provide for a rainy day and for the time when he wants to retire, and in order that his wife may not be left penniless when he dies. David Jones is saving up for similar reasons, but he has an acquisitive nature and likes to see the money which he pays into the Post Office Savings Bank grow—as it does, because it earns 2½ per cent. interest per annum. But Charlie Brown would save for a rainy day or for his other reasons even if he earned no interest at all.

People sometimes save up money because they think that by postponing their purchases they will be able to buy cheaper at some future time. All postponement of spending is saving. Before the war, Mrs. Charlie Brown saved up her money every spring in order to spend it in the summer sales, when she expected to get better bargains than if she spent the money earlier in the year. People also sometimes spend their money in order to buy commodities which they do not need at the moment, because later on they think that they will have to pay more for them. If then they store the commodities which they buy, and do not use them till they want them, then they are saving commodities instead of saving money. That is what Mrs. Charlie Brown has done since the war. A year ago she bought a length of material for a costume, not because she wanted a costume then, but because she thought the price of the cloth would go up and even that she might not be able to buy cloth of such good quality. Mrs. Charlie

Brown bought the costume length for her own use. It was her raw material for a costume. She spent her money but saved her costume length until she wanted to use it. A great many business people buy their raw materials, not necessarily when they want them for immediate use, but because they think the price will go up or they will be difficult to obtain later on. Other business people buy raw materials and other commodities that they never intend to use themselves, but which later on they intend to sell to other people who require them. They also spend their money but save the commodities.

Saving is a result of abstinence. People who save abstain from using something—whether money or a commodity—at the moment when it comes into their possession in order that they may use it at some later time or derive some advantage by lending it to somebody. Mrs. Charlie Brown had her reward in saving up her money for the sales in that she got bargains, or enjoyed the thought that she was getting bargains. She got her reward for postponing the use of her costume length (when she really did not want it much) by having it when her old costume was worn out, and particularly that by postponing its use she had the satisfaction that she was able to have it made up at a time when it was impossible to buy such a good quality, even by Mrs. Robinson with all her money. But if she had saved up her money and took the risk of lending it to somebody else instead of buying her costume length, she would be less likely to continue saving in the future, unless she had some inducement to take the risk and some reward for her abstinence. In practice this risk and this reward for abstinence is covered by the interest which the borrower pays to the lender. Or we may look at it from the other side of the picture, and say that it is the borrower who is willing to pay interest to secure a share of the limited amount of money which people are willing to lend. The rate of interest depends partly on the length of time that the lender is out of his money and partly on the risk involved; that is why some people have to pay a higher rate when they borrow than other people.

People save up for different purposes, and consequently for different lengths of time. Mrs. Charlie Brown, when she was saving up for the sales, only wanted the money in three months' time, and therefore could have lent her money during that time. A friend of Robinson's saved up money from the time his boy was twelve years old until he was eighteen in order to be able to send him to the university, and during those six years he also could lend the money. Charlie Brown was saving up for his retirement—perhaps in twenty years—and in the meantime he could lend the money.

It is very fortunate that there are people who are saving for short periods (or as we call it "short-term"), or medium-term, or long-term, because there are always borrowers who want to borrow either on short-term, medium-term, or long-term. For instance, Benjamin Hogge, the farmer, used to borrow from his bank for a few weeks to see him over the harvest, so that he really was one of the short-term borrowers for whom the short-term saver was looking. Some borrowers want to buy machinery and pay for it over five or six years. Such people would be suitable borrowers for a medium-term saver, like Jack Robinson's friend, who was saving up for his boy's education. Finally, there are borrowers for long-term savings, who want to use the savings for the building of railways, docks, harbours, etc., which would take some years to complete, and possibly some more years before they became profitable and could begin to pay back the money which was borrowed out of the profits which were made. They might be suitable customers for the long-term savings of Charlie Brown. Perhaps, however, some or all of these savers would have said that they did not want to run the risk of lending to the people we have described, although they could get good interest. In such cases they would find that they could have lent their money either on short-term, medium-term, or long-term to the British Government, where it would be perfectly safe, but where, because the risk was less or virtually non-existent, the interest which they could get would be less.

How do people save? All the houses and factories, machinery, docks, and railways are the result of somebody's saving. Consumable commodities are saved. Mrs. Robinson saves them in her store cupboard; Benjamin Hogge saves them in his barn; other people save raw materials, and so on, in warehouses. Money is saved in various ways. Sometimes notes and coin are saved in houses or in safe deposits, where they earn no interest, or money is saved in the Post Office Savings Bank or the Trustee Savings Banks, where it earns interest. It is sometimes invested in Government bonds like Consols or War Loan; or people buy Stock Exchange securities—that is, stocks and shares which are bought and sold on the Stock Exchange, and on which they earn either interest or dividends; or they buy National Savings Certificates, where the interest is accumulated and added to the sum which the saver will ultimately receive.

If the saver pays his money into an ordinary bank he may deposit it either in his "current account," where it can be withdrawn at any time on demand, but on which he earns no interest, or on "deposit account," where it earns very little interest, but it can only be withdrawn after a period agreed upon with the bank. Deposits on "current account" in banks are, however, usually not permanent savings. They are more in the nature of working capital, which may be wanted at any moment, but which is more conveniently kept in the bank than in the safe in the firm's office. Deposits on "deposit account" are often either working capital which would normally be in current account, but which it can be foreseen will not be wanted for a little time, perhaps because business is bad or for other reasons, or it is money waiting the opportunity of investment in some permanent form. The amount, however, which is saved through the Post Office Savings Bank, the Trustee Savings Banks, National Savings Certificates, and building societies, and by many other means, is really saving (mainly by the less well-to-do people), and is greater in amount that the whole of the money deposited in the deposit banks.

When we deposit our money in banks or the Post Office Savings Bank we are lending it to them, and they, in their turn, lend it to someone else. It would be a nuisance if every lender had to go out and find a suitable borrower, or every borrower had to find a lender. The banks act as a channel, and they are re-lending at the present time most of their deposits to the Government by one means or another, and the Post Office and Trustee Savings Banks lend all their deposits to the Government. In times of peace a smaller proportion of their deposits is lent by the banks to the Government, and a larger proportion to trade and industry. It may appear curious that if David Jones, for instance, deposits some money with Ian Mackintosh's bank, which enables that bank to lend an equivalent sum of money to the Government, David Jones can still withdraw his deposit when he likes and lend it to his son Ivor. Is the money not lent twice over this way? The answer is "no," because unless Ivor (or someone else to whom he pays the money) deposits it in his turn with Ian Mackintosh's bank, then the bank will have to call in an equivalent amount of its loans or sell an equivalent amount of its securities.

The fact that many people save money enables those who require it for the development of their business to borrow it, and it is through savings that enterprises become possible and that new machinery can be installed, new houses, factories, docks, and railways can be built, and that stocks of consumable commodities like everything which is in the shops, and tea, coffee, sugar, rubber, and so on in the warehouses, can be accumulated.

In these ways the whole country, and indirectly the whole world, benefits from the savings of the Smiths, Joneses, Browns, and Robinsons, which pass into the sources that need them through the intermediary of thousands of branches of banks, of one of which Ian Mackintosh is the manager.

Chapter VIII

WHY A CAPITAL MARKET?

Capital is the result of saving whether it be the saving of commodities or the saving of money. What is a capital market? What is any market? It is a place where people congregate in order to buy and sell. It may be a covered-in market, like Covent Garden, or the markets at which we shop at the seaside, or it may be a street like Mincing Lane and Petticoat Lane. Or it may be a whole town; Calcutta is the market for jute, and Chicago is the market for wheat. In this country Liverpool is the market for cotton, and London is the market for money and the market for capital.

People who are willing to lend money and people who want to borrow money for short periods do so through the intermediary of the banks, but people who want to borrow or lend capital for a long period of years or buy and sell capital do so through the intermediary of business firms which specialize in this business, and whose offices have come to be situated within a radius of half a mile from the Royal Exchange in London, and it is this area which forms the London capital market.

The business of the capital market is to bring together people who have money and the people who want money. The people who are seeking money in the capital market want it in order to start new enterprises, or to extend enterprises which are already in existence. In peace-time the demand for new capital arises from the desire for industrial development or the building of railways, docks, harbours, electric supply stations, waterworks, and so on. The suppliers of this capital—that is, the people who are willing to lend it in the London market—are mainly (but not entirely) our own people; but in normal times the demand for this capital comes not only from our own people but also from the Dominions, Colonies, and from foreign countries all over the world.

In times of war one of the greatest seekers after money repayable after a long term of years is the British Government, who want money, among other things, to build warships and merchant ships, to make aeroplanes, tanks, guns, and all the implements for carrying on war. Its credit is very good, and therefore people will lend to it even if they receive only a relatively low rate of interest.

In times of peace the new capital is required for two purposes: one for the purchase and erection of fixed assets like factory buildings and machinery, and the other (to a smaller extent) for working capital, *i.e.* the money which is required for paying wages and for the purchase of the necessary raw materials and so on, for which purposes Jack Robinson used it, as we show later on. Working capital is required to carry on the normal business of a firm, but not to carry on exceptional business, such as Christmas trade, for which purpose it will borrow from the banks whose business it is to lend for a short period. If the firm obtained this money needed for the Christmas trade as working capital it would be lying idle for three-quarters of the year, as it would only be required at one season.

The people who have saved the capital, which is subsequently lent through the market for raising new capital, either lend the money or they take a share in the enterprise. If they lend the money, they receive debenture bonds on which interest at a fixed rate must be paid every year, and the capital is usually repayable after an agreed term of years. If the new enterprise cannot pay the interest each year, the debenture holders are entitled to have their capital repaid before other people to whom the enterprise owes money, and therefore the repayment of their loan is secured to them by the value of the works and the machinery and the whole of the assets of the enterprise. Therefore this money is lent at a relatively low rate of interest, because their capital is assured. Some of the savers, however, want a higher rate of interest, but at the same time want to know with some degree of certainty how much interest they are going to receive. So when a new company is formed it attracts the money of these people by means of preference shares. These shares are entitled to a fixed rate of interest, provided that interest has been earned by the company. They will get a higher rate of interest than that earned by lenders against debentures. Their interest, however, will be paid after that of the debenture holders, but before that of any other people who also put money into the concern. But it will only be paid out of the profits that the concern makes.

Savers who want a still higher rate of interest on their savings and are people who are prepared to take greater risks than the debenture holders or preference shareholders, are the ordinary shareholders, between whom (after the interest of the debenture holders and the preference shareholders has been paid) are divided the whole of the net profits of the concern, after provision has been made for reserves and depreciation. Unlike the debenture holders, both the preference shareholders and the ordinary shareholders have become partners or shareholders in the concern; but if things go wrong and the firm fails, they differ from partners in a private business because the liability of these shareholders is limited to the amount of money which they have subscribed, whereas in a private partnership everything the partners possess must be used to pay the debts of the partnership. For instance, if Charlie Brown's business fails, his creditors can take not only the money which he has in the shop and the contents of the shop, but also his house (if it belongs to him), and his furniture, and his National Savings Certificates, or any other money he has outside the shop. But the wholesale firm from which he buys his meat is a limited company, and if it failed, anyone who had shares in it could not lose more than the amount they had paid for the shares, or promised to pay for them if they were not fully paid-up.

Jack Robinson has recently been having some conversations with eight or ten of his chief competitors in a large way of business, all of whom have been using certain materials which have always been produced abroad and imported into this country. They have considered the matter, and have come to the conclusion that many of these materials can now be produced at least as cheaply in this country, and if all of them would use as far as possible home-produced materials it would be worth while setting up two or three big factories to manufacture the required commodities. To build these factories, buy the necessary machinery, and provide the working capital essential for wages and raw material, they would require some £400,000. They have been in touch with one of the business firms in London, who are the channel through which money is provided for long periods for new ventures, and a scheme has been formulated by which £100,000 shall be borrowed by inviting people to take 4 per cent. debentures in a new limited company, and to buy £100,000 in 6 per cent. preference shares, and £200,000 in ordinary shares. Jack Robinson and his competitors are each prepared to put a certain amount of their savings in this new company. David Jones told Robinson that he will take some debentures and also some preference shares, while his son Ivor, with an eye on the larger gains, intends to buy a few ordinary shares. The rest of the money will be provided by thousands of other savers if they approve of the scheme. So much for the capital market through which the money for new enterprises is provided.

People (like David Jones) who have lent their money to a limited company by taking debentures are entitled to get it back after a considerable number of years, but if they have taken preference or ordinary shares they are only entitled to get it back on the liquidation of the company, which, if successful, may well last a century. Charlie Brown has been saving with the idea of providing for the time when he retires in about twenty years. With this idea he put some of his money into National War Bonds, repayable by the Government in about twenty years' time, but he may be obliged, owing to ill-health, to retire earlier than he anticipated, and he will want to realize his bonds. The Stock Exchange will help him to do this. Its business is to bring together buyers and sellers for investments which are already in existence. All Charlie Brown has to do is to go to a stockbroker and ask him to find a buyer for his investment in National War Bonds.

There are people who, when they invest their money, do not contemplate that during their lifetime they will want to get back their capital. All they want is to have enough money by way of interest on their investments on which to live after they have ceased to earn money. When they die, however, their capital will probably be divided amongst their children, and in order that it can be so divided the investments of the parent may have to be sold, and this can be done through the medium of the Stock Exchange. Unless people were satisfied that they could get their money back at once should they require it in an emergency, they would be very loath to lock it up for long periods, and the existence of the Stock Exchange which meets their difficulty enables money to be forthcoming for the capital market which provides for the new enterprises of commerce and industry.

