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BY

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VOL. II

THE COMMERCIAL SYSTEM



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INTRODUCTION

The Scope and Purpose of this Book.

This is the second volume in the series of three books in which it is intended to cover the field of Commerce for the information of the student and of the general reader. In the first volume the meaning of fundamental terms was explained, and an outline given of commercial activities. In the approach to the subject, the view was taken that Commerce is to be regarded as a part not only of the economic system, but of the social system as a whole.

This view has become necessary as a result of great changes in the structure of human Society which have made obvious to all the fact that it is co-operation rather than competition which is to provide the key-note of human activities in the future, if human civilisation is to survive. Planning and control must play an increasingly important part in human affairs ; more and more must the good of the community be placed before private profit and individual gain.

It is no part of the purpose of this present volume to discuss in detail the methods by which this necessary aim is to be achieved ; its purpose is to present information rather than to urge the claims of particular proposals for reform or of political causes. But it must be pointed out that if any progress in civilisation depending on co-operation is to be achieved, the fundamental necessity is that the citizens of the community must possess, besides the will to progress, that knowledge of the social and economic system which is indispensable to those who wish to guide and control the social and-economic system. This statement would be a platitude were it not for the fact that accompanying a widespread enthusiasm for reform of the social and economic system there is often a deep ignorance of the structure of that social and economic system

To enable one to improve and repair machinery, competence in mechanical engineering is a fundamental necessity ; to enable one to play one's part in the activities of a community in which social and economic factors are the very warp and weft of the social fabric, a knowledge of the operation and influence of those

factors, and of the institutions through which they are expressed, should be part of the equipment of every citizen.

An attempt has been made in the previous volume to present the reader with the information necessary for the acquirement of this knowledge. It is not intended to repeat in this book the facts given in that volume beyond what is necessary to give this present book unity and completeness. The first volume was intended as an introduction to the subject of Commerce; the present one takes the subject to a more advanced stage, and discusses the problems of Commerce in relation to the wider social field. The student who is coming to the subject for the first time is strongly recommended to read the opening volume in the series, and to take advantage of the diagrammatic presentation of the subject-matter—a method designed to overcome the difficulties which attend the attempt to obtain a bird's-eye view of an intricate system: such a wide view is essential if the student is to realise the unity of economic life. It is assumed, therefore, that the student is conversant with the matters dealt with in the first volume, and that he is in a position to pursue further the study of Commerce in relation to the social and economic environment.

The Place of "Commerce" in the Educational System.

The theme underlying each of the three volumes is that "Commerce" is worthy of a far greater dignity than has hitherto been accorded this study in the educational system. In education for Commerce, there has been hitherto little acknowledgment of the necessity of service to the community if the human soul is to progress. The word "commercial" has implied self-seeking and profit-making; it has been understood that the "plums", the "big money", went to the men who were smart enough to get to the top and reach a position where they could exploit to the full the possibilities for self-enrichment.

The great economic and social changes which followed the First World War, and which began to operate even before the end of the Second World War in more vigorous fashion and to a more fundamental degree, have had their origin in part in the growing conviction among ordinary men and women that only in co-operation and in service to the social ideal can there be any justification for private reward; that the best career is one in which the steps are marked, not by mere advantage in

the struggle for existence, but by contributions to the general welfare.

That such service to the community can be given under a system in which private enterprise continues to exist cannot be doubted; but it can no longer be held that a satisfactory system can be built upon a basis of unrestricted freedom to gain profit at the expense of the community. The "struggle for existence" itself can have but little meaning in a world which has found itself able to provide vast material resources in the shape of munitions of war; the ordinary man and woman demand that the production and distribution of our resources shall be planned and organised so that we shall live in a sane world of plenty and of mutual service.¹

Here is a splendid opportunity for a true education in Commerce. For "Commerce" is the system by which material exchangeable benefits are made available to the members of the world community; in a planned world it would have reference not only to exchange, but also to the processes of production and distribution.

The world of the future demands that every citizen, if he is to play a full part in the social life of the community, shall be educated in citizenship; and this function is becoming more exacting as the economic and social structure becomes more complex and technical. This is not to say that every citizen must become an advanced student of Commerce. But in the primary and secondary schools there must be an adequate preparation for a social life in which a knowledge of ancient Greek is a graceful accomplishment, but a knowledge of how the social, economic and political system works is a necessity.

The author cannot pursue in this Introduction a discussion on the minimum of knowledge of Social Theory which the young citizen in a modern community should possess; his contribution in that sphere is published as *The Elements of Sociology*.² But it is urged that the commercial worker of the future will be the technician of economic life, the person who translates the economic and commercial valuations of the community into practice, just as the engineer and the chemist use their technical skill in the manipulation of material substances.

It must, then, be granted that even in the junior Commercial

¹ The recent successful use of atomic power, for the first time, is of great significance in this connection

² University of London Press, Ltd. (1942).

School or Department the student's studies must be centred on Commerce ; it was the purpose of Volume I to indicate the place of this study in relation to the social and economic system ; and to provide a presentation of the basic facts in such a way as to enable the student to pursue his studies in any particular branch of commercial study without losing sight of the fact that henceforth, under the circumstances of social and economic change and progress, Commerce is but a branch of Citizenship, and that in training for Commerce he is training to become a technician in that particular branch of public service in which he is specialising, whether his personal ambition leads him to a post in a managerial or administrative capacity, or whether he remains content in a subordinate post—for ambition varies in intensity among individuals, and its gratification is often bought too dear at the price of personal happiness.

In the education of senior students, Commerce must still remain the central subject of a Commercial Course, though it may be called "Business Economics". The latter subject is, indeed, properly the study of the economics of business undertakings. The operations of Commerce are carried on by means of business undertakings, and it is with the methods of operation of business units, the problems of typical business units, the "natural history" of the typical business undertaking, so to speak, that Business Economics is concerned. The present volume, after a survey of the field of Commerce and of the nature of commercial operations in general, concerns itself with these problems of business undertakings ; it deals also with the financial institutions essential to their working ; it considers the influence of the State on commercial activities, and discusses the State itself as a business organisation.

Once again the initial approach is sociological ; Commerce is viewed as part of the social system, and commercial institutions as social institutions. It is an approach rendered necessary by the needs of the times, and especially by the greater awareness of the meaning of Society and of social facts that the Second World War has brought so forcibly to the ordinary man and woman. In the more progressive centres of higher commercial education the study of Commerce is already being related to the study of Society ; the Departments of Commerce of our Technical Colleges and Universities may well evolve into Departments of Economic and Social Science, or of Industrial Economy, in which

such subjects as Social and Political Theory, Social Institutions and Social and Industrial Psychology will be studied side by side with the technical subjects, such as Accountancy and Commercial and Company Law. It may be that there will emerge a British school of Sociology which will be far more concerned, and more profitably concerned, with the affairs of the