The Stock Exchange deals with all long-term British Government securities. It also provides the market for buying and selling investments not only in Dominion and Colonial Government securities, but in foreign Government securities, in municipal stocks of various countries, in banks, canals, and docks, British, Dominion, and foreign railways, electric light and power companies, gas companies, insurance companies, mines, iron, coal, and steel concerns, breweries and distilleries, telegraphs and telephones, tramways and omnibuses, waterworks, shipping, and companies dealing with various products such as oil, nitrates, rubber, tea, and coffee, and so on. In fact, securities dealt with on the Stock Exchange cover almost every form of activity.

It is not only rich people who are interested in the capital market. Outside the physical area of the London capital market there exist facilities for investment for the savings of the less well-to-do people. Very large sums—some hundreds of millions—are invested by these people, for instance, in building societies either as depositors (*i.e.* people who have lent their money to the society), or as shareholders (*i.e.* people who have bought a share in the business on which they get a fixed rate of interest if sufficient profit has been earned). These are the people who provide the money for paying the builder, etc., and the demand for the money comes from the millions of people who through the building societies have bought or are in the process of buying their own houses on the instalment plan. These people form one out of every five or six householders in the country.

The Post Office Savings Bank also accumulates the capital of the less well-to-do people, and lends it (among others, the 6d. a week which Janet Smith deposits) to the Government either for short or for long periods, and in the same way insurance companies attract the savings of the people (like those of Mrs. Smith, who insures her husband's life), out of which they supply the capital market with funds.

CHAPTER IX

WHY FOREIGN EXCHANGES?

WHAT is foreign exchange? It is the exchange of the money of one country for that of another. The other day an American soldier on leave walked into Charlie Brown's shop and bought some meat. He offered to pay by giving a United States dollar note. Charlie Brown looked at it and said, "I don't quite know what to do with it, mate. It's not my money. People here want pounds, shillings, and pence," to which the American soldier replied, "Why, our money is good money. It's the best money in the world." "Yes, I know," said Charlie Brown, "but I don't know how much change to give you. I'll just slip across to the bank and change it if you'll wait half a moment."

The exchange value for the money of one country for that of another is called the rate of exchange. For example, 4 dollars 2 cents are at present the equivalent of £1, because the Bank of England will give £1 for every 4 dollars and 2 cents, while the corresponding bank in the United States will give 4 dollars and 2 cents for an English £1. In peace-time the rate would vary according to the relative demand and supply of the two currencies, unless it was fixed by agreement between the Bank of England and the equivalent U.S.A. bank. Other countries sometimes fix the value of their currency themselves as being exchangeable for so many pounds sterling or U.S. dollars.

Why must we exchange our money for foreign money or *vice versa*? The reason is that the foreigner wants payment for what we buy from him in his own money, for that is the only currency he can use in his country, and we want payment for what we sell to him in pounds sterling, because that is the only currency which we can use in our country.

Charlie Brown would want foreign currency—*i.e.* Argentine pesos—to pay for the frozen beef which he bought if he imported it himself. But it is the importer from whom he bought the beef who really requires the Argentine pesos, and who obtains them through his bank. Charlie Brown also buys New Zealand lamb. The currency of New Zealand is also pounds, but Charlie Brown's importer cannot buy by paying in English pounds, because although the two currencies have the same name and the same division into pounds, shillings, and pence, four English pounds are worth as much as five New Zealand pounds.

All our community—the Smiths, Joneses, Robinsons, Browns, and Mackintosh—are indirectly interested in foreign exchange. Indeed all of us are, every man Jack of us; it is really amazing the variety of foreign goods which we buy and the number of countries the currency of which somebody in this country must acquire in order to pay for them without anyone thinking anything of it.

Let us think of the breakfast table in peace time. We want bread. We import wheat from the Argentine or from Canada (which has a dollar currency) or from Australia, and yeast from Belgium, Holland, or Germany (francs, guilders, marks). We import butter from Denmark (kroner), New Zealand, and Holland, and eggs from a variety of countries, Egypt (Egyptian pounds), Holland, Denmark, and Poland (zlote). Bacon comes from Denmark, Canada, and Holland. We import pepper from the Dutch East Indies (D.E.I. guilders) and Malaya (dollars). Marmalade is made from Seville oranges (pesetas), and possibly Cuban (pesos) or Mauritius (rupees) sugar, and grapefruit with which we started our breakfast comes from Palestine (Palestine pounds) and South Africa (South African pounds). Tea comes from India or Ceylon (rupees) or perhaps China (Chinese dollars), and if we take coffee for breakfast it may come from Kenya (pounds), Costa Rica (colones), and many other countries. The blades of our knives are made from steel, the raw materials for which are imported possibly from Sweden (kronor), Algeria (francs) or Spain for the iron ore, while the chrome for hardening the steel may come from Turkey (Turkish pounds). The bone for the handles possibly comes from Uruguay (pesos), or if they are made from ivory, it may come from Africa. The cutlery may be made of silver coming from Mexico (pesos), and even if silver-plated, silver is still wanted for that purpose. Perhaps the glass for our salt-cellars or butter dish comes from Czechoslovakia (korun), and the flax for our tablecloth may be grown in Russia (roubles), Belgium, or Latvia (lats), while the wood for the table may come from Scandinavia.

Before we have breakfast we have to dress. When Jack Robinson got up in the morning he wanted wool for his underclothing and for his suit, which comes from Australia. He also wanted cotton for his shirts, which comes from the United States, Egypt, or possibly Peru (soles). He wanted rubber for his braces and for the rubber heels for his shoes, which comes from Malaya; and for the clasp on his braces he wanted tin, which may have come from Bolivia (bolivianos) Malaya, or Nigeria (pounds). The hide out of which his shoes were made may come from many countries—possibly the Argentine. The buttons on his suit, if they were the best buttons, were made from a hard nut which comes from Brazil (cruzeiros), or they may have come from France if not made from these nuts. The lining of his coat was made from mohair from Turkey, while the horsehair for padding his coat possibly came from China. The dyes for his clothing may have been manufactured in this country or they may have come from Germany or Switzerland (Swiss francs). The silk out of which his tie was made came from Japan (yen). He used Swedish matches to light his tobacco (which came from the United States). Before he had breakfast he shaved with soap which was made from oil seeds from West Africa (pounds) or from soya beans from Manchuria (yuan), and the bristles of his shaving brush and hair-brush came from China.

From the time Robinson got up and until he finished his breakfast he required at least thirty-five imported commodities, and indirectly, in order to pay for them, the foreign currencies of perhaps twenty-nine countries; and as he went through his day the list could be very much extended, because all the people who made these commodities would also require imported foreign materials to manufacture them.

Up to now we have shown how people are indirectly concerned with foreign exchange through the foreign commodities which they consume. But, curiously enough, some member of each family of our little community had —before the war—direct experience of the need to exchange foreign money for our own money, or to exchange our own money for that of some foreign country.

Tom Smith had a brother in the United States who was earning good money, and sent Tom 20 dollars every three months to help to support their old mother. This money came to Tom in the form of a money order worth 20 dollars, which he could encash in sterling at the specified Post Office branch. Before the war Tom used to get about £4 in exchange for 20 dollars, but since the war he gets about £5 for them. On the other hand, Mrs. Brown's (the butcher's wife) sister is a widow in Australia with four children, and finds it very hard to make both ends meet. Charlie Brown used to send her about £20 a year, £4 or £5 at a time. If he sent four English pounds, his sister-in-law (owing to the rate of exchange) got five Australian pounds for them.

Before the war young Ivor Jones, who was a bit of a lad, used to like a trip over to Ostend occasionally for a week-end and to have a fling at the Casino. In order to do this, he would buy from Ian Mackintosh Belgian belgas of which he got (in July 1937) 29.50 for every English pound, each belga being equal to five Belgian francs.

In February 1937 Mrs. Robinson went over to Vienna to stay with an old school friend, and while there bought clothes and hats. She changed some of her sterling travelling cheques (issued by Ian Mackintosh's bank) through a bank in Vienna and obtained 26.5 schillings for each pound.

Her husband, Mr. Robinson, bought castor seed from an exporter in India which he wanted for making commercial castor oil in his factory, his chief customers for the product being in the textile trade who used it in their manufacturing processes. The amount of his bill came to about 4,200 rupees, in order to purchase which he had to pay Ian Mackintosh at the rate of 1s. 6d. for every rupee.

Finally Ian Mackintosh, or rather his bank, was directly concerned with foreign exchanges because it had in some way or other to pay for the Belgian francs, the Australian pounds, the Austrian schillings, and the Indian rupees which Mackintosh had to supply to Jones, Brown, and the Robinsons. Ian Mackintosh's bank bought these from banks with which it was in connection in the various countries. These continental banks, on the other hand, also had customers who wanted English pounds to pay for goods which they had bought here. The continental banks bought the pounds from Ian Mackintosh's bank, and the transactions between the two banks largely cancelled each other. Of course on any given day the two transactions did not exactly cancel each other out. Ian Mackintosh's bank might some days owe more to the Belgian bank than the Belgian bank owed to Ian Mackintosh's bank. The difference might have been left outstanding for a certain length of time ; that is to say, the Belgian bank might have given the English bank a certain amount of credit, but if it went on too long or became too much, then Ian Mackintosh's bank was obliged to find the amount of Belgian francs which had not been cancelled out. The bank would go to other banks in London, who had perhaps a surplus of Belgian francs, and would buy francs from them. If in the market as a whole, however, there were not sufficient Belgian francs, then the demand for the Belgian francs would be greater than the supply. There would be two buyers and only one pig, and just as that would result in the price of pigs going up, so it would result in the price of Belgian francs going up, and it is this variation in the demand and supply of foreign money and English pounds that causes the rate of exchange between England and those other countries to go up or down.

Chapter X

WHY ALL THIS FUSS ABOUT CREDIT?—I

"If everybody minded their own business," said the Duchess with a growl, "the world would get on a deal faster." However this may be, credit perhaps plays a part in giving it the twirl that keeps it spinning. In any case it is credit which enables crops to be grown throughout the world, live-stock to be raised, minerals to be extracted from the bowels of the earth, all kinds of commodities to be manufactured, and for all these things to be moved from places where they are not wanted to places where they are, and stored up from the time of production until they are needed for consumption.

In this complex world of ours, it happens more often than not that the people who save capital are not the people who have the energy, enterprise, and initiative to use it, and if it is lent to the latter we call it "credit." It also happens that the producer cannot afford to wait until his product reaches the ultimate consumer. The farmer generally, for example, in the U.S.A. has not enough capital to enable him to pay his labourers and live, while he grows cotton and waits for payment until Janet Smith buys her cotton blouse over the shop's counter. It is credit that bridges the gap. The farmer who raises cattle in Argentina cannot wait until Mrs. Robinson pays Charlie Brown his weekly book; credit again plays its part.

In discussing credit, it is useful to take the example of a ship. Credit is necessary to bridge the time from when the iron ore is mined until it is finally made into steel plates. It is also required for the timber from the time that it is felled and the long period required for seasoning it and its transportation (perhaps from Burma, if it is teak for the decks) till the time it reaches the shipyard where the ship is being built. Credit is required during the making of the machinery and fitting-out of the ship generally; and finally, after perhaps as much as a couple of years, when the ship is launched, an entirely different set of credit transactions comes into being. The ship begins to carry goods to and from all the four corners of the world, and credit again is wanted from the time of the production of every raw material or foodstuff until the final product is bought, and even then sometimes the retailer gives credit. Throughout all these voyages supplies must be kept—oil, coal, etc.—in different ports so that the ship can refuel as she goes along. The necessary stocks of oil or coal are carried by some means of credit.

If, then, credit does all these things, why all this fuss about credit? There are several reasons. First, there are a large number of people who think it is wrong to buy something before they have saved up enough money to be able to pay cash for it. Secondly, there are some people who thinks that credit is wrong because in our world the reward to the person who gives the credit is in the shape of interest. Perhaps the most important or usual objection to interest comes from people who think that the lender has not been involved in physical or mental labour, and therefore is not entitled to receive payment for doing nothing. These people are apt to look upon rentiers (that is, people who are living on interest and doing no work) as parasites on society.

Another kind of objection relates to credit given by banks and comes from people who believe that banks can create as much credit as they like, and even create it out of nothing. They think that credit is such a great power in the world for good or for evil that the giving of credit should be a function of the Government, and not a power placed in the hands of joint-stock banks, which belong to private shareholders, and which some people think have a monopoly.

Credit is used very often merely as a matter of convenience. Mrs. Robinson needs credit from Charlie Brown, not because she has not got money to pay at the moment when she buys the meat, but because it is inconvenient to pay cash. She telephones her order in the morning, and it is inconvenient for her to go round during the course of the day and pay Charlie Brown for the meat which he has delivered, or to leave the money with the cook who gives it to the butcher's boy.

Charlie Brown, on the other hand, takes credit from his suppliers because he has to give credit to some of his customers. Robinson takes credit from his bank to purchase certain raw materials which he requires to meet a demand for one of his products, which always increases in anticipation of the Christmas trade. It is cheaper for him to take this occasional credit from his bank for a short period than it would be for him to increase the capital of his company, as he would only be able to use the increase for this short period.

We have already explained that another reason for credit is that the saver is not always the man who is fit to use his money in industry or commerce, and he therefore lends it to someone else who is capable of using it. Even if the borrower has some money he may not have enough to build, for instance, a factory sufficiently large to be run in the most economical manner, and therefore borrows from other people. Furthermore, lenders are not always in the place where the money is wanted. There may be need for a railway in Abyssinia, where it is impossible to borrow the necessary money from the Abyssinians. The money, however, can be borrowed from lenders in New York or in London. Although it cannot be found by one lender, it can be collected from thousands of lenders through firms whose business it is to act as a channel for the investments of these lenders.

We must distinguish between credit and capital. There are two main differences between credit and capital, using the term "capital" in the ordinary business or financial sense, *i.e.* money capital, for instance, "How much capital has he in his business?" First, money which is put into a business in the form of capital is generally intended to be an investment of a permanent nature, and it is not expected as a rule to be repaid or taken out of the business until the business is finally wound up. This does not mean, of course, that the owner of the capital cannot sell his investment in it to someone else; but the capital would still remain in the business. It may be in a private business or it may be in the form of shares in a limited company. Charlie Brown, if he has shares in a company, can sell them to David Jones, but the amount of money which Charlie Brown paid to the company originally to acquire the shares still remains with the company. The ownership has changed from Charlie Brown to David Jones. Credit, on the other hand, is the postponement of the payment of a debt (Mrs. Robinson's weekly butcher's book) or of something which is lent (Robinson's loan from the bank), the intention being that it should be paid back within some definite period. The second main difference between capital and credit is that the capital in the business must be used in case of necessity to pay the creditors of the business before the owners of the capital can get their money back. For instance, suppose Charlie Brown has £200 capital in his business which he has used to fit up his shop, buy a butcher's van, and keep the cash necessary to pay his assistant, and then buys £200 worth of meat on credit. If Charlie Brown now loses £50 of his capital because some of his customers owe him money and don't pay, and because a big store has started to sell meat and is taking away a lot of his customers so that his expenses are too heavy for the amount of business which he can do, the people who sold him the meat on credit would still be paid in full when the customers to whom it has been sold pay their bills, and the whole of the loss of £50 would fall on Charlie Brown—not half on Charlie Brown and half on his creditors.

Now let us turn to the question of interest. The rate of interest which borrowers pay varies according to the risk which the lender runs in lending his money. In the first place the risk varies with the length of time for which the money is lent, because the longer the loan is outstanding the greater the risk. In practice the least risk is run in this respect by banks who lend day-to-day money to the money market, that is, money which is lent for one day only. Even here there is some risk, because something unfortunate might happen to the borrower even in one day which might prevent him paying, but the risk is very small. Secondly, the risk varies with the security which is given for the repayment of the loan. Even if the security appears to be first-class there may be some risk. It happened some time ago that first-class municipal bonds, which were given as security to banks, were forgeries. Risk in lending money also varies in accordance with the creditworthiness of the borrower. A borrower with plenty of capital of his own and a long-established reputation for honesty is naturally more creditworthy than a man with a small capital doing a large business in proportion to his capital and who has not been trading sufficiently long to establish a first-class reputation. Again it depends on the nature of the borrower's business. A borrower who is carrying out a contract for the British Government is more creditworthy than one who is selling goods on credit abroad to buyers from whom repayment is less certain than it is from the British Government.

There is another feature besides risk which accounts for differences in rates of interest: that is the expenses of the lender in making the loan. A loan made by a bank for £5,000 which is taken at one time against first-class security costs the bank in expenses less than a loan for £5,000 which is drawn out by the borrower from time to time as he requires it, and which consequently will involve the bank in book entries each time part of the loan is drawn out, as against the one book entry which they had to make for the borrower who took all the money at once. Furthermore, the second borrower may have given the bank as security commodities (such as cotton, wheat, etc.), or stocks and shares, the fluctuating value of which the bank must watch from day to day in order to make sure that the value of its security is maintained, and all this watching involves the bank in further expense.

Let us see how all this works in practice. The rate which the day-to-day borrower has to pay for a loan of £365 works out at a little under 2d. for one day. It is not much surely. Why then all this fuss about credit? The fuss arises because people do not realize that when they are charged 4 or 5 per cent. for their overdrafts (say 10d. to 1s. a day for the loan of £365), the difference between that and the 2d. a day for the day-to-day borrowers is caused by the difference in risk and the difference in expenses involved.

Payment for risk and expenses of giving credit is not always taken in the form of interest. Many manufacturers and shops give a discount for cash, which of course means that people who take credit and do not take a cash discount have to pay more than cash customers in order to recompense the shopkeeper or manufacturer for the risk and expense which he is running in giving credit. If a shopkeeper or manufacturer gives no cash discount, even if he charges the same price for his goods—whether sold for cash or on credit—he is still getting payment for his risk and expenses in giving credit, because his goods are priced a little dearer than if they were all sold for cash, and the cash buyers are thus paying some of the payment for expenses and risk which really should only be borne by the credit buyers.

CHAPTER XI

WHY ALL THIS FUSS ABOUT CREDIT?—II

IN the previous chapter we mentioned the various objections which are heard from time to time on the question of credit. Before dealing with them individually, it will make the answers clearer if we say something about the essential features of all *sound* credit. Credit, if in the shape of money lent, must be repaid ; if in the shape of goods given without immediate payment, they must be paid for at some future date. In order that credit may be sound, the borrower or the buyer of the goods must be creditworthy—that is to say, first, he must not only be sufficiently honest to have the will to pay his debt, but second, he must also have every reasonable prospect of being able to do so. It is desirable that the credit given should itself provide the means of repayment. This we will explain more clearly later on. The commodity purchased on credit should remain in being (that is, should not be consumed or used up until it has been paid for) or, failing that, sufficient of its value should remain unconsumed to equal the amount of the debt still outstanding.

We may now consider the objections which are raised against credit, and in considering these objections apply the essentials which we have cited above for sound credit.

The first objection was, " It is wrong to buy something before we have saved up enough money to be able to pay cash for it." It would be wrong to buy anything on credit if we are not as sure as we reasonably can be that we shall be able ultimately to pay for it. It would be wrong for Janet Smith to buy an expensive fur coat which costs more than all her savings, and for which she could not pay if she lost her job. Of course, the people who object to Janet Smith buying an expensive fur coat before she has saved up enough money for it would possibly also object if she *had* saved up enough money, and would say it was a piece of gross extravagance for a girl in her position. If, however, Mrs. Robinson bought an expensive fur coat on credit, it would not be wrong, because if the worst came to the worst, she has plenty of National Savings Certificates which she could realize to pay for the coat. The reason, then, why it was wrong of Janet is that she contravened our first rule of buying something on credit for which she is not quite certain—or as certain as she humanly can be—that she can pay.

Would it be equally wrong for Janet to buy a sewing-machine on credit? She may have talked it over with her mother, and pointed out that it would really save her money, because she could make some things more cheaply than she had been in the habit of buying them from the shops, and with the money she saved she could pay off the cost of the sewing-machine. Besides, it might happen that the two ladies for whom her mother works might have promised to give her sewing that she could do on her machine, and she could thus earn enough to pay off the cost gradually. Now, in this case it is not wrong of Janet at all. She has not contravened any of our rules—

1 She can see a reasonable prospect of paying for the machine.
2 The buying of the machine in itself provides the means of payment out of the money which she is going to earn from her mother's ladies.
3 The machine will still be there after she has paid off the debt. It is true that if she has not paid off all her instalments and has to sell the sewing-machine, it will not realize as much as she paid for it, as it will be second-

hand, but in the meantime she will have paid off a certain amount, and what it does realize ultimately may possibly be sufficient to cover the remainder of the debt.

These considerations and these rules do not only apply to Janet Smith and Mrs. Robinson, but apply to all forms of commercial and industrial credit. If money is lent to Benjamin Hogge, the farmer, to grow a crop, the crop when grown provides the means to repay the debt. If money is lent to Robinson for five or six years to put in some new labour-saving machinery, the saving effected would pay for the loan within the period and the machinery would still be there. If money is lent for twenty years to Abyssinia to build a railway which would lead to the development of the country, the money earned by the railway would, during the twenty years, not only pay the interest stipulated but also provide an annual fund called a "sinking fund," by which the whole of the loan would be paid off at the end of the twenty years, and the railway would still be running.

The second objection mentioned in the last chapter was, "Credit is wrong because in our world the reward to the person who gives the credit is in the shape of interest. Perhaps the most important or usual objection to interest comes from people who think that the lender has not been involved in physical or mental labour, and therefore is not entitled to receive payment for doing nothing. These people are apt to look upon rentiers (that is, people who are living on interest and doing no work) as parasites on society." Of course these people do not mean that it is always wrong. They would not consider it wrong if an old man, who had worked hard all his life and saved up enough money, lived on the interest of his savings during his declining years, or when he died left his money to his widow, who lived on the interest. But they do think it wrong that people capable of work should be able to live on the interest arising out of inherited money, or out of money which they themselves have quickly gained as a result of speculation. There is a great deal to be said for the point of view that it is wrong for people to do no work and render no service to their fellow beings (of course sometimes they do render services which are unpaid). But is it any more wrong if they are living (without working) on the interest on their savings than it would be if they had no interest and lived without working by spending the savings themselves, *i.e.* their capital ? The wrong is not really the existence of interest, but the existence of idle people.

The third objection comes from people " who believe that banks can create as much credit as they like, and even create it out of nothing. They think that credit is such a great power in the world for good or for evil that the giving of credit should be a function of the Government, and not a power placed in the hands of joint-stock banks, which belong to private shareholders, and which some people think have a monopoly."

Can banks create credit, and can they create it out of nothing ? Can Charlie Brown create credit, and can he create it out of nothing, and what is the difference between what the banks can do and what Charlie can do ?

How much credit can Charlie Brown give or create ? Part of his money—that is, his capital—has been used in fitting up his shop, just as part of the bank's capital is used in buying its premises and fitting them up. To the extent that either Charlie Brown or the banks have any surplus capital available after paying for all these things, Charlie Brown can use such surplus capital to pay cash for his meat and sell the meat on credit, and the banks can use any surplus capital to give credit to the Government by lending directly or indirectly to it, or by buying Government bonds, or they can give credit to private people or business firms by lending to them. But both Charlie Brown and the banks can give credit beyond the amount of their surplus capital. To what extent can they do this? Having no more capital available, Charlie Brown can only give further credit and the banks can only lend further sums if they can get an equivalent amount of credit from someone else. If Charlie Brown can get credit from the people who sell him the meat, or borrow money from his bank and pay cash for the meat which he buys, he can give more credit to his customers; if the banks can get credit by the public lending them money (that is, depositing the money with them), they can give more credit to other customers. If either Charlie Brown or the banks gave more credit than the amount of their own capital which was available, plus the amount for which they received credit (in the case of the banks, their deposits which they owe to the public), they would both smash.

How does Charlie Brown get the cash that he wants for his business? He draws it out of his bank out of the money standing there to his credit. How do the banks get their cash? They draw it out of the Bank of England out of the money standing to their credit. The difference is, that if the Bank of England thinks that the banks have not got enough cash and consequently cannot give as much credit as the country requires for an expanding trade it can, and does, provide them with cash by buying from the public Government securities. The cheque which the Bank of England pays the public for the securities is paid by the public into the banks, and the banks can then, if required, cash the cheque with the Bank of England, thus obtaining notes and coin. But the total amount of bank-notes which the Bank of England can issue is subject to the consent of the Government and Parliament.

To the people who say that the granting of credit should be a function of the Government and not of the banks, the answer is that the whole basis of credit depends on the amount of bank-notes issued, and this is determined by the Government. The function of the banks is, not to determine the total amount of credit which can be given, but to distribute it among the borrowers who want it.

The other difference between Charlie Brown and the banks giving credit is this. If Charlie Brown gives credit to Mrs. Robinson, he has one entry in his books showing that Mrs. Robinson owes him so much money. If a bank makes a loan it has two entries in its books, one showing that the borrower owes it the amount of the loan, and the other crediting the borrower's account with the amount so that he can draw it out. These are merely bookkeeping entries.

The banks are always liable to be called upon to pay their customers—that is, their depositors—cash in notes and coin. Experience has taught them that if they keep £10 ready cash for every £100 of deposits, that is sufficient to meet all requirements. If, when the customer has drawn out his loan to pay somebody else, the third party does not lend the money back again to a bank in the form of a deposit but takes it out in cash, the banks cannot go on lending money but must reduce the amount which they have lent. For example, suppose Robinson takes a loan for £1,000 from Ian Mackintosh's bank. He can either draw the money out in cash and use it to pay wages, etc., in which case it will come back to the banks from the shops, and the bank's cash position will remain unchanged; or, if Robinson has bought some raw materials with the £1,000, he will give a cheque for the amount to his suppliers, Oil Seeds Ltd. If Oil Seeds Ltd. pay the cheque into the bank to their credit, the bank's position will also remain unchanged. But if Oil Seeds Ltd. have not enough confidence in the bank to leave the deposit with it, and draw out cash which they put in their strong-room safe, then the bank's cash is reduced by £1,000, and it will be forced to reduce the amount of credit which it gives either to the public or to the Government, otherwise it cannot maintain its ratio of £10 cash to £100 deposit.

The latter part of the third objection was that the banks should not be allowed to create credit because they have a monopoly of creating credit. Banks have not a monopoly. They are not only in keen competition with each other as regards giving credit and with other credit-giving institutions, but also with those business people who have a relatively large capital and can give credit to their customers by using their own capital and without borrowing from the banks. As regards bank deposits on deposit account, the banks' keenest competitors are the Post Office and Trustee Savings Banks; the intensity of this competition is shown by the fact that while the Savings Banks pay 2½ per cent. interest to their depositors, the ordinary banks can only pay a mere fraction of this for deposits on deposit account.

Chapter XII

COMPLAINTS

We may now consider three other complaints which are sometimes heard against the methods of the banks in giving credit. Some people complain that they cannot get credit, that banks will not give credit to small people. It is quite untrue that banks will not give credit to small people. The Midland Bank, for instance, stated some time ago that more than half of the total number of the bank's advances were in sums not exceeding £100. Many of the complaints of this kind come from people who are not creditworthy. Shopkeepers would be as loath as banks in giving them credit, and it must always be remembered that the banks are lending the money of their depositors and cannot afford to use it in ways which are not safe.