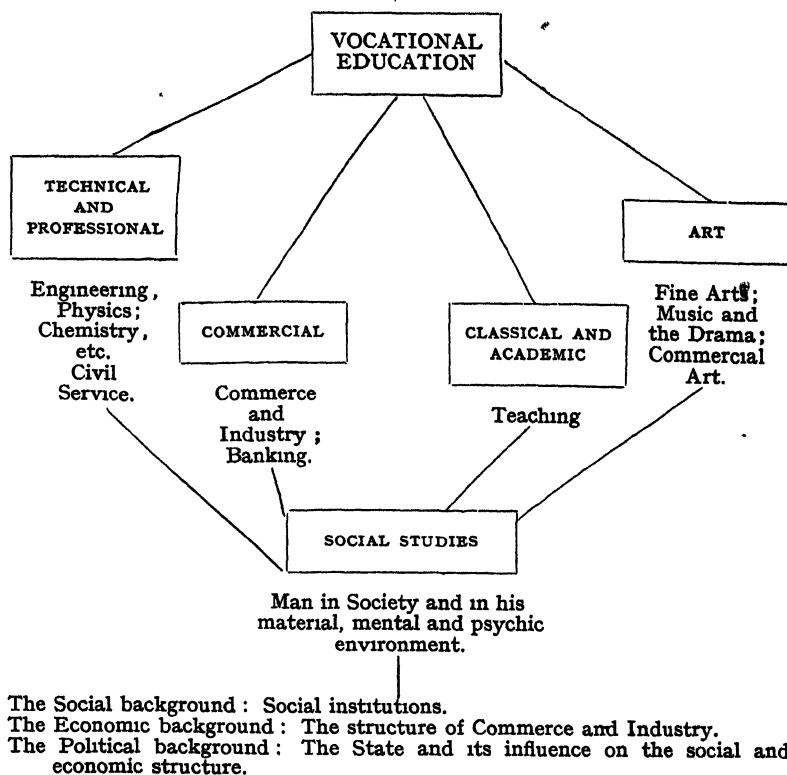


FIG. I.—THE SOCIAL AND ECONOMIC BACKGROUND OF VOCATIONAL EDUCATION.

ordinary men and women of the ordinary community than the abstract, obscure and puzzling Sociology of the German school that has for so long held the field to the derision of many economists, practical men impatient of the rarefied cerebrations of the German philosophers.

To the University will be left the exacting discipline of the correlation of economic factors in its courses of Applied Economics

and Business Administration ; the student who proceeds, say, to the B.Com. degree of London University has before him an intensive course representing a high stage in the conception of Commerce.

The opportunity to attain a greater dignity and a more satisfying discharge of responsibility to the community is waiting for the Schools and Departments of Commerce of our technical educational system to take up. It is not too much to say that upon them will devolve the main task of training the youth of our country in citizenship and service to the community. To the Commercial Department of the Technical College can go the students of the Technical Departments for lectures in Social Science, Economics and Industrial History. The author has been engaged in teaching of this kind, and has found the results satisfying to students and lecturer alike. The Commerce Department of the large Technical College affords, indeed, an admirable means by which the technical activities of students may be related to the activities of the whole industrial scene.

In the senior Commercial Department, Business Economics is the central subject of study ; and it is for the use of students of Commercial Departments that this book has been prepared, though it is hoped that it will prove of value to students of Technical departments of Technical Colleges whose studies include the social and economic aspects of their work.

PART ONE

COMMERCE IN THE ECONOMIC SYSTEM

CHAPTER I

THE FIELD OF COMMERCE

The Place of Commerce in the Economic Field.

The study of the methods by which human beings seek to make use of the material resources at their command is called Economics. Marshall, in his famous *Principles*, says that it is "a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being.

"Thus it is on the one side a study of wealth; and on the other, and more important side, a part of the study of man."¹

Marshall showed in his great work a breadth of vision and a comprehension of the true scope of Economics, or Political Economy as it was also called in his day, which have not always been shared by later writers, who have tended to abstract, or consider economic facts in themselves and without much reference to wider social issues. To a certain extent, this abstraction, away from "the ordinary business of life", has been inevitable, for progress in the study of economic principles must involve abstraction. But the greater the abstraction, the greater the divorce from life, and the more necessary it becomes to view the principles evolved in the light of their relation to the affairs of ordinary life; for the attainment of results which can be expressed satisfactorily in mathematical formulae but hardly in ordinary language may be a source of gratification to the academic theorist, but is of little use to men and women not protected by the walls of the University from the tears and toil and sweat of economic life itself.

The old term for what to-day we call "Economics" was "Political Economy", the study of the economic affairs of the *polis*, or the community; the underlying conception of this term

¹ Marshall, *Principles of Economics*, p. 1. (Macmillan, 1938.)

took account of the various political and social factors influencing the economic life of the community. As Wicksell points out in his *Lectures on Political Economy*, the term arose during a time when it was regarded as a duty of the State to exercise a considerable influence over the affairs of individuals. Subsequently, there was a rejection of State control and influence : individualistic ideas prevailed, so that unlimited freedom of the individual in economic affairs was regarded as the ideal. Thus arose the system of private capitalistic enterprise whose decline we are witnessing to-day ; it was the system responsible for the economic exploitation of socially helpless persons in the Victorian Age of profits and self-righteousness, when the term " survival of the fittest " was twisted into a principle of Economics. It was a system which dispensed with conceptions of human rights and happiness, which were regarded as having nothing to do with Economics ; it raised the hideous cities and reeking hovels of the industrial districts ; and it paved the way for the two-terrible wars whose only virtue has been that they have brought Mankind face to face with a crisis in social and economic affairs which has forced the abandonment of old attitudes and compelled Mankind to review human conceptions of economic and social principles hitherto regarded as partaking of the nature of natural and inevitable law.

Control of economic life by the authority of the community has again become a matter of practical politics ; there was a marked tendency in this direction before the Second World War, for the welfare of the community was a problem too complex, too dependent on the interplay of factors, national and international, social and political, economic and ethical, to be left to the chance resultant of the interaction of private interests. The coming of war necessitates at once a stricter control by the Government, and the chaos that would result were these controls to be discarded upon the cessation of hostilities, or upon the signing of peace agreements, or upon any other arbitrary circumstance, can be avoided only by a continuing control.

There is, however, a twofold danger arising from public control. The first, and the lesser one, is that of bureaucracy : we must face the fact that human beings have not reached such a maturity of development as to enable them to surmount the temptation to arbitrariness and laziness inherent in all of us. Power, to however small a degree, tends to corrupt, for it appears to be an

inescapable law of human destiny that no man may obtain power over the life of another and maintain his complete moral integrity. This is no place in which to enter into philosophical discussions ; but an issue of major importance need not be joined ; for if the public official is inclined to become the slave of his forms and regulations, the general public is to a greater degree of intensity impatient of them, and the compromise arrived at between them is a workable one. In Great Britain the Civil Servant may be the victim of a certain amount of banter and good-humoured satire, but he is incorruptible, and enjoys a high prestige.

The second danger is a more serious one ; it arises similarly from the fact that the mental powers and administrative institutions of Mankind have developed to a much higher degree than Man's spiritual life. A political and social machinery designed and constructed for the running of a country's affairs is not merely a machine, impersonal, coldly efficient. It is a machine whose major moving parts are human beings, of which the motive power is the energy supplied by human desires and emotions. The human psychological make-up is such that in every human being there is a will to power, an innate urge which drives him on to success in life. In some, the goal is reached by success in the arts or sciences ; in others—and these are the happiest of mortals, those in whom the intensity of desire for superiority is perhaps comparatively weak—success in life comes with the integration of their lives into a balanced, quiet existence in which the attainment of a happy home life and an enjoyment of the little things, and especially of the free gifts of Nature, loom far greater in importance than the success obtained by labour or strife.