Another complaint comes from people who have gone to the wrong shop. Robinson, we have seen, obtained an advance from his bank to carry him over the Christmas trade, because the money would be repaid directly the Christmas season was over. But if Robinson wanted money to extend his factory, buy new machinery, etc., he could not get it from his bank, because the money would be locked up for years before it could be repaid; and as banks are liable to pay out the money to their depositors on demand, or after short notice, they would be very ill-advised to tie up the money for long periods when it would not be available quickly if needed. Robinson could get the money, if it were wanted for a sound object, through other institutions in the City, but it is not the bank's business to lend it him. He has gone to the wrong shop in exactly the same way as Mrs. Smith would have done if she tried to buy her cabbages from Charlie Brown.

A third cause of complaint frequently heard against banks is that their charge for credit is too high. Some years ago the minimum charge for banks' overdraft was 5 per cent., but that has long gone by the board, and now the average charge is probably in the neighbourhood of 4 per cent. Is that still too dear? At how much does it work out? It means that £365 can be borrowed for 10d. a day, which is a little over 4 per cent. a year. If it was reduced to 3 per cent. a year it would cost about 7½d. a day. What would be the consequence? Mr. McKenna, chairman of the Midland Bank, said a few years ago that if the rate were reduced by 1 per cent., either all bank salaries would have to be cut by one-third or shareholders would receive practically no dividends. If Charlie Brown has borrowed £365 from his bank, is it indeed fair or just that in order that he might save 2½d. a day the salary of Ian Mackintosh and his clerks should be reduced by one-third?

People who complain about the charges made by banks overlook the large amount of work which they do for nothing. One evening when Mackintosh had gone across to the Robinsons, and Mr. Robinson had drawn his attention to a letter in the papers about bank charges, Mackintosh explained some of the work which his branch had to do without payment. He pointed out that every client was given a pass book or pass sheets with a copy of his account, for which book and sheets they made no charge, nor did they make any charge for supplying all their customers with cheque books.

"Oh," said Betty, "but when I check mother's pass-book she is often charged for a new cheque book."

"Not for the expensive and beautifully printed book," said Mackintosh, "only for the 2d. stamp on the cheques, which is a tax imposed by the Government. There is another service which costs you nothing. When you people went for your summer holidays before the war and locked up the house, you sent to the bank a big box full of silver and jewellery for safe keeping, Again, English banks do not charge for bankers' orders, which involve an increasing amount of work."

"What are bankers' orders?" asked Betty.

"Orders to pay club subscriptions and life insurance premiums, and, if the size of the account warrants it, instalment payments to building societies or hire-purchase payments (but not weekly). In certain cases my bank also makes payment of wages and salaries for firms, and for their accounts owing."

"You would be surprised, too, at the amount of my time which is taken up in giving free advice or listening to and discussing the difficulties of my clients. Naturally people come to me to ask about the financial standing of their customers, but I have also to answer questions on matters like lost dividend warrants, how to fill up Government returns, what clients should invest their money in, and questions relating to fire insurance and life insurance. The different affairs on which a poor branch manager is expected to advise is astonishing. All this sort of thing costs the bank money, and the cost has to be met in some way or other, and if not charged for, can only come out of money which the bank earns."

Our community—the Smiths, Joneses, Browns, Robinsons, and Mackintosh—is a microcosm of the country as a whole. Mackintosh's branch bank is a cog in that great machine, the working of which enables all our friends to obtain the notes and coin which they require for their daily transactions, provides through the cheque system the means of paying and receiving larger sums, cares for their savings and deposits, provides new capital and credit where credit is required and the borrowers are creditworthy, affords a market for the purchase and sale of their investments, and provides them with any foreign money they may require or buys from them any foreign money which they may receive.

The machine is always changing and constantly being improved. In spite of all the changes, however, the saying "as safe as the Bank of England" not only remains true but can be applied to all the savings banks and the great deposit banks of the country. In the last decade or two there were many banks in foreign countries about which this could not have been said. More changes will, no doubt, become desirable with the passing of time, and there is no lack of suggestion as to what those might be. Some of the suggestions are thoughtless and ignorant, some thoughtful but ill-informed, and some both thoughtful and well-informed. In considering them it should not be forgotten that our whole monetary and financial system is based on confidence: confidence that the Government will not play any tricks with our currency, by printing notes in order to pay its way; confidence in the Bank of England, now 250 years old, with a vast experience behind it but still sufficiently progressive to make those changes which changing times call for; confidence on the part of the public that the money which they entrust to the savings banks and deposit banks will always be repaid; confidence on the part of the banks in the creditworthiness of those customers to whom they have lent money; and, finally, confidence on the part of each one of us in the honesty of the people with whom we deal and in their ability to pay their debts.

Confidence is a very tender plant which takes much experienced handling and care to bring to maturity; one blast, however, of the keen wind of general mistrust can so damage it in a day that it may take years before it can be restored. While, therefore, all suggestions for change which contain a grain of reason should be carefully examined and considered, yet to each and every one of them there should be applied the acid test, "How will it affect confidence?"

PART THREE

HOW WE PAY FOR THE WAR

CHAPTER XIII

WE AND *THEY*

FOR our present purpose by *we* we mean the people, and by *they* we mean the Government. The question of what *they* do in regard to money and finance, particularly during the war, looms large in the minds of all the Smiths, Joneses, Browns, and Robinsons, for they are beginning to feel more and more that anything which the Government does in the realm of money and finance affects their daily life through their pocket. The people are showing a desire to be better informed than they were on these matters, and are asking questions about them. To some of these questions readers will have found answers in preceding chapters.

One question, and indeed a very important one, which is constantly cropping up, is, "How do we pay for the war? If we can spare all the money for that, can we not spare it for peace objects?"

The subsequent chapters of this book will be devoted to an attempt to answer this as simply and clearly as may be; and in doing so we shall find that many other questions arise incidentally, and to these, too, an endeavour will be made to find an answer and to give it in a form so that *we* may understand what *they* are doing and why they do it.

There are two things to remember. The first is that *they*, the Government, have no money of their own, nor can they spend any money without the consent of Parliament which *we* have elected. All the money needed to pay for the war and for the expenditure of the Government in times of peace must, in some way or other—directly or indirectly —come out of the pockets of the people. The second thing to remember is that if *we* have only a certain amount of money we cannot buy everything we want; we must choose what we want most. It is like a large family in which all the members contribute to the household expenses; the members being *we*, and *they* being represented by the mother who does the housekeeping. Imagine the family (i.e. *we*) suddenly faced by a disaster through the house catching fire. It has to be restored, and we therefore agree amongst ourselves that we will contribute an extra amount of money so that the mother can have it put right, and in order to do so, economize on things on which we had been accustomed to spend our money.

Some people say that *they* (the Government) can make as much money as they want in order to buy the commodities they need for war purposes; but making money does not make commodities, and the real limit of what we can have is the amount of things which can be produced by as many people as possible working, and working their hardest. What we want during the war are guns, ammunition, ships, and aeroplanes, and money is a useful means of inducing people to supply them; but however much money we have, it cannot buy more than can be produced. At the present time what the people want most is to win the war, and for this purpose are willing to make great sacrifices in order to buy more armaments and less of other things. As Hitler used to say, "Guns must come before butter."

How Much Does the War Cost?

During the first four and a half years of the war Government expenditure amounted to about £20,000 million, of which about one-quarter would have been spent even if there had been no war. To the ordinary man, astronomical figures like these convey no more meaning than to say that the sun is 93 million miles away from the earth. We must try and reduce it to smaller dimensions. Even if we divide it by four and a half, and say that the average annual expenditure for the four and a half years was about £4,400 million, it is still meaningless. In 1944, after four and a half years of war, we were spending about £16 million a day. Who can grasp what £16 million a day means? Let us try and reduce it to some figure which we can understand.

In Great Britain there are about 47 million people. The total expenditure in 1943–44 (including that which would have been spent had there been no war) was £5,799 million, or equal to an average daily expenditure of 6s. 9d. by every man, woman, and child in the country, and it will be convenient to use this figure of total expenditure in what follows. It must be repeated that this 6s. 9d. is an *average* figure. Young children cannot contribute to it at all, and as regards the others, the more well-to-do have to find the most, and the less well-to-do a smaller share. At all events we have a figure that does mean something to us, and it can be divided among the various methods by which *we* (Tom Smith and his wife and daughter Janet, David and Ivor Jones, Charlie Brown, Jack Robinson, Ian Mackintosh, Benjamin Hogge the farmer, and Mugglethorpe the wireless shopkeeper) find this money for the Government.

How Far do Taxes Pay for the War?

Before dealing with this question, it might be useful to compare the expenditure during the war of 6s. 9d. a day by every man, woman, and child with that of a normal peace year.

If we go back ten years to 1934–35 (*i.e.* 1st April 1934 to 31st March 1935—which is the Government financial year) we are dealing with a normal year of peace-time activities. Trade was recovering from the great depression of 1929–31, and the Government had not yet begun to spend abnormally large sums of money on the army, navy, and air force. In that year the Government's expenditure, instead of being 6s. 9d. per head per day, averaged 9¾d. per head. The difference between this 9¾d. and 6s. 9d. represents (except for comparatively minor changes) the cost of the war. In 1934–35 all the money which the Government spent was provided by the taxes paid by the people, but during the war rather less than one-half has been provided by taxes. In 1943–44 revenue amounted to 52 per cent. of total expenditure. Nearly the whole of the balance was raised either by savings lent by the people to the Government, or was raised by loans from the banks to the Government, and these loans were made by the banks out of our money which we had deposited in them.

Are Taxes the Same for Everybody?

If this question means, "Does everybody pay the same amount of money in taxes?" the answer is "No"; but the Government tries to make the sacrifice borne by everybody the same. It endeavours to frame its whole taxation (not necessarily individual taxes) in such a manner that the burden of sacrifice shall be no greater on the wage-earner earning £2 or £3 a week than on the rich man with an income of perhaps £2,000 a year.

How is this equality of sacrifice to be achieved? It obviously will not do to demand the same amount of taxes from everybody whatever his income. Taking £2 a week from Tom Smith, who with his wife is earning £4, would entail an incomparably greater sacrifice on him than taking £2 a week from Jack Robinson earning £40 a week (say,

£2,000 a year). Nor will it do to take the same proportion of the income. Taking £2 again from Tom Smith with earnings of £4 would be to take half his income and leave him only £2, on which he could not adequately support his family; while taking half the income of Jack Robinson earning £40 a week would still leave him £20 a week, and his sacrifice would be much less than that of Tom Smith, for, although he might have to economize substantially on his expenditure, there would still be quite sufficient left to feed, clothe, and house his family adequately. But in measuring sacrifice, we cannot take into consideration only the amount of money left, but how much is left compared to that which people have been accustomed to.

In order to obtain an equality of sacrifice, taxation must be graduated, the higher incomes paying a larger proportion of their income, and the lower incomes paying a less proportion of theirs. It is, however, a very difficult thing to measure the degree of sacrifice, as it varies not only from the less well-to-do to the very wealthy man, but between similar incomes in the same class. For instance, in order to try to obtain equality of sacrifice, a single man begins to pay income tax when he earns over £110 a year, but a married man without children only begins to pay this tax if he earns over £150. If he has one or two children he pays no tax unless he earns more than £200 a year with one child, or £250 with two children, and with exemption of £50 for every additional child. That is the way the tax is graduated between Tom Smith and his neighbour.

Now as between the less well-to-do Tom Smiths and the more well-to-do Jack Robinsons, the income tax of the married man earning £200 (with no dependent children) works out at 1s. 3½d. in the £, or £13 a year, while the income tax of the Jack Robinsons with ten times the income

(£2,000) instead of being ten times as much (say, £130 a year in income tax) is £751 (with three dependent children for whom he gets allowances), which is 7s. 6d. in the £. A man with more than £2,000 a year begins to pay a graduated surtax (which is an additional income tax on higher incomes). A very rich man, with an income of £9,000 a year, might be paying about £6,000 or 13s. in the £, in income tax and surtax, *i.e.* nearly two-thirds of his income, while a man whose income was £25,000 a year would be paying about £21,000 or about 17s. in the £.*

HAS THE INCREASE IN THE STANDARD RATE OF INCOME TAX RESULTED IN A PROPORTIONATE INCREASE IN MONEY FOR THE GOVERNMENT?

The standard rate of income tax during the war compared with 1934–35 has risen from 4s. 6d. to 10s. in the £, or rather more than double, but the income which the Government has derived from income tax has increased about five times. This is because in addition to the increase in the standard rate, many more people are paying income tax to-day than before the war, first, because the exemption limit has been reduced and has brought in about six and a half million new income-tax payers, and secondly, because the tax is now deducted from wages, and therefore some wage-earners who escaped paying before the war, although they were liable to the tax, are brought automatically into the net. Thirdly, more people are paying income tax because there are more people working; unemployment has been reduced to almost the vanishing point, and a great many people who did not need to work are now in employment; also wage rates are higher, and people are earning more overtime.

Carrying out the principle of equality of sacrifice is

* See page 86.

much more difficult for the Government in war-time than in peace-time. In peace-time if we cannot do everything we want (say in the way of expanding education) without inflicting an unfair burden of taxation on certain sections of the population, we can postpone it. But we cannot postpone war expenditure. In the first case the choice is between doing what we like to do at the time, or postponing it. In the second case the choice is between finding the necessary money to carry on the war, or defeat. In times of war the need of the Government for money is so urgent that it has to find the money where it can, even if in doing so some people sacrifice more in paying the tax than others. But difficult though it is, the Government does aim to carry out this principle of equality of sacrifice in levying its taxation, and to maintain a fair proportion between direct and indirect taxation.

What is "Direct" and what is "Indirect" Taxation?

By direct taxation we mean those taxes which are intended to be borne by the person who pays the tax to the Government, and it is not intended that the burden of the tax should be shifted on to anyone else's shoulders. Such taxes, for instance, are the Death Duties which are borne by those who inherit the money. The other forms of taxation which are generally included under the heading of direct taxation are income tax, surtax, stamp duty (on the transfer of property only), National Defence Contribution, and excess profits tax, and these taxes in the year ending March 1944 accounted for 64 per cent. of all the taxes which we paid to the Government.

Apart from income tax and surtax there are other direct taxes which are graduated. For instance if Tom Smith leaves less than £100 when he dies, there is no Death Duty payable. If the money left by Charlie Brown is between

£100 and £500, 1 per cent. of the amount is payable; and if Jack Robinson by the time he dies leaves £50,000, nearly £10,000 is payable (or 20 per cent.). On the estate of a millionaire leaving £1,000,000 the Government would take over half.

Indirect taxation consists practically entirely of Customs and Excise Duties. These indirect taxes are paid in the first instance by the importer or manufacturer, with the intention (unlike the case of direct taxation) that he shall pass the burden on to the consumer by including the tax in his price. Customs Duties are the taxes levied on the import of commodities from overseas, the one which brings in most money being tobacco (which accounts for almost 70 per cent. of the whole), followed by mineral oil, wines and spirits, sugar, and tea. Excise Duties are mainly duties charged on certain commodities manufactured in this country, the most important from the tax point of view being beer (bringing in over half of the whole Excise Duty), purchase tax (realizing a fifth of the total), spirits, entertainment tax, and matches. Licences for selling liquor, and other licences like dog licences also come under Excise Duties. Together indirect taxes accounted for more than one-third of all the taxes which we paid in the year ending March 1944. As a larger part of Tom Smith's income and of the less well-to-do classes generally is spent on the main items —beer and tobacco—than is the case with Jack Robinson and the more wealthy people generally, the sacrifice made by paying these taxes is, unlike the case of the direct taxes, greater for the less well-to-do than for the wealthier classes. This does not mean that a working man smokes or drinks more than a wealthy man, but he spends a larger *proportion* of his income in satisfying these desires.

The Government, however, has taken two steps which tend to relieve the burden of indirect taxation on the less well-to-do. First, purchase tax is graduated—luxuries up to 100 per cent.—whereas there is no purchase tax on necessities and on utility clothing. The second step which the Government has taken is to subsidize certain foods so as to prevent the price of them rising to the detriment of the poorer section of the population. If they had not done so, the price of the 4 lb. loaf, instead of being 9d., would have been 1s. 2d.; the price of potatoes instead of being 6¾d. for 10 lb., would have been 10¼d.; the price of eggs would have been nearly doubled, sugar would have been 5½d. instead of 4d., and to a lesser degree flour, oatmeal, meat, milk, cheese, and bacon would all have been dearer.

It must also be remembered that—certainly as regards beer and tobacco—these taxes are optional. A teetotaller and a non-smoker does not pay them, and any man can reduce the amount he pays by smoking or drinking less. No doubt the abstinence involves him in a degree of sacrifice; on the other hand it may improve his health. Since the war the tax on tobacco has increased nearly four times and the tax on beer nearly sixfold. On every packet of ten cigarettes costing about 1s. 2d. we are paying about 1s. in tax to the Government, and on every ounce of pure tobacco which we smoke about 2s. goes to the Government.

How far do Taxes Cover the Cost of the War?

We are now in a position to make up our budget, showing how much of the 6s. 9d. per day for every man, woman, and child which the Government is spending is obtained by it from the taxes which we pay, and to show in greater detail how much is obtained from the various forms of direct and the various forms of indirect taxation. The following table shows that out of our 6s. 9d., 3s. 5¼d. was raised by taxation, direct and indirect, in 1943–44.

TAXATION'S CONTRIBUTION TO THE 6s. 9d.

	s. d.	s. d.
Direct Taxation		
Income tax and Surtax	1 5½	
Excess Profits Tax and National Defence Contribution	7	
Estate Duty	1½	
Stamps and other Inland Tax Revenue	¼	
		2 2¼
Indirect Taxation (of which tobacco and alcoholic drink provided nearly 10¼d.)		
Customs Duties	7¾	
Excise	6¾	
Motor Vehicle Duties	½	
		1 3
		3 5¼

There still remains the balance, namely 3s. 3¾d., to be accounted for out of 6s. 9d., and in the next chapter will be described how *we*, the people, provide the Government (*they*), with the 3s. 3¾d.

NOTE. In the Supplementary Budget introduced in October 1945, the Chancellor of the Exchequer announced that in the next budget year 1946–47 the standard rate of income tax would be reduced from 10s. to 9s. in the £, and that various alterations would be made in the scale of allowances. For example, a single man would not begin to pay income tax until he was earning £120, a married man with one child would not pay until he earned £250, and with two children until he earned £300. A married man without children earning £200 would pay no income tax, while if his income was £2,000 (and he had three dependent children) he would pay about £650 or 6s. 6d. in the £, if £9,000 a year he would pay about £5,600 or nearly 12s. 6d. in the £, and if £25,000 he would pay about £20,600 or 16s. 6d. in the £.

Chapter XIV

BORROWING TO PAY FOR THE WAR

We have seen in the preceding chapter that towards the 6s. 9d. per day per head of the population which the Government spent, it received 3s. 5¼d. through taxation. But that is not the whole of its revenue, for it has in addition what is called "non-tax revenue." This accounted in 1943–44 for 1¼d. of the Government's expenditure of 6s. 9d. per day per head, making with the 3s. 5¼d. from taxation 3s. 6½d., or more than half of the total expenditure.

The final result, then, is that out of the total of 6s. 9d. the Government still had to raise 3s. 2½d. This it borrowed from the people directly or indirectly.

The five chief sources from which the Government was supplied with borrowed money were, first, "Small Savings"; second, "Large Savings"; third, the Floating Debt; fourth, Tax Reserve Certificates; and fifth, miscellaneous items, and we will now consider these under their separate headings and calculate how much of the 3s. 2½d. per day per head of the population which the Government borrowed in 1943–44 came from these sources.

Small Savings

For our present purpose small savings can be taken to be our deposits in the Post Office and Trustee Savings Banks, and our purchases of National Savings Certificates and 3 per cent. Defence Bonds through the Post Office.

There were on 31st December 1942 (the last year for which figures are available at the time of writing) about 16 million active deposit accounts in the Post Office Savings

Bank, with an average deposit of £63, made up by the individual amounts of each depositor. For instance, Janet Smith had only £2, David Jones £60, Charlie Brown £110, and all the others various amounts. In the Trustee Savings Banks there were 3,536,000 accounts, with an average deposit of £107. It should be mentioned that people may have accounts both with the Post Office Savings Bank and a Trustee Savings Bank. The smaller average deposit in the Post Office Savings Bank is no doubt due to the fact that many accounts for very small amounts are opened for young children, which does not seem to be the case to the same extent with the Trustee Savings Bank depositors.

There were about 17 million holdings of National Savings Certificates, the total amount outstanding by the end of 1943 being (with accrued interest) £1,450 million, or an average of £85 6s. for the 17 million holders. In addition, small savers had invested £853 million through the Post Office. The average total amount of these small savings in 1943 was somewhat greater than the average of the whole of the amount of money deposited in the ordinary banks, and amounted at the end of 1943 to an average of £85 for every man, woman, and child in the country.*

All the deposits in the Post Office Savings Bank and Trustee Savings Banks which are not invested in Defence Bonds or National Savings Certificates are lent during the war (and nearly all, before the war) to the Commissioners for the National Debt (a Government department) at 2⅞ per cent. per annum. Out of this 2⅞ per cent. the Savings Banks pay 2½ per cent. to their depositors, and any profit

* It must not be forgotten that the small saver, in addition to what he has saved through the Post Office and Trustee Savings Banks and National Savings Certificates, has very large sums saved in building societies, and in the purchase of his own house, and in industrial life insurance companies and other thrift institutions as well as in ordinary banks.

arising out of the difference between the 2½ and 2⅞ per cent. —after paying expenses and building up the necessary reserves—is returned to the Government. These Savings Banks are Government-supervised organizations, not run with the intention of making a profit but for the benefit of the depositors and no one else.

After this digression we may now return to the question as to how much of our 3s. 2½d. of borrowed money per day per head of the population arose in 1943–44 from the increase in small savings. These amounted to £678 million, or 9½d. per day per head of the population, which, deducted from our figure of 3s. 2½d., leaves 2s. 5d. still to be accounted for.

Large Savings

From the saver's point of view, and taking it all in all, the most advantageous method of lending his money to the Government is to put it into the Post Office or Trustee Savings Banks. He is at liberty to withdraw the whole of any part of it at any time, and he receives 2½ per cent. interest on all of it, whereas an ordinary bank pays him nothing on his current account, and only ½ per cent. on his deposit account. Moreover, the Post Office and Trustee Savings Banks make no charge for keeping an account, and depositors do not have to pay the 2d. duty on cheques on withdrawing or transferring their money. From the Government's point of view, however, it is the least advantageous method of borrowing, for, as we have seen, the Government pays 2⅞ per cent. for what it borrows from the Post Office and Trustee Savings Banks, whereas the average rate on all other money which it borrows is very considerably less (nearer 2 per cent.). Because of this the Government is not prepared to borrow all the money it needs from the Post Office and Trustee Savings Banks, and the amount which those banks will take from a depositor in any one year is limited to £500; large savers therefore are obliged to lend their savings to the Government in other forms.

Large savers comprise the more wealthy members of the community, but more particularly business firms and institutions. Banks and life insurance companies are the most important lenders to the Government. In order to borrow the money from large savers, the Government borrows at rates of interest varying according to the length of time for which the money is borrowed. Tom Smith, the Joneses, and Charlie Brown are small savers, and Jack Robinson's firm and Ian Mackintosh's bank are large savers.

Large savings in the case of private people arise in exactly the same way as they do in the case of small savings, *i.e.* from people or firms spending less than their income. In the case of business firms they arise, first, from the firms earning more profit than they pay out to their shareholders; and secondly, because before paying out any profits, the amount which a prudent firm puts on one side to cover depreciation of its buildings, plant, and machinery, and for extension of its works, cannot as a rule be spent during the war, but is allowed to accumulate, and very often is lent to the Government.

As regards life insurance companies, during the war the difference between the amount which the companies receive in the form of premiums paid annually by the people who hold life insurance and the amount which the companies have to pay out on the death of the policyholders (or after an agreed term of years) is lent by the life insurance companies to the Government.

We must distinguish in the case of banks and other financial institutions between short-term and long-term lending. We will deal hereafter with short-term lending; here we are only concerned with the banks' long-term lending to the Government repayable after a term of years at varying rates of interest. These loans are made by the banks lending to the Government part of the money which the banks receive from their depositors.

All the above together form "Large Savings," and the amount of large savings in the financial year 1943–44 was £1,072 million, or 1s. 3d. per day per head of the population. Large savings for our purpose comprised in 1943–44 investments in 2½ per cent. National War Bonds, 3 per cent. Savings Bonds, and loans free of interest (*i.e.* that money lent by certain patriotic persons to the Government on which no interest is asked).

We have seen that the amount for small savings was 9½d. per day per head of the population, and if the amount of 1s. 3d. arising from large savings is added to the 9½d., we have a total of 2s. 0½d., which, deducted from our 3s. 2½d., leaves still 1s. 2d. to be accounted for.

WHAT IS THE FLOATING DEBT?

A very large part of the money which the Government borrows during the war comes from what is known as the "Floating Debt."

The Floating Debt consists of money which the Government borrows in three ways—namely, through Treasury Bills, Treasury Deposit Receipts, and Ways and Means Advances.

Treasury Bills.—Treasury Bills are promises by the Government to repay the amount borrowed after three months, and the rate of interest paid on these bills averages about 1 per cent. per annum.

Treasury Deposit Receipts.—The second form which the Floating Debt takes is a new method which has been invented during the present war. The banks or other financial institutions are asked to deposit every week with the Treasury for a period of six months a certain sum, which is arranged between the Treasury and the banks, on which 1⅛ * per cent. is paid, and this is the remuneration which the head office of Ian Mackintosh's bank in London receives for the large sums of its depositors' money which it lends on short term to the Government (or, in the case of Treasury Bills, about 1 per cent.*). The cost to the Government for borrowing by Treasury Bills or Treasury Deposit Receipts is under 1d.* a day for every £100.

Owing to the large Government expenditure, more money than formerly comes weekly to business firms who are doing work for the Government, and this money is put into the banks (in spite of the fact that it earns little or no interest), because these firms also require to spend more money than they did before the war to pay wages and other expenses. This is due partly to the fact that they are employing more people, partly because wages have risen, and partly because more overtime is worked.

Further, owing to the rise in prices which has taken place during the war, they have to pay more for the raw materials which they buy, and therefore they have to keep more money in the banks, and they cannot lend it direct to the Government, as they are constantly requiring it for their business. But as business firms in turn draw money from the banks for wages or for the purchase of raw materials, it comes back into the banks through the shops in which the wages are spent, or from the sellers of the raw materials. This increase in bank deposits should perhaps be considered more as an increase in the working capital of the firms, kept in the form of increased bank balances, rather than as an increase in savings. But it should never be forgotten that the money which Tom Smith puts in the

* In October 1945 the rate on Treasury Deposit Receipts was reduced from 1⅛ per cent. to ⅝ per cent., and the rate on Treasury Bills from 1 per cent. to ½ per cent. thus reducing the cost to the Government to under ½d. a day for every £100 borrowed.