But in the striving towards superiority and the satisfying of ambition in the case of those whose temperament and ability lead them to positions of power and influence, there is a real danger to the community. In a modern civilisation, such as existed in the Western World up to the outbreak of the Second World War, power has meant material power, economic power, power over natural resources and over the means of transforming those resources into articles of greater value : the " big " man has been the great manufacturer, or industrialist, or merchant. Personal power has often been gained at the expense of the community ; there have been " rings " and " corners " in food-

stuffs and essential materials ; there have been speculation and financial juggling. Exploitation of the earth's resources, carrying with it psychological and psychic benefits, has not been the heritage of the community in the sense that the community is the sum total of the ordinary men and women and children, but mainly the inheritance of those who have been the heirs of feudal violence, and the reward of those in whose characters a strong drive towards personal power, with or without an anti-social contempt for the rights of the human personality, has been a leading feature.

Until the travail brought about by the coming of the Second World War, these reflections would have been regarded as platitudinous not to say irrelevant philosophising, of no practical significance ; but we live at the beginning of the Age of Planning for the needs of the community as a whole. Schemes of social insurance ; of improved education and general welfare ; of reconstruction of the economic system ; of repair and overhauling or rebuilding of the commercial system that is the practical expression of the working of the economic system, are in process of promulgation and discussion. The Western World is trying to steer a course between the Scylla of selfish, individualistic, completely free private enterprise and the Charybdis of complete Socialism, whose logical and final state must be the obliteration of the individual human personality and its absorption into a mechanised, rigid State that would be socially little in advance of the beehive.

It has become evident that we cannot plan a new commercial system without reference to general social factors ; we must take account of political, ethical and psychological strands in the web of human life. Economics and its practical expression in social life, Commerce, must be regarded from the sociological point of view—from the point of view, that is, which regards Commerce as a means of achieving the welfare of Man in Society. Moreover, in the modern world, Commerce becomes a planned means, a deliberate and conscious system, and not merely a group of phenomena to be studied as one studies the instinctive and mechanised activities of the beehive.

Commerce, then, becomes the practical art of translating into social activities the principles of economic science. Economics is here regarded as a social science which is not merely a body of knowledge based on observation and classification of the facts

relating to the means by which human beings in Society seek individually to achieve material well-being, but which is a science based on the ultimate aim of deliberate planning on the part of Mankind as a whole to achieve that material well-being. With this definition, no doubt, the orthodox economist will quarrel; but it is a feature of the social sciences that the human factor, which is one of the subjects of their study, itself plays a part in shaping ends and means.

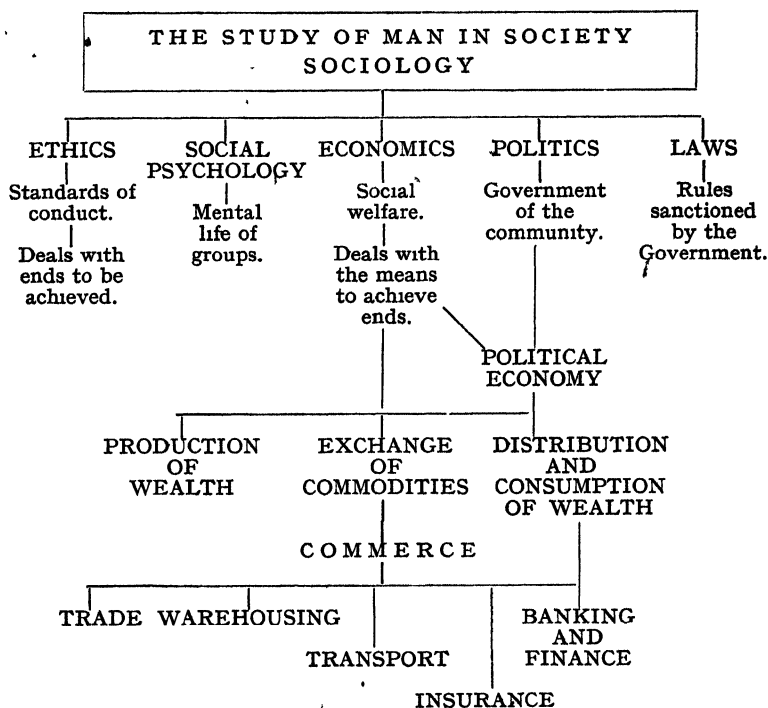


FIG 2.—THE PLACE OF COMMERCE IN THE SOCIAL SYSTEM.

In his *Essay on the Nature and Significance of Economic Science*, Robbins defines Economics as "the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".¹ Even though the power of Mankind over the material environment has made great advances in recent years, there still remains the fact that the means of deriving material welfare from the environment

¹ *Op. cit.*, 1937, p. 16.

are, in practice, scarce, or limited. Labour, including Organisation, and Capital, remain scarce means in the sense that they cannot be employed in two places and at different times as once; labour which is employed in building bridges cannot at the same time be used for the purposes of trade.

The fundamental problem of Economics thus devolves upon the choice of alternative means to secure given ends. As Wicksell points out in his *Lectures on Political Economy* (Routledge, 1935), by an economic phenomenon or activity is meant every systematic endeavour "which seeks, with the available means, to achieve the greatest possible result, or a given result with the least possible means".¹

He points out that the familiar expression, "to obtain the greatest possible results with the smallest possible means", is illogical, and should be avoided.² Either the result to be attained is known, in which case the aim is to achieve it with the least possible expenditure of human resources; or the means are given, and with them it is desired to achieve the greatest possible result.

There are thus two principles which may be followed by a community in its economic activities; and although normally both are followed to some extent at the same time, to that extent the combined process is illogical. During the era of free individualistic enterprise of which the zenith has lately been passed, the second principle was more closely followed in an individualistic fashion, so that exploitation of resources, material and human, to their utmost capacity was regarded as the natural field of commercial enterprise, which included not only the processes involved in the exchange of commodities, but also industrial activity in producing for a "market". The word "commercial" thus came to denote exploitation entirely for the sake of selfish, personal gain; and from the implications of this connotation it suffers to-day.

From the standpoint of the consumer, whether the ultimate consumer or the consumer of articles for further processing, the first principle governed the side of demand. A person buys commodities up to their marginal utility to him; that is to say, he will buy a particular commodity up to the point where he is in doubt whether it is worth his while to incur the outlay required to obtain the final increment, or *marginal* increment. The

¹ *Op. cit.*, p. 2.

² *Ibid.*

utility, or pleasure-giving power, of that final increment is called the *marginal utility* of the commodity to him. The total utility is the satisfaction obtained from the total amount purchased by the individual purchaser.

A good deal of economic theory is taken up with the discussion of the theory of value, especially in connection with the scale of preferences of the individual in respect of various commodities. The importance of the Marginal Utility Theory lies mainly in its explanation of the important fact that often articles of great utility, like bread, have a low market value.

An increase in the supply of a commodity usually brings about a fall in its price; price is determined by the marginal utility to a consumer, and when the supply is adequate, the marginal utility of a loaf of bread will be low. In fixing the price of a commodity, sellers unconsciously estimate its marginal utility to consumers in general.