Post Office Savings Bank, and which is lent by the Post Office Savings Bank to the Government, belongs to Tom Smith, and the Post Office Savings Bank remains liable to him for it. In the same way the money which Jack Robinson's firm puts into its bank, and which the bank lends to the Government, belongs to Jack Robinson's firm, and the bank remains liable to Jack Robinson's firm for the amount.

If Tom Smith, instead of putting his savings into the Savings Bank, chose to keep them in the form of notes and coin in his house, the Post Office Savings Bank would have less money which it could lend to the Government; and if Jack Robinson, when he received payment from the Government for what he had sold to it, preferred to cash the cheque received from the Government instead of paying it into the bank, and took for it banknotes and kept them in his safe, then the banks would also have so much less money to lend to the Government.

The increase in Treasury Bills from 1st April 1943 to 31st March 1944 was £310 million, and the increase in Treasury Deposit Receipts was £421 million. All of this increase represented money which was lent to the Government on three or six months' terms by the banks or other financial institutions (*i.e.* short-term lending).

Ways and Means Advances.—The third item in the Floating Debt is what is called "Ways and Means Advances." The receipts by the Government from taxation and borrowing are at certain times for a few days larger than their expenditure during those periods, and at certain other times they are smaller. When they are smaller the Government bridges the gap by what are known as "Ways and Means Advances." These are sums borrowed for this temporary purpose either from the Bank of England or from certain funds like the Unemployment Insurance Fund, National Health Insurance Fund, Widows' and Orphans' and Old Age (Contributory) Pensions Fund, and various Government insurance funds to cover war risk.

The Unemployment Insurance Fund at the present time —as unemployment insurance contributions are still paid and as there is virtually no unemployment—has accumulated large funds, and the other funds have also surpluses in hand. These may be invested in Treasury Bills or short-term Government Bonds, or may in part be lent to the Government under Ways and Means. The increase between 1st April 1943 and 31st March 1944 of Ways and Means Advances was £105 million. The increase in the three items together—Treasury Bills, Treasury Deposit Receipts, and Ways and Means Advances—worked out at 11¾d. per day per head of the population.

In addition to these three forms of borrowing reference must be made to a fourth form of borrowing in the shape of Tax Reserve Certificates.

Tax Reserve Certificates

The arrangement by which people can pay their taxes in advance, receiving interest in the meantime, has already been referred to. Interest is 1 per cent. per annum, but as it is free from income tax, it is (with a standard rate of income tax at 10s.) equivalent to 2 per cent., and that is the amount which it is virtually costing the Government for money borrowed in this manner. By the end of the financial year ending 31st March 1944 there was £562 million outstanding for taxation which had been paid in advance. Here we are concerned only with the increase between the financial year 1942–43 and the financial year 1943–44, which was £119 million, or about 1½d. per day per head of the population.

Residue

The total of all borrowing was £2,705 million, which amounted to 3s. 1¾d. per day per head of the population. This leaves us still with ¾d. to account for, which, on the table below, we have called "Residue." This is our fifth item, and amounts to £56 million (that is, 1 per cent. of the total expenditure of 1943–44). This £56 million is accounted for by certain capital receipts not included in the above figures. The amount of these capital receipts, however, is offset to some small extent by duplication arising from some Post Office Savings Bank deposits being invested indirectly in some of the Large Savings or Floating Debt items, and the £56 million is the balance left after the necessary adjustment has been made.

Note Issue

Something must be said regarding the note issue, which, in the year under review, increased by £190 million (that is, from £950 million to £1,140 million). The Issue Department of the Bank of England is obliged by law to hold Government securities against all notes which it issues. As the public draw out notes from the banks they are indirectly making a loan to the Government, but for our purpose the amount of the increase in the securities held against the notes is already included in the National Debt.

We are now in a position to make up the final figures, showing how the Government paid for the war in the financial year 1943–44, the cost of which was 6s. 9d. per day per head of the population. These figures are shown in the table on the next page.

How the Government obtained the money which it spent in the Financial Year 31st March 1943–1st April 1944, which amounted to £5,799 million, or 6s. 9d. per day per head of the population*

	£ Mils. per year	Total £ Mils. per year	Per day per head	Total per day per head	GRAND TOTAL per day per head
			s. d.	s. d.	s. d.
CONTRIBUTION BY TAXATION					
Direct Taxation					
Income tax and Surtax .	1,260		1 5½		
Excess Profits Tax and National Defence Contribution	500		7		
Estate Duty	99		1½		
Stamps and other Inland Tax Revenue	19		¼		
		1,878		2 2¼	
Indirect Taxation (of which tobacco and alcoholic drink provided nearly 10¼d.)					
Customs Duties . . .	561		7¾		
Excise	482		6¾		
Motor Vehicle Duties . .	27		½		
		1,070		1 3	
CONTRIBUTION BY NON-TAX REVENUE					3 5¼
Miscellaneous and other Non-tax Revenue		90			1¼
CONTRIBUTION BY BORROWING					
National Debt Increase					
Small Savings—net . .	678		9½		
Large Savings—net . .	1,072		1 3		
Floating Debt:					
Treasury Bills—net . .	310		4¼		
Treasury Deposit Receipts —net	421		6		
Ways and Means Advances —net	105		1½		
Tax Reserve Certificates —net	119		1½		
		2,705			3 1¾
RESIDUE (miscellaneous items)		56			¾
		5,799			6 9

* Excluding Post Office expenditure

CHAPTER XV

WHAT IS THE NATIONAL DEBT?

ALL the borrowing described in the previous chapter necessarily increases the National Debt, and the National Debt, as we should expect, showed a corresponding increase in 1943–44 over the preceding year.

The National Debt as we now know it commenced in the reign of William and Mary. Prior to this in our history, and indeed in the history of other countries, kings had raised by various devices the money which they needed for carrying on wars or for extraordinary expenditure.

First, they accumulated treasure in times of peace which was available for war expenses, the treasure consisting of coin or precious metals. Traces of this have persisted in our finances up to the present day. Before the outbreak of the present war the Government had accumulated gold worth several hundred million pounds sterling, part of which was used, before the United States introduced Lend-Lease, in part payment of supplies which the British Government imported from that country. (Afterwards the U.S.A. sent us a large part of our requirements under Lend-Lease, and these supplies were not to be paid for in money but in a manner to be settled later.)

Secondly, kings obliged their subjects to pay taxes in anticipation of the due date. Sometimes these taxes were paid several years in advance, and this method more often than not was merely a way of increasing the customary taxation. The people were forced to pay in advance, and in that respect it differs from our system during this war of obtaining money for the Government by the voluntary payment of taxes in advance, by which several hundred million pounds have been raised by means of what are known as Tax Reserve Certificates, on which the Government pays interest.

Thirdly, former kings adopted a method of forced loans. The only trace of anything analogous to a forced loan which has appeared in our present war finance is that part of our income tax which we have paid and for which the Government has given us post-war credits, promising to pay back these amounts after the war. Money so paid might more fairly be considered a forced loan than a contribution by the people in the shape of taxation, for money raised by ordinary taxation is never paid back by the Government.

A fourth method of raising funds adopted throughout our history was borrowing for short periods for specific purposes and often against specific security—on occasion even the pledging of the king's jewellery for money loaned to him. For instance we are told that in 1428 Henry VI paid back £500 which had been borrowed by his father from the mayor and commonalty of the city of Coventry to enable Henry V to undertake a voyage in the third year of his reign, and for which he had pledged "his great collar called Ikelton Collar, garnished with 4 rubies, 4 great sapphires, 32 great pearls, and 53 other pearls of lesser sort, weighing 36¾ oz., then valued at £500."

Our Government to-day has other means of raising money, and our kings do not pawn their jewels. But it is within the recollection of the writer of this book that on one occasion a former Shah of Persia endeavoured to pledge his Crown Jewels in London in order to raise some ready cash.

When William III came to the throne it was necessary to raise large sums of money by loan, in addition to the increased taxation, in order to carry on the war which was then raging. But the system which existed of raising money by loans in anticipation of various duties became discredited as the incoming money from the duties was insufficient to meet the liabilities, so in 1692 money was raised by selling life annuities, 10 per cent. on the purchase price being paid for seven years and afterwards 7 per cent. Later, in 1694, the Bank of England was formed with the object of lending the whole of the subscribed capital of £1,200,000 to the Government. From time to time further sums were borrowed from the Bank, until a total of £14,686,800 was raised by 1816. In 1834 it dropped to £11,015,100, at which figure it has stood in the books of the Bank of England for over a century.

At the beginning of the reign of William III and Mary the National Debt (not that due to the Bank of England only) was £3 million, and it continued to grow with each war. At the end of the reign of George II it amounted to £133 million; but the wars of George III with America and France brought the debt to over £800 million, and it fluctuated between that figure and £600 million until the outbreak of the Great War when it was £706 million. The Boer War of 1899–1901 only increased the National Debt by about £120 million. Wars were cheap in those days. But the Great War, by which time carrying on a war had become very much more expensive, increased the National Debt from £706 million in 1913–14 to £7,481 million in 1918–19. At the outbreak of the present war it was over £8,163 million, and after four years of fighting this figure had been doubled. It will thus be realized that practically the whole of the National Debt is due to expenditure on wars.

But this is not a history book, and we must get back to our question of what the National Debt is.

The National Debt is the total of all Government borrowing which has not been repaid. The difference between the money which we have paid in taxation and that which we have lent to the Government is that the money which we have paid in taxation is finished with as far as we are concerned: it is gone, we shall never get it back (except for the post-war credit). But the money which we have lent to the Government, and which constitutes the National Debt, we have really lent to each other. *We*, the taxpayers of the country, are liable in the future to the people (ourselves) who have lent the money to the Government for the money necessary to pay the interest and to repay the capital when due. For example, if David Jones has lent the Government £45 by the purchase of National Savings Certificates, the taxpayers of the country between them owe him that sum. If every man had lent to the Government an amount of money which was proportionate to the taxes which he had to pay, each man would in effect have been simply lending to himself, and would be liable to himself for the interest on his loan and the repayment of it. But that has not been the case. Some people have lent nothing to the Government; others have lent more than their share. Those who have lent nothing will still have to pay their share in future taxes in order to find the money for those who have lent it; those who have lent more than their share will be receiving more in interest than is provided out of the taxes which they pay.

In borrowing the money to carry on this war the Government has made it repayable at different periods; some as short as three months, others as long as twenty-six years, and at various periods in between. Anyone who has lent money to the Government indirectly, through the savings banks or the ordinary banks (both of which have been lending to the Government the money deposited with them), can get it back when required. People who have lent money at three months can get it back before the end of the three months by selling the Government debt to them to other people. Lenders whose debt is not repayable by the Government for periods up to twenty-six years, can get their money back by selling the Government debt to them on the Stock Exchange to people who are willing to buy it.

The Government may at some time pay off part of the debt by using some of the future taxation for this purpose, but they cannot pay off the whole of the increased debt within the period of twenty-six years; and in order to carry out their obligations to pay it off to the present lenders, they will have to borrow again. Part of the National Debt, however, consists of money which the Government has borrowed without fixing any date at which it is obliged to repay. It can repay the debt if it likes; but the lenders have no right to demand repayment as there is no due date, and that part of the debt is to all intents and purposes a promise on the part of the Government to continue to pay the interest as long as the debt exists—in other words it is an annuity.

In conclusion a word must be said about that part of the National Debt which is sometimes called "The External Debt." During the last war and during this war, the Government not only borrowed money from our people in the United Kingdom but also from our Dominions and foreign countries. This is also part of the National Debt.

Chapter XVI

WHY CANNOT WE PAY FOR THE WHOLE WAR OUT OF TAXATION?

In order to pay for the war, the United Kingdom is raising by taxation an amount which is a larger proportion of its national income than either the United States or Canada. The figures for 1942–43 are as follows:

Total taxation as percentage of National Income

United States	24 per cent.
Canada	36 „
United Kingdom	42 „

The national income may be taken as being the total of all the individual incomes in the country, *e.g.* wages and salaries and net profits of firms (that is after deducting the amount necessary for depreciation, for the maintenance of buildings and machinery, or their replacement when worn out). There are many definitions of national income, and in defining it as above the writer may be accused of over-simplification; but there are many other things in this book about which he might be accused on the same score by the experts.

There are at least four reasons why the whole of the money which is spent on the war should not be raised by taxation.

First, as we have shown, the principle of the Government in taxing the people is to maintain as nearly as possible an equality of sacrifice among the various taxpayers. This is always difficult and becomes more so in times of war, and the higher the taxation the greater is the sense of unfairness on the part of those taxpayers who believe they are bearing an undue share of the burden imposed by the various taxes. To pay for the whole of the war by increased taxation would mean that the present yield of taxation would approximately have to be doubled. People who are now able to save money and lend it to the Government would have to pay their savings, or part of them, over to the Government in taxes instead of lending it. Possibly, too, some of the extra taxation could be raised by making people spend less and pay more taxes. The sense of unfairness in sharing the burden would be greatly increased, and that unity among the people so necessary to bring the war to a successful conclusion might be seriously jeopardized. By the Government borrowing some of the money which it requires instead of taking it all in taxation, inequality of the burden can to some extent be reduced. It is perfectly true that a number of people could save and lend their money to the Government but do not do so, and this affords some case for making a certain amount of saving compulsory as was suggested at the beginning of the war by Lord Keynes. On the other hand, as saving is voluntary, if a man feels that the burden he is bearing through taxation cannot be increased without unduly impairing his standard of living he does not save, while the man who has a surplus does save, and to that extent the burden borne by the two men tends to be equalized.

Secondly, it is essential for carrying on the war that production should be maintained at the maximum possible. In order that this can be done, people who formerly did not work have now to work, and everyone has to work at the jobs which the Government decides, and to work their very hardest. That means not only working hard during their normal hours, but sacrificing their leisure by working overtime as far as that can be done without impairing the efficiency of their labour.

Patriotism and the desire to win the war is a great incentive to people to make the sacrifices necessary in producing as much as possible, and for a certain time may be sufficient, as it was after Dunkirk. In the long run an additional incentive to that of patriotism is necessary. People must feel that they are obtaining a reward which they consider adequate for the extra work which they are doing. Paying for the whole of the war by taxation would mean that the whole of the increased monetary reward for the extra work would be taken from them by the increased taxation which, when once paid, is gone for ever. A sense of dissatisfaction and disgruntlement would be bred, and the efficiency of labour would be impaired. On the other hand, if the increased reward for increased work is left to the people in the shape of savings, they feel that they have obtained something for their increased effort. Unlike the case of taxation where the money has gone for ever, their reward in the case of money saved is only postponed, and the time will come (when the war is over) when they will actually feel the benefit of the extra work which they have done by being able to use their savings in such a way as they may personally choose to satisfy their wants.

Thirdly, people require their savings for all kinds of purposes. In Chaper VII on "Savings" we gave the reasons why the various members of our little community—the Smiths, Joneses, Browns, Robinsons, and Mackintoshes—were saving. Charlie Brown was saving to provide for a rainy day and for the time when he wanted to retire, and in order that his wife might not be left penniless should he die before her. The effects of preventing Charlie Brown from making these savings, if he had to pay all this money in taxation, would be serious. Again, to take the case of a friend of Robinson's who was saving to send his boy to the university; it would be unfortunate for his son if the money were taken in taxation.

Some people save to buy their houses or insure their lives and, before the war, had already paid many instalments for this purpose. If these instalments ceased to be paid because the money was taken in taxation, the repercussions on these useful institutions (building societies and life insurance companies) would be very serious. By leaving the savings in the pockets of the people and enabling them to pay these instalments, these institutions can lend the money to the Government. Savers—unlike their position if they had paid away their money in taxation—can realize their savings when they require them by selling, to other people who are willing to buy such claims, their claim on the Government for the amount which they have lent. For example, if they have received National War Bonds for the money which they have lent, they can sell the Bonds on the Stock Exchange. But if they had paid out all this money in taxation instead of saving it, they could not in a time of emergency (say sickness or death) go to the Government and ask the Government to pay them back some of the money which it had obtained in taxation during the war, as they can if they have saved by Savings Bank deposits or National Savings Certificates.

If the Government obtains the necessary funds by borrowing, the sacrifice made by the people is less than it would otherwise be if the money were taken by taxation, and a greater feeling of contentment remains which enables production to be carried on efficiently and the unity of spirit of the people to be maintained.

Fourthly, during wars—whether they be wars of aggression or wars of defence—most people believe that they are being fought not only for the benefit of the generation then existing but also for their children and their children's children.

Wars can only be carried on by means of the stocks of food, raw materials, ships, aeroplanes, and armaments which exist at the outbreak of war plus the quantity of those commodities which can be produced during the war. A war cannot be carried on by means of any production which may take place when the war is over. And in that sense the whole of the burden of any war must fall on the generation which is living at the time when the war takes place. But since most people feel that posterity will benefit from our present sacrifices, they see nothing unfair in the idea that some of those sacrifices should be borne by the coming generation, if that is possible. A part of the present burden *can* be shared by them, in so far as they can sacrifice part of what they will be producing in the future, in order to provide the interest on the money which their fathers and mothers lent to the Government during the war.

Let us put it in terms of commodities instead of money. We require now a certain amount of cloth to clothe the troops. That cloth must come out of existing stocks or present production. Any cloth which our children may produce cannot help to clothe our soldiers now. Suppose somebody now living lends cloth to the Government, which the Government promises to pay back after a certain number of years, but in the meantime agrees to give to the lender annually one yard of cloth for every forty yards which the Government has borrowed as a recompense for his abstention in using the cloth himself or exchanging it for something he desires. Although the cloth which our children or our children's children will produce in the future cannot be used to carry on the present war, it can be used to pay back to the present lenders of the cloth or their heirs the amount of cloth which has been borrowed, and until this can be done, to continue to make the annual payment of one yard on every forty yards which the Government has borrowed. One yard is 2½ per cent. of forty yards, but a bargain such as we have described would (as the Government has been forced to borrow so many different kinds of commodities) be found to be very inconvenient.

It would be much more convenient to value the cloth in terms of money and then say the Government would pay 2½ per cent. interest on the value. This bargain could be carried out to the extent necessary by future generations, and to that extent some of the burden of carrying on the present war would be shifted on to their shoulders, which could not have been done if the whole cost of the war had been paid out of taxation.

Chapter XVII

DOES GOVERNMENT BORROWING TEND TO INFLATION?

In order to escape all the pitfalls inherent in trying to give a simple definition of inflation, and to avoid all the " ifs " and " buts " and all the qualifications and limitations which a definition necessitates, it is desirable to put this question in a somewhat different form and ask, " If instead of taking all the money by taxation, the Government borrows a part of it, will the borrowing lead to an increase in the prices of the things on which we spend our money ? " That is the question which really interests the Smiths, Browns, Joneses, Robinsons, and Mackintoshes. We need not concern ourselves with the very high-priced luxuries one sees in the shops during the war, all of which are subject to a 100 per cent. Purchase Tax.

If everybody saved and lent to the Government the amount of money which they would have had to pay in taxes if the whole cost of the war was paid for by taxation, the answer to our question would be, " No, the policy of borrowing would not raise prices." If Janet Smith paid in taxation part of the rise in wages which she has received since the war, and put the remainder in the Post Office Savings Bank and left it there, there would have been no more effect on prices than if she had been obliged to pay the whole of the rise to the Government in the shape of taxation. But as saving is voluntary, Janet may have spent part of the money, and such spending, when as at present the things she buys are in short supply, would have the effect of raising their prices owing to the increased competition for the limited amount of goods which her increased spending has set up. As things are, the answer must then be "Yes," unless the Government takes measures (as it does) to prevent this. We will refer to these measures later on.

Janet Smith's purchases would still have the effect of raising prices, even if the people from whom she bought saved the money which she paid them and lent it to the Government. Let us repeat this. If Janet Smith does not spend the money and lends it to the Government, the money has done one piece of work: gone straight from Janet Smith to the Government. But if she spends the money, and the person from whom she has bought her purchases lends the money to the Government, that particular sum of money has done two pieces of work—namely, it has passed from Janet Smith to the shop in payment of Janet's purchases, and then from the shop to the Government as the shop's savings. It may not be only Janet Smith's spending; there may be various other links in the chain of spenders before the money is ultimately saved and lent to the Government, and the longer the chain the greater would be the effect in increasing prices.

This does not only refer to Janet Smith. If Jack Robinson's firm spends money in increasing its stock of raw materials or replenishing machinery instead of putting it into its bank, which would lend it to the Government, such spending will have the effect of raising prices and will reduce the amount of the deposit in the bank of Jack Robinson's firm. If this were all, the bank having less deposits would not be able to lend as much money to the Government as it could do before the firm had spent the money. But it is not all. Robinson's firm in spending the money has given a cheque to its supplier, and the supplier pays the cheque into his bank, which cancels the decline in the deposits of Robinson's bank. The deposits of the banks as a whole, it is true, remain the same as they were before Robinson's firm withdrew its money, and the banks as a whole will thus be able to lend to the Government as much as they could have done if Robinson's firm had not withdrawn part of its deposits. But the spending of Jack Robinson's firm will have tended to raise prices, which would not have been the case if it had been obliged to pay the money in taxation which it spent, or if the firm left it to its credit with its deposit bank. Here, again, the greater the number of spenders in the chain before the amount is left unspent as a deposit in the bank, the greater will be the effect on prices, although throughout the chain of spending the total of bank deposits will remain unchanged. We have to look at the number of times money is transferred by making payments as well as at the amount of money.

Before taxation was as high as it is at present, and before the Government had taken the measures to prevent an increase in prices which it has since taken, prices rose considerably from the outbreak of the war for the first two years, but from the end of 1941 the average of prices as far as they can be ascertained has not increased to any substantial degree. The measures which the Government took prevented any appreciable rise in prices since the end of 1941. These measures were, first, an increase in taxation which absorbed a considerable part of the increased spending power of the public—the increased spending power being due to an increase in earnings of the people derived partly from an increase in the rates of wages, partly from payments for overtime, and partly from the earnings of an increased number of people in employment.

Secondly, as time went on the Government absorbed more and more of the spending power by means of borrowing, effective propaganda inducing people to save for patriotic reasons instead of spending their money.

Thirdly, in order to prevent a rise in prices of certain necessaries, the Government subsidized the producers of these necessaries, enabling them to sell at lower prices than would otherwise have been the case. The effect of these subsidies has been described in Chapter XIII.

Fourthly, the Government rationed a large number of commodities. This not only ensured a fair distribution of the available supplies of these commodities by preventing favouritism, but stopped those who could pay more from buying as much as they wanted by offering higher prices than those which could be afforded by the less well-to-do.

Fifthly, the Government took steps to control prices of many commodities, forbidding them to be sold at higher prices than those which it had fixed. For example, such things as cauliflowers, tomatoes, and utility clothing all had maximum prices fixed, above which they might not be sold.

Experience has shown that prices inevitably rise in war-time, but considering the length of time this war has lasted, prices in the United Kingdom have been kept on a reasonable level.

Great dangers, however, loom ahead for the country directly the war is over, because, while vast sums have been accumulated in savings, commodities must inevitably be in short supply for some time after the fighting has ceased.

We have all during the war abstained from buying many things which we should have liked to have, and which in ordinary times we would have considered necessary. When once we are again at peace, Jack Robinson's firm and all other manufacturers will want to replenish their machinery, and indeed, to some extent, repair their factory buildings. There will be a great shortage of houses which must be built as quickly as possible, and those which have been badly damaged by air raids will require repairs. One has only to look round London or any other great city to see how much money should be spent on repainting or otherwise restoring buildings which, although they have not been damaged by enemy action, have suffered (as is always the case) from the effects of wind and weather. And what applies to these larger requirements applies equally to all of us in our individual capacities. It is not only the outside of our houses that want repainting, they will also want redecorating inside. Pans and kettles, towels and sheets, carpets and curtains will all require replenishment, and we shall all desire to make good our individual wardrobes which we have been unable to maintain during the war. We shall want more and better holidays and the enjoyment of those amusements from which we have refrained in war time, and finally we shall all want to indulge in more, better, and more varied food than we have been able to obtain during the war.

Now if, in order to satisfy these requirements, we indulge not even in an orgy of spending, but in an attempt on the part of each one of us to satisfy immediately our perfectly natural and normal desires and requirements, the result of all the simultaneous spending (as commodities will still for some time be in short supply) will lead to a great increase in prices, or to the need of maintaining very stringent control by the Government. Both are undesirable; the first because we shall be spending our money in acquiring what we want at abnormally high prices, and the second because the sooner we can exercise our normal liberty of action (so long as such exercising does not injure others), the sooner we shall achieve that freedom for which we have been fighting. Contrariwise, if we regulate our expenditure and postpone it until it can fit in with an increased production and supply of goods, prices will not rise, and we shall be getting very much better value for our money. The time to buy for all of us is not when prices are high and the stocks in the shops are low, but when shops are well stocked (as they will be again if we have patience) when prices are relatively cheap (as they will become unless we all rush to buy at the same time), and when the choice offered by the shops will be far greater than anything to which we have been accustomed during the years of war.

During the war the high level of taxation has acted as a brake on civilian expenditure, and forced people to abstain from satisfying their requirements except those which were most essential. But after the war, as Government expenditure declines, it will not be possible to maintain taxation at a high level merely in order to prevent people from spending their money. It will therefore become more necessary than ever that people should save during the transition period, and the work and achievement of the National Savings Committee will be even more essential than they were during the war.

For some time after the end of the war the slogan " Kill the Squander Bug " will still be necessary. Otherwise if we all rush to spend our money at the same time, the result will be as it was after the last war : an extravagant boom followed by a slump, unemployment, and a great depression in trade. We may have found means since then of mitigating slumps, but the best remedy of all—although not the easiest—is to stop a boom.

CHAPTER XVIII

MONEY FOR WAR AND MONEY FOR PEACE?

WE have one final question to answer. If we can spare all the money for carrying on the war, can we spare it for peace objects? The answer to our question is that if we as a nation make up our minds as to what peace objects we desire, and are ready to make the necessary material and financial sacrifices to achieve them, lack of money need not stand in the way. But we must make up our minds what we want to do, and the order in which we want to do it.

During the war people are united on one object: to win the war, and for that purpose they are prepared to make any sacrifice necessary to achieve their aim. It often happens that a family or group of friends decides to go on a holiday together. Difficulty arises, however, when they have to agree where they are going to, as each of them thinks the place which he suggests is the best possible. Furthermore, there may be certain members of the family or of the group of friends who, while pretending that the idea of a joint holiday is excellent, do not really want to join in. It may be they are not very sympathetic to certain others, or they have become so tied to their home and their old habits and comforts that they have become selfish. If they have to fit themselves in to the general wishes of the party, it will involve a degree of unselfishness which will impose a great strain upon them.