Thus, the relative preferences of consumers for various commodities and the factors influencing marginal utility, including relative scarcity, are of great significance in determining the economic foundation of the commercial system. The point at issue in the modern world is how far the commercial machinery is to remain as the chance result of the free interplay of purely economic forces—using the word “purely” to denote the fact that the selfish preferences of individuals are the basis—and how far the reconstruction of this machinery is to be related to the planning of the new world. The Beveridge scheme relating to Social Insurance and Allied Services is an example of the discussion of the expenditure of resources to achieve a given result.

We are now in a position to realise the general implications of a planned economy in relation to the field of Commerce. In Volume I, Commerce was described as a system of activities having as their aim the exchange of commodities, which were defined to be articles produced for exchange and having an exchange value, or price. The commercial system comprises those institutions and activities engaged in Trade, the actual processes of exchange, and in the Auxiliaries to Trade, or those institutions and activities which assist the functioning of Trade, viz., the banking and financial system, the transport system, warehousing, and insurance. Commerce functions through business units, or undertakings; the study of the problems of the establishment,

organisation, management and development of typical business undertakings is called Business Economics.

But even before the end of the era of free enterprise, the system of commercial activities could not escape a certain amount of control by the central Government in the interests of the community ; and the central authority and local authorities were obliged to concern themselves to some degree with economic activities which, in the light of our discussion on the field of Commerce, must be called commercial activities.

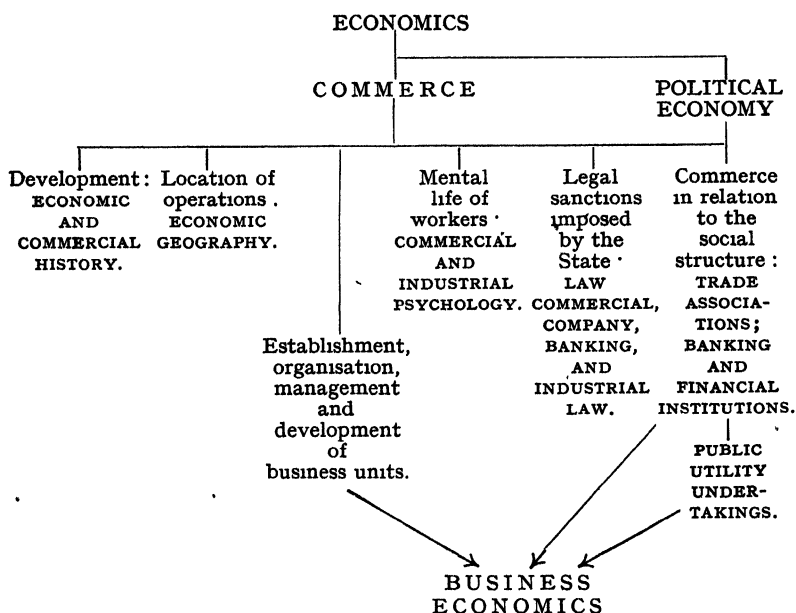


FIG. 3.—THE PLACE OF BUSINESS ECONOMICS IN THE STUDY OF COMMERCE.

Thus, there have developed Public Utility undertakings controlled by the State, *e.g.*, the Stationery Office ; or managed by an officially appointed body, *e.g.*, the Central Electricity Board ; or regulated by Act of Parliament, *e.g.*, the Railway Companies ; undertakings controlled by local authorities, directly managed by them, *e.g.*, the local transport services, or managed by a specially appointed body, *e.g.*, the London Passenger Transport Board ; and, in addition, organisations have been set up for the control of the production and distribution of

commodities, as in the case of the various Agricultural Marketing Boards.¹

It is difficult at the moment to estimate the exact extent of the control of Industry and Commerce by the Government ; and the post-war period of planning and reconstruction must inevitably be one of flux and experiment. But for the purposes of our review of the scope of " Commerce " it is sufficient to note that the term cannot now be restricted in meaning to the mere buying and selling of commodities by private persons or companies ; nor even can the term " Trade ", for in Trade, as in its Auxiliaries, Banking and Finance, Insurance, Transport and Warehousing, activities by central and local authorities are manifest.

We come, then, to a modern conception of a view of Commerce which regards it as the practical expression of the economic activities of the community ; and though, in the Classification of Economic Activities given in the first volume, Commerce has been separated from Industry for the sake of presenting a comprehensible scheme, we realise that in practice those undertakings engaged in Industry, *i.e.*, the primary, manufacturing and constructive industries, are all engaged in commercial activities, in that their products are produced for a market, to be sold to consumers, though some of these consumers require their purchases for further processing ; ultimately, the commodities are produced for the final satisfaction of the ultimate consumers, the members of the community.

Until the development of principles first put into operation in this, the opening stage of the Era of Planning, the standard of material life has depended mainly on the free play of economic forces whose theoretical discussion will be found in any of the well-known academic text-books of Economics ; the income of the average ultimate consumer was determined by his marginal utility to an employer, and his obtaining of material benefits was determined not by his needs, but by his effective demand—that is, by his ability to buy. Supply and effective demand operated on one another in a reciprocal merry-go-round of parsimonious economics, dependent on how much each party to a transaction could get out of the other.

A planned world cannot destroy the settled principles of Economics ; but it must result in a different way of looking at the problems of economic life. Although, as has been pointed

¹ See Fig. 20, Vol. I.

out, resources of factors of production are scarce in the sense that they are limited, they are only relatively so. In point of fact, in relation to human needs, they are vast, as the example of the Second World War has so clearly shown.¹ Thus, the function of an economic system controlled by the community resolves itself into the practice of methods by which, with given means, and under given circumstances, the greatest possible result may be obtained or by which a given end may be achieved; the problem is lifted out of the narrow economic sphere into the wider one of sociological and ethical significance: if a given end is to be achieved, is this to be done without regard to the happiness of the members of the community? It may be profitable, in terms of that happiness, to run an enterprise "at a loss".

It will be noted that Sir William Beveridge, in his Report, did not avoid references to ultimate values. In fact, the commercial student cannot avoid reference to moral and ethical values. The various activities of human life cannot be separated into mutually exclusive departments. The criterion to be applied to business undertakings is no longer whether or not they are "producing the goods", and selling them at the highest possible profit, whether the goods be machines or tins of poor-quality salmon which will make poor people sick, but whether they are effectively performing their function of acting as a link in the chain designed by the community for the production of commodities and their equitable distribution.

The Scope of the Study of Commerce.

The use of the word "equitable" is an indication of the changing meaning of Commerce, and, indeed, of Economics itself in the modern world, with its demand for planning in the interests of the community. Hitherto the economist has tended strenuously to deny that his is to any great degree a normative study, concerned with what ought to be; though he has never appeared to be very sure of this attitude until he has been asked to make concrete suggestions in the face of complex and sometimes mutually conflicting tendencies; his yearning to attach to his subject the prestige of Science has often led him away from the bitter reality of the workaday world into the serener realms of abstract theorising, where none but the earnest student cared to follow him.

¹ The possibility of the use of atomic power must also now be considered.