Similar considerations will apply when the country has to decide on the peace objects on which our money should be spent. We shall have to agree where we are going to, and where we are going to *first*, because when the war is over war expenditure will not cease immediately. Troops will have to be brought home from all over the world, and gratuities will have to be paid to them. All kinds of contracts for war supplies will have to be wound up, compensation for cancelling some of these, and for restoring property which has been damaged during the war or for property taken over the Government will have to be finally settled, and all this will involve Government expenditure. Furthermore, enemy countries will have to be policed by our troops among others; and if we are not to be caught napping again, we shall have to contribute our share to a force necessary to maintain the future peace of the world, or, failing that, to defend ourselves. But a considerable amount of this expenditure will be liquidated within a measurable time, after which the annual amount of money which we desire the Government to spend on peace objects will be comparatively small compared with the money which the war cost.

In making this comparison, however, there are three things to remember. First, war expenditure is limited to a period (including the aftermath of the war) of, say, five, six, or seven years, but a very great part of the expenditure which people envisage when they talk of peace objects will last far longer than that. For instance, the Government has announced a plan of building three to four million houses over the next ten to twelve years. This is a very desirable object, but in so far as it will involve Government expenditure, that expenditure will go on certainly during the twelve years and possibly longer, while expenditure on improved education, health services, war pensions, and widows' and old age pensions will continue as far as one can foresee into future generations.

Secondly, as regards the sacrifices which were involved in carrying on the war, and those which will be necessary in carrying out our peace objects, it must be remembered that although it is not our habit to talk much about these things, somewhere at the back of our minds during the war was the feeling that whatever material and financial sacrifices we were called upon to bear, they were really insignificant compared with those of our people who were obliged to sacrifice their lives, limbs, or health. This stimulus to sacrifice will not operate in peace-time. In war-time we are constantly reminded of the sacrifices which others are making: our friends and relatives have lost somebody in the war; we read of and see the maimed and wounded in the streets; we know the misery of the people who have been bombed out of their houses, even if they have not been killed or wounded. All these things are constantly before our eyes and make our own personal sacrifices appear petty. But in peace-time, although we know there are a large number of people who are under-nourished and overcrowded (*i.e.* have an insufficiency both of food and living space), and although we are told that our system of education is far from being as good as it might be, that our health services are in urgent need of reform, that the people want more security against unemployment, and so on, these are things which our minds can escape if we so desire. They are not constantly before our eyes as is the misery caused by the war, and therefore the urge to sacrifice for them is less. Furthermore, during the war we see daily in front of us the uniformed soldiers walking about the streets, the military lorries, and the anti-aircraft guns. What we are paying for is visually present, whereas it needs a much greater effort of imagination when we see a group of people to envisage that we are paying for the improvement in the education, health, housing, and nourishment of their children. On the other hand, we shall have the feeling that whereas the sacrifices we made during the war—necessary though they may have been—resulted in the destruction of human life and material wealth, the sacrifices which we shall have to make in peace-time will, we believe, result in an improvement in the well-being of our people.

Thirdly, as we have seen in the preceding chapters, the Government obtained about half the money which it spent during the war by taxation and about half by borrowing. (It will be remembered that about one-quarter of the expenditure during the war was normal peace-time expenditure.) Most of the objects which we want to attain in peace-time—education, health services, pensions, etc.—ought to be paid out of taxation and not out of borrowed money. By this means we shall pay for those services as we go along; but it will be very difficult ever to give them up, and therefore we are placing an obligation on future generations to carry them on. In this connection it is well to remind ourselves that the authorities who study these subjects believe that the population of this country will decline unless there is a substantial increase in the birth-rate. In one sense the decline in the population will involve a smaller expenditure on certain things like education; but over all these years, while the population is declining, there will be a continuing disproportion between the number of young people in the country and the number of old people, and during this period the burden on the young of supporting the old will be constantly increasing. This coming decline in population is a fact of which we must not lose sight in discussing the provision of money for peace objects and the objects on which it is desirable it should be spent.

There is, however, an exception to paying for peace objects out of taxation. One of our peace objects is to maintain employment at as high a level as possible, so that we are not again faced with the great evil of mass unemployment which existed for many years in the period between the two wars. During this time it was widely held that the State should economize in its expenditure;

that because trade was bad we could not afford to allow the State to spend our money on objects for the good of the community as a whole, however desirable such objects might have been in times of prosperity. Such economy resulted in a further decrease in employment. During the past few years opinion on this matter has greatly changed, and it is now generally believed that it is just at the time when trade is bad and unemployment growing that the State should step in and employ the unemployed people by spending money on housing, schools, and other similar objects, and spreading over such armament expenditure as is necessary for defence so that it is spent as far as possible in years of trade depression. This policy of State spending in times of depression should, it is held, be pursued even if this involves borrowing, and thus increasing the National Debt.

We may now compare the sacrifices in which the war involved us with the sacrifices in which we shall be involved in allowing the Government to spend our money on peace objects. During the war the State spent annually about two-thirds of our average incomes for us in order to win the war. To achieve our peace objects it will not be necessary for the State to spend annually more than, say, a quarter of the present national income. On the other hand, unless we are agreed upon the peace objects very urgently, we may not be prepared to hand over to the State even a smaller part than a quarter of our average incomes. During the war the sacrifice in handing over so large a part of our income became very widespread, and is likely to continue to be widespread. The number of income tax payers during the war increased from four million in 1938–39 to ten and a half million in 1941–42, and it is from these ten and a half million people (if money is to be found for peace objects) that a large proportion of the money will have to come. Not much of the money which we shall want for peace objects could be found by further taxing the incomes of very rich people, because they have been so heavily taxed already that there is not much more income that can come from that source. But this does not mean that the money cannot be found, because there has been so great a redistribution of wealth in this country that now (after paying taxation) 80 per cent. of the total of all private incomes in this country is held by people with less than £500 a year.

The Real Limit of what can be Spent on Peace Objects

In discussing whether the country can afford the money for such peace objects as it desires, it is well to bear in mind that money is merely a go-between. We do not fight wars on money, and we do not achieve peace objects on money. What we fight with are the material things and services which money enables to be exchanged between different persons or to be transferred to the State. It is the extent to which these material things and services can be provided that limit the possibilities of carrying on the war or of attaining desired peace objects. It is therefore worth while considering how the State obtained the material things which enabled it to carry on the war. These material things were obtained by an increase in production.

Government Direction of Labour and Capital

This increase in production was brought about partly by a great mobility and adaptability of labour and capital. The Government obliged people to do the work which it required to be done. It ordered girls to go into munition factories—even in different towns from where they lived. It ordered boys, irrespective of the careers which they had mapped out for themselves, to go into the Services and the mines. It ordered people to work longer hours than had been the custom before the war. Many married women undertook whole or part-time work, and many people who had retired from work owing to old age returned to it. All these measures were necessitated not only because we wanted a large production of materials for carrying on the war, but because a considerable part of our labour force was absorbed into the military services.

Some direction of employment by the Government may be necessary for a time after the war, and Government measures will induce people to enter certain occupations in greater numbers than would have been the case in the absence of these measures. For instance, improved education will require many more teachers; improved health services will require many more doctors and nurses; improved housing will require a vast number of builders; and the administration of peace objects will require more Civil Servants than before the war. But any sacrifice which may be necessary after the war to attain our peace objects in respect of the mobility of labour should be small compared to those which were made during the war.

While we were at war the Government also directed the owners of capital concerning the use to which their capital should be put. Some businesses were closed down, many were obliged to change over from their peace-time manufacture to making munitions under the direction and supervision of Government officials, and buildings and factories were taken over entirely from their owners and used for Government purposes. Here, again, while a certain direction of capital may be necessary in peace-time, it need not assume any dimensions comparable to those which took place during the war. But it is worth while here putting in a word of warning that, if the country is to be prosperous (and unless it is prosperous the full peace objects cannot be carried out), a greater mobility of labour and capital than that which existed pre-war is imperative. We shall not be able to afford the bolstering up of decaying industries on the one hand, while on the other hand there must be every inducement for labour and capital to move into expanding industries.

Redistribution of Wealth or Increased Production?

Improved education, health, and housing plus new inventions and more research on the application of science to industry should increase our production of material wealth per head of the population, and thus lighten the sacrifices which our children will have to make in carrying out those peace objects which we desire to attain. Let us illustrate this by coming back to our friend Jack Robinson. If, during the period when he was paying for the education of his children and supporting his old father and mother his income remained constant from year to year, the burden of this expenditure would have been very heavy, and his sacrifice correspondingly great. But if his business was expanding and his profits were growing, then he could have done all these things without having had to economize in other directions and having to forgo some of those amenities of life to which he had become accustomed.

This is the real answer to those who compare national expenditure with personal expenditure, and say that the same test should be applied to the nation as to the individual who, if he is a sensible man, asks himself before increasing his expenditure, "Can I afford it?" Jack Robinson could afford to educate his children and maintain his aged parents if he could correspondingly increase his income. Even if he could not increase his income, he could still afford it if he and his wife were prepared to make the necessary sacrifices by abstaining from spending on themselves the amount which they desired to spend on their children and their parents—in other words, if they were prepared to redistribute the spending of their income in order to attain their object. And it is the same with the nation. If the national income can increase correspondingly to the increased expenditure, the nation can afford it. If the national income does not increase, but the income of all the people is so redistributed that money formerly spent on themselves will now be handed to the State for expenditure on objects believed to be for the good of the whole community, then the State can afford the increased expenditure just as Jack Robinson could. The crux of the whole matter is this. Peace objects can be attained either by a redistribution of wealth, *i.e.* some people doing without certain things in order that other people may enjoy other things which are thought desirable, or by such an increase in production that those things may be achieved by increasing the standard of living of some without reducing the standard of living of others. Our peace objects will probably be attained by a combination of these two methods. It is so important to remember this, that at the risk of repetition it is worth while giving another illustration which actually occurred during the war. There was a shortage of milk; cows were not producing enough to meet the normal requirements of the whole population. It was thought desirable that the quantity of milk available to young children and expectant mothers should not be reduced, and the sacrifice of the necessary reduction had to be borne by the remainder of the population. If, however, in peace-time by one means or another cows could be induced to produce more milk or the number of cows increased, adequate supplies could be provided for the children, expectant mothers, invalids, etc., without necessitating any reduction in the existing consumption of milk of the population as a whole.

Consumption

During the war, because it was essential to produce the things which the Government needed to carry on the war, *we*, the people, had materially to reduce our consumption of all kinds of commodities and services because there was not sufficient labour available to provide the Government with that which it required, and at the same time to provide the people with that to which they had been accustomed. With the freeing of labour now employed in the Forces, and with the reduction of the Government's requirements to peace objects, this difficulty should not occur; and although it may be necessary for a time to ration consumption, and we may not immediately get rid of queues, all this should disappear fairly quickly directly normal employment is restored, and the sacrifices which this reduced consumption entailed during the war will cease to exist. Whether we shall be able to afford to import in the future as great a variety of goods as we did before the war is another question depending on the extent to which we can increase our export trade.

Capital

Another means by which the Government's requirements were met during the war and all resources possible devoted to those requirements was the postponement of repairs to factories, machinery, and so on, and the withholding of new capital flowing into industry which would normally in peace-time have been necessary for its expansion. If so much of our material resources were, in future, to be directed to building schools, houses, and hospitals that not enough was left for the proper maintenance of existing factories and machinery and the building of new factories, etc., the eventual result would be a decline in our productivity, and consequently in our general standard of living. Here, again, it is a question of adjustment. Some governmental direction of the uses to which our savings—that is, our new capital—should be put may be necessary until production gets back into its full swing. This will involve a sense of sacrifice on the part of those people who feel that they cannot use their savings in the manner which they would desire.

Increase in Standard of Living

Our standard of living during the war has seriously declined. There are many things to which we were accustomed which we have had to forgo. Spending money by the State for social objects believed to be for the good of the community as a whole, while raising (if the money is well spent) the standard of living of those who directly benefit from it, may postpone for a time the attainment by others of the standard of living which they enjoyed before the war. We are doubtless all agreed that it is a very desirable thing to raise the general standard of living, but we must not be in too great a hurry. We must not think that everybody can, immediately peace is declared, revert to and even improve the standard of living which he enjoyed before the war. We must commence by raising the present war standard of living, and then gradually, as production increases, the country should be able not only to carry out the peace objects which it desires to attain, but ultimately to improve the general standard of living.

Can We Afford It?

Finally, the author can recollect few proposals for expenditure on social reform during his lifetime which were not met by the contention on the part of many people that we could not afford it. This contention has always been falsified.

A book called *Every Man His Own Broker*, by Thomas Mortimer, published nearly two hundred years ago, quotes a letter from a client. "The patriot sighs for his bleeding country—the malcontent exclaims against the measures of the ministry, and damns politics—the antiquated maiden, who subsists on the annual income of her property in the funds; and the miser, who always hated paper-money, tremble alike for their property, and reason thus with themselves—'Stocks are fallen 6 per cent. Perhaps to-morrow it may be worse, and the following day worse still; better sell before all is lost. Alas! poor Old England, this national debt will be thy ruin one day or another: well! land cannot run away, I'll e'en go into the city and sell before it is too late.'" Since the two hundred years when this was written "poor Old England" has been going strong, and steadily increasing her wealth, her prosperity, and also her National Debt, in spite of the social reforms which have been introduced or possibly on account of them. If in the future the money is found to attain all our peace objects, there is no reason to suppose that the country will not continue to thrive if the spirit of enterprise is sufficient to meet world conditions, if commerce and industry are efficiently managed, if productivity of labour is increased, and if we can keep our workers and other resources fully employed.

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