To some degree this attitude has been encouraged by the powerful interests in the community, who have had no objection to the study of Economics so long as it did not concern itself with the study of what ought to be on ethical grounds, so long as it remained a coldly disinterested survey of the human scene, with a vague leaning towards an "economic" justification of whatever evil the system produced. When the economist ventures to link up his Economics with the practical issues of life, as Sir William Beveridge did in his Report, he raises a storm among those whose interests are affected, which shows only too clearly that the study of Economics as an abstract social science is a contradiction in terms; a social science is one which refers to social facts, and as such cannot help but take note of all relevant factors, political, ethical and psychological. Otherwise, Economics is nothing, unless it be cerebral exercise akin to mathematical analysis.

'There is some claim for a revival of the old term "Political Economy" to refer to the study of the factors that go to make up the ordered life of the community; in a planned world such a study would be undertaken with the end of investigating the application in relevant circumstances of the two principles we have discussed, and relating the results of these investigations to the welfare of the community.

In order that this study shall be adequately pursued, the scope of "Commerce" must be considerably enlarged; the commercial student in the modern world must be equipped with a sufficient sociological background to enable him to realise the importance of the various factors that influence the processes of commercial life. Otherwise, an import duty, say, becomes merely a complication to be dealt with by the prescribed procedure, and not something which has to be discussed and whose implications have to be considered in relation to the life of the community. And who is better fitted to discuss such a problem than the very people whom it most intimately affects, the very people to whom the Government should turn in order to obtain information as to the impact of the duty on commercial life?

To reply that such information would be given from the prejudiced standpoint of the self-interested is to assume, first, that the old social system of desperate self-seeking is to be perpetuated; and secondly, that the system of education will continue to be such as render the average man and woman unable to see the implications of any problem placed beyond the vicinity

of their own noses. A planned world means that it is a world planned, in effect, by an educated and enlightened majority, or at least approved by them.

At present this remains an ideal, but it is an ideal which is now at least to be reasonably hoped for, if not expected. If Commerce, as the social science of Applied Economics, is to take its rightful place in the education of the future citizens of the community, it must comprise a training in the principles of right thinking, in the elements of the social sciences, in History and Law. It will be, in fact, the specialism of those to whom the community will look as the advisers of its economic life in general.

This specialism, under what it is to be hoped will be the prevailing feature of the New World, will inevitably take on the character of Service to the Community, superseding the old idea of "Commerce" as Service to Self and the devil take the hindmost. The Commerce student will view the economic scene in relation to the needs of the community, and his preparation for entry into industrial or commercial life must therefore include a training in the principles of Citizenship in its widest sense, comprising the study of the principles of the social sciences and of the central subject of Sociology.

With this background, he will be the better able to view in relation to the needs of the community the functioning of the primary industries, the manufacturing and constructive industries, the strictly commercial activities—trade and its auxiliaries—the banking and financial system, the public utility services, and the direct professional services, following the classification of economic activities given in Vol. I.¹

The scope of the study of Commerce thus includes not only the study of the technical matters dealt with under the heading of Trade and its Auxiliaries, but also the relationships of the associations concerned with the institutions of the whole economic and social structure. It recognises the "commercial" nature, in accordance with the operations of the two principles discussed in this chapter, of all the economic activities of Man engaged in making a living. The occupation of the engineer, from the standpoint of his making a living, is just as "commercial" as that of the trader; and, as has been pointed out, the occupation of the trader, from the stand-point of public service, may as justly accord with human dignity as that of the engineer.

¹ P. 30.

In the modern world, then, we may regard the scope of Commerce as comprising the systems and institutions designed, consciously and deliberately, or unconsciously, by the members of a community to achieve, for the benefit of the community, the greatest possible economic result with the available means, or to achieve a given economic result in the way most advantageous to the community : thus the illogicality in the attempted reconciliation of the two principles discussed in this chapter is removed, for ends are related to means, and both are considered on the basis of community values. It follows that those whose future careers lie in the field of Commerce must be prepared, in the modern world, to undergo a training to fit them not only as technicians in the particular branch of commercial activity which they desire to enter, but also as leaders of thought in those matters related to the economic welfare of the community. This remains an ideal at present, but many other social attitudes and valuations now part of the psychic make-up of modern civilised persons have been regarded as being merely ideals in the past.

CHAPTER II

TRADE

The Distribution of Commodities.

Trade lies at the heart of Commerce, for it is the method by which commodities are distributed. It is the method by which our infinite variety of wants is realised; it is the method by which we are made aware of a multitude of things the possession of which enriches and broadens our lives; it is a form of intercourse between individuals and groups in countries of widely different habits and cultures making for knowledge and understanding of other peoples and other customs, and providing additional threads of inter-relationships between peoples, making ever yet more complex and closely-bound the social life of Man.

Trade comprises the exchange of commodities at all stages, from the raw material to the completed article ready for consumption. The commonest articles of our everyday consumption have behind them a long and complex history of buying and selling of raw material, of transport to places where the raw material is processed, of buying and selling of the processed material, of buying and selling of other raw materials and processed materials, of buying and selling of semi-processed material and finished articles, until at last the consumer obtains what he requires for use.

Trade is buying and selling, whether of commodities in unfinished form for further processing, or of finished commodities for distribution to the final consumer. The nature of those articles, and the extent of the trade, depend to a very great extent on the expressed desires of consumers, or on the estimations of those desires made by those engaged in trade. The desires of consumers are subject to many and varied influences; some desires, such as the desire for bread, are more or less regular in form and extent, whilst other desires, such as those relating to articles of dress, may be influenced by a thousand changes in points of fashion and taste.

It is therefore extremely doubtful whether in the most carefully planned of societies it would be possible or expedient to attempt a control over the processes of distribution such as would tend to

interfere with the system of free expression of desire for commodities and the satisfaction of these desires—apart, that is, from trade in commodities whose consumption is harmful without proper restriction, *e.g.*, opium. What supervision by authority is needed is rather in the direction of making commodities more freely available ; and this problem, of course, is intimately bound up with prices and wages, and all the endless ramifications of a system that cannot be radically modified without confusion and danger of utter chaos, unless modification comes slowly and as the result of the deliberate and expressed desire of the community.

One reason why this is so is that the system has grown throughout the ages in response to the needs of Man ; those particular parts of the system which are in need of rapid reform are interpolations inserted not in response to the needs of the community, but as a means by which the unscrupulous take advantage of the ignorance and weaknesses of their fellow-men . in this category come some aspects of speculation and company promotion.

The trader is a collector of commodities from primary producers and manufacturers and a distributor of these commodities to the consumer ; the importer and exporter are traders specialising in aspects of foreign trade. Broadly, the intermediary body of traders, engaged in trading between producers and manufacturers and retailers, and thus excluding those manufacturers marketing their own products, are called merchants.

The merchanting class has suffered greatly as a result of the Second World War. The home merchants found their activities taken over by the various basic commodity controls, while merchants trading abroad have suffered not only directly from war circumstances, but also from the Lend-Lease arrangements, under which exports have been no longer necessary in order that the country might secure essential imports. Export merchant business had been declining for some years before the War, and in the opinion of some industrial leaders, the cost of maintaining an efficient export service was a prohibitive one. Nevertheless, there is a strong case for the revival of the merchant : the general export merchant is usually also an importing merchant ; his business is concerned with a wide variety of articles ; and he not merely sells them, but also finances their sale ; he has an expert knowledge of the particular needs of his customers. To the small producing undertaking his services are indispensable.

Yet, in effect, the War has caused the phenomenon of Government trading on a large scale to be regarded as a feature of commercial life which will continue for some time to come, at least to some degree. International control of raw materials has long been advocated by many people, and the controls rendered necessary by the War did much to bring it about. In January, 1942, the Combined Materials Board was established to control the purchase and distribution of raw materials available to Great Britain and the United States, with the object of seeing that the maximum use was made of them by all the Allied nations.

Joint action in the regulation of the supply and distribution of essential materials was thus taken by the various Governments ; a scramble for scarce secondary materials was prevented, and the Board formed a centre at which problems relating to the distribution of materials could be discussed. Although it was desired to disturb existing trade relationships as little as possible, in many cases normal trade channels have had to be diverted ; old rivalries and traditional trading and transport arrangements were put under an unwonted control which, however, achieved a degree of unity and stabilisation of which there was little hope under the pre-War system of free competition.

The problems of post-war reconstruction cannot but include those concerned with Trade ; in the White Paper, *Proposals for an International Clearing Union* (Cmd. 6437, 1943), four main lines of approach are suggested :

- “ 1. The mechanism of currency and exchange ;
2. The framework of a commercial policy regulating the conditions for the exchange of goods, tariffs, preferences, subsidies, import regulations and the like ;
3. The orderly conduct of production, distribution and price of primary products so as to protect both producers and consumers from the loss and risk for which the extravagant fluctuations of market conditions have been responsible in recent times ;
4. Investment aid, both medium and long term, for the countries whose economic development needs assistance from outside.”¹

The White Paper touches upon the suggestion of “ international bodies charged with the management of a Commodity

¹ Preface, p. 3.

Control ”¹ for dealing with the financial problems involved in “ buffer stocks ” of primary products—“ buffer stocks ”, as their name implies, being stocks whose effective management would prevent violent fluctuations of prices, stocks being purchased when prices are tending to be low, and sold when supplies are low and prices are tending to rise.

It is evident that trade, while preserving its main features of pre-War economic activity, will be subject to changes the exact natures of which are unforeseeable at the present moment ; like the whole structure of Trade and Commerce, the new pattern will be worked out in accordance with the needs of the times. The general form of that pattern is, however, unlikely to be radically different from what has served men’s needs in the past—the distribution of commodities will still operate to a great degree through the channels of primary producer and manufacturer and importer, through the produce markets and wholesaler to the retailer and thence to the consumer.

The Retail Trade.

The large number of retail units in this country and the variations in organisation make it difficult to describe in general terms the structure of the retail trade. Estimates of the number of retail shops vary from about 500,000 to 1,000,000, though the latter is certainly too high. Henry Smith, in his book *Retail Distribution* (Oxford U.P., 1937), puts the number in England and Wales in 1932, excluding public-houses, restaurants, fried-fish shops, and boot repairers, at approximately 530,000. The numbers of individual types for 1931 varied from Grocery and Provisions (92,700), General and Mixed Businesses (78,500) and Textiles and other clothing (74,000) to Drugs and druggists’ sundries (10,100), the latter having the largest population per shop (4,000), followed by Ironmongery (3,300), Furniture (3,130) and Boots and Shoes (3,080). A street of a hundred houses will house a population of about 400. Smith gives the annual turnover per shop as follows : Boots and shoes, £4,940 ; Meat, £2,880 ; Greengrocery, £1,910 ; Sugar confectionery (sweets), £1,370.

The number of shops owned by the chain stores and other large groups has been estimated at 60,000–70,000, with an estimated total retail turnover of about £1,000,000,000. Smith quotes the

¹ P. 18, para. 39 (3).

estimate of S. P. Dobbs of 1,000 as the number of department stores, with an average turnover of £150,000. But it is difficult to distinguish between the department store proper and some of the largest shops, especially the drapery establishments handling other commodities like furniture. In 1940, the large units, including such stores as Woolworth's, earned £8,000,000 net profit (Woolworth's net profit for 1943 was £5,203,654—

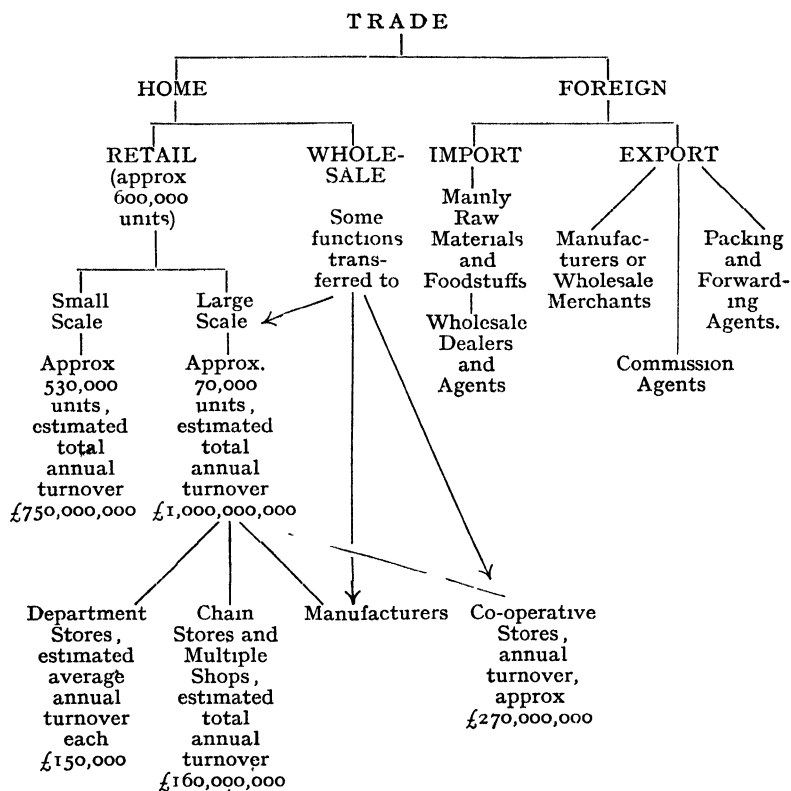


FIG 4 —A GENERAL VIEW OF BRITISH PRE-WAR TRADE

£496,168 less than that of the previous year—a drop of 8·70 per cent.); their total turnover can be estimated at £160,000,000. The turnover of the Co-operative Movement has been put at about £270,000,000.

It is evident that not a large amount of trade was left before the War to the average small sole trader; and for some time past it has been considered by some that there have been far too

many of these small retailing units. The restrictions imposed on trading as a result of the outbreak of war have made the position of the small sole trader yet more difficult.

Nevertheless, it is very doubtful whether the British public would tolerate any organised attempt to get rid of the small independent sole trader, the personal touch is too valuable to be lightly discarded. There is no reason why the small sole trader should not become a friend anxious to procure for his customers the exact article they require and to be always in a position to render help and assistance and advice. Many druggists have held such a place for years in the affections of their public.

The demand for legislation to control the number and variety of retail shops seems to have come mainly from the large concerns, including the manufacturers who have entered the retail trade; this demand has as its object the elimination of the competition of the small shops. It is not uncommon for small concerns which have contracted to supply the large stores to find themselves eventually "in the pockets" of these large undertakings and bought out after suffering progressive decreases in prices for the supply of their products.

Legislation against the small retailer has the air of victimisation. If the small retailer does not function efficiently, economic forces will oust him: the process is described by H. G. Wells in his *History of Mr. Polly*. People do not buy from small retailers mainly from philanthropic motives. It is true that a good deal of competition results in the waste of the resources of the community. But this criticism applies as much to the giant concerns as to the small ones.

The main problem is how far efficiency should be sacrificed to the undoubted advantages which the small sole trader possesses. He operates under great initial difficulties, for he buys his stock in small amounts and in great variety, and therefore does not obtain the advantage of large discounts, as do the big stores. Nor can he afford the expert buying and sales services of the large stores. On the other hand, away from the main shopping centres his operating costs need not be high, and he is assured of a constant circle of customers, to whom he offers considerable conveniences. There is evidently still a valuable service to be rendered by the small retailer in the suburbs of towns and near the residential areas.

But the selling by the retailer of his own brands of products

has gone. Branded goods, nationally advertised, now form the greater part of the retailers' stocks. Producers give the retailers advice, even dress their windows and subsidise their advertising. The independent manufacturer and the independent retailer have, indeed, forged links of mutual aid. In many trades, associations have been formed composed of manufacturers and retailers, concerned mainly with terms of sale, but also dealing generally with problems common to the trade; thus, in the grocery trades, in bookselling, in the retailing of photographic sundries, in tobacco and stationery, in pharmacy, in the motor and cycle trades, these associations are of particular importance. In such trades as those concerned with tobacco, the manufacturer plays a leading part; in such a trade as bookselling, the retailer has an important voice. Again, bakers have associations which exercise a considerable influence over the trade, and in the various Chambers of Commerce are found co-ordinating authorities of local influence.

Thus, the small private trader for some time past has been losing his complete independence, and in the sale of many commodities he is the mere agent of the manufacturer or of a number of manufacturers, whose proprietary brands he distributes.

The Co-operative Retail System.

The £270 millions annual turnover of the Co-operative Movements indicates the relative importance of co-operation in the sphere of trade. In Great Britain, with its strong tradition of individualism, producers' co-operation has met with far less favour than consumers' co-operation; though the Government Agricultural Marketing Schemes and the further supervision of agriculture imposed as a consequence of war conditions have resulted in a kind of compulsory co-operation with features similar in some respects to those of the co-operative farming system adopted in Denmark before the War.

Consumers' co-operation has to some extent suffered from its connection with political ideologies. The original appeal of the Co-operative societies was to the "working" and "lower middle" classes; and in these days, when such social distinctions are beginning to provide subjects of study to the social historian rather than indicate the existence of real strata of Society, this particular appeal has lost a good deal of its force. Certainly the

Co-operative Movement has not succeeded in becoming a self-sufficient organisation in Society. About a third of the commodities sold are obtained from non-Co-operative sources; the

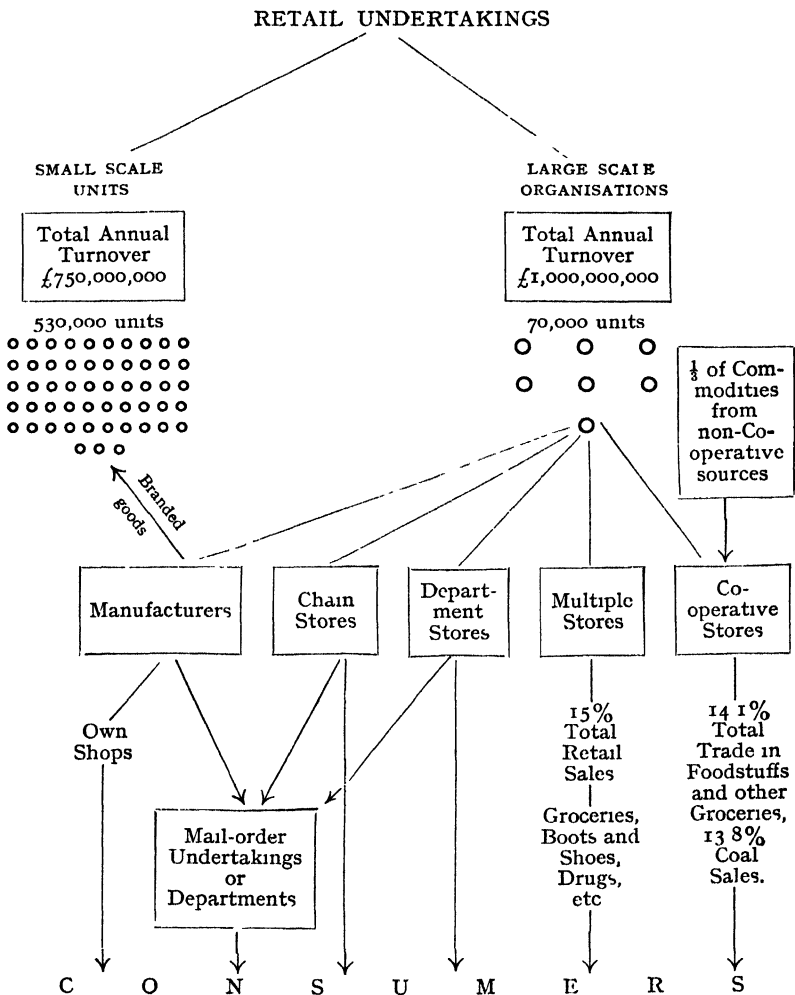


FIG 5 —THE BRITISH RETAIL TRADE (PRE-WAR)

non-food proportion of the trade is low, and prices and quality of commodities have not been so attractive as to enable a favourable comparison to be made with those distributed through other retail channels.

Before the War, the strongest position of the Co-operative trade was found in such commodities as milk and bread, the organisation of distribution in such goods not requiring a complex system of organisation to meet market intricacies. In 1939, the Co-operative Union handled 14.1 per cent. of the total turnover of the nation's retail trade in foodstuffs and other groceries, 13.8 per cent. of the turnover in coal; the figures for boots and shoes were 9.1 per cent.; for piece goods, women's wear and men's wear 6.6 per cent.; for furniture and hardware 3.5 per cent.¹

Smith (*Retail Distribution*) points out one feature at least to the credit of the Co-operative organisation: it has remained free from the practice of selling at enhanced prices ordinary standardised commodities packed as branded goods, a practice particularly pernicious in the case of drugs and medicines.

The Large-Scale Retail Undertakings.

The great part played in the structure of the retail trade by the large-scale undertakings is evident. Neal (*Retailing and the Public*) and Smith (*Retail Distribution*) have investigated the position of the retail trade and have given some interesting figures. Excluding Co-operative and fixed-price chain shops, the multiple organisations are estimated to represent 15 to 20 per cent. of the total retail sales; in the boot and shoe trade they are believed to account for more than 40 per cent. of the annual retail turnover.² Levy quotes the claim of a multiple tailoring company to supply one out of every five suits sold in the country; whilst the largest multiple chemist concern, with more than 900 branches, controls about one-sixth of the total trade in its field. Multiple grocery concerns, of which there were in 1932 more than 400, controlling more than 10,000 branches, control probably an even larger proportion.

The entry of manufacturers into the field of retailing is an important factor in the development of the retail trade, especially in the boot and shoe trade, in tailoring, and in pharmacy; and here the producers sell their own products almost exclusively, whilst alongside the large producers marketing their own products are a large number of small producers who have not entered the retail trade. In the boot and shoe trade, Freeman, Hardy and Willis, controlling over 500 branches, has changed over from

¹ Levy. *Retail Trade Associations* (Kegan Paul, 1942), p. 28.

² Quoted by Levy, *op. cit.*, p. 28.

manufacturing to retailing, its own manufactures forming only a small part of its trade; whilst True Form (J. Sears and Co.), operating about 700 branches, starting from a distributive business, now has control of a large manufacturing business also. In tobacco, the Imperial Tobacco Company of Great Britain and Ireland, Ltd., though not possessing a monopoly, has a substantial mastery of the home market.

A combination of chain-store activity with the mail-order business has taken place in the case of the Great Universal Stores, Ltd, probably the most important organisation of this type in the country; a part-time agency organisation has been built up, and would-be purchasers were grouped into clubs, in which articles were paid for by instalments. The club system has also operated in other businesses, the Provident Clothing Co. is an outstanding example, and it was in operation also in the case of Dolcis, the boot and shoe retailers

Mail-order undertakings, as we noticed in Volume I, are of three main classes (1) the true mail-order type, or middleman type, the goods being bought from the manufacturers and stored; (2) the manufacturing type, manufacturers selling their products direct to the public, and (3) the Mail-Order Departments of Department Stores—*e.g.*, Gamage's and Selfridge's. Increased postal charges and limitation of supplies have presented a serious problem in this form of enterprise.

The Position of the Wholesaler.

It is evident that as a result of the policy of cheap selling by the largest retailers, there is a tendency towards the elimination of the payment made for intermediary services. The most important function of the wholesaler as an intermediary between manufacturer and retailer has been the holding of stocks, so that he acted as a buffer against price fluctuations. Large undertakings, like Marks and Spencer, Woolworth's, and the British Home Stores, have been able to make purchases on a huge scale and thus to avoid using the services of the wholesaler. Even where there is a considerable risk of changes in fashion, the large undertakings, like Selfridge's and Swears and Wells, the furriers, gown and mantle dealers, buy direct in bulk from the manufacturers. The emphasis in the administration of the big stores is on reduction of costs, and this means a tendency towards the elimination of the wholesaler. The functions of the wholesaler—grading

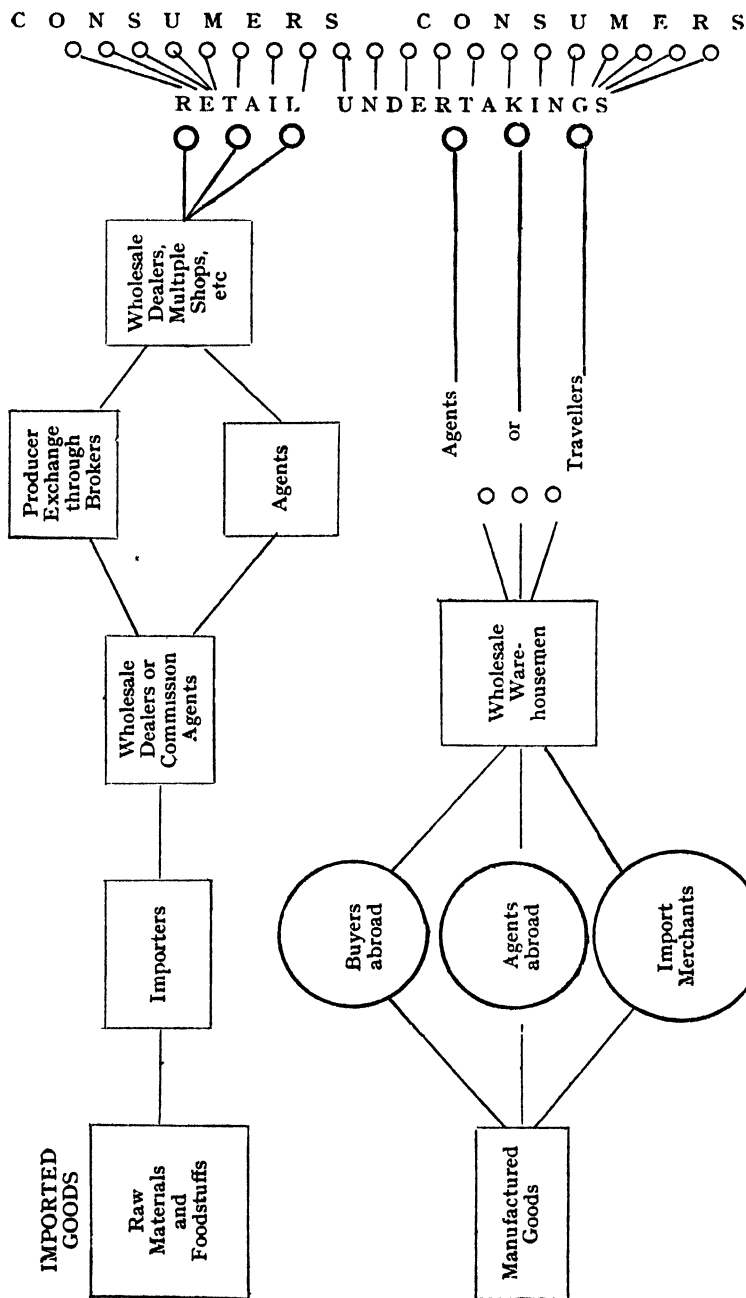


FIG 6.—THE ORGANISATION OF THE IMPORT TRADE

and packing, standardising, sorting, taking the risks of business, exhibiting goods, financing operations—have not been eliminated, but transferred to units operating both as retailers and wholesalers; to the great retail concerns; or to the great combines such as Unilever, Ltd.

Where the output in individual businesses is comparatively small, the trade seasonal, and the transport facilities lacking, the wholesaler fulfils a necessary function, and is often found operating on a small scale and dealing in a variety of goods. Where there is a steady sale, as in the case of branded goods, the retailer may be supplied direct by the manufacturer, and the services of the wholesaler may be dispensed with.

The true wholesaler buys in large quantities and sells in smaller lots, and in foreign trade he still exercises important and numerous functions, though the wholesaling activities may not consist wholly of a purely wholesaling type. Let us glance at the organisation of the importing and exporting trade.

Foreign Trade.

The bulk of imports into this country consist of raw materials and foodstuffs, and are made indirectly through professional importers. In the case of raw materials, the commodities often pass through several hands before reaching the consumer; the collection of the goods may be made by a wholesale dealer or a commission agent. Manufactured goods pass mainly through the hands of the wholesale warehousemen, who may obtain goods by sending buyers abroad, by placing agents abroad, or from import merchants, who perform the functions of the true wholesaler by buying in large quantities and selling in smaller amounts.

Exporting is carried on (1) by manufacturers acting alone or in associations; (2) by wholesale merchants exporting their own goods to buyers or branch houses abroad; (3) by commission agents acting as buyers for merchants abroad, shipping under their own invoice the different items of the indent; (4) by export agents, who may represent several non-competing manufacturers; and (5) by packing and forwarding agents, acting for traders who have received orders direct from their principals. There are also (6) the branch houses of foreign and colonial traders acting under the orders of their houses.

We have already considered the difficulties of the position of the merchant, and suggested that there might be a revival of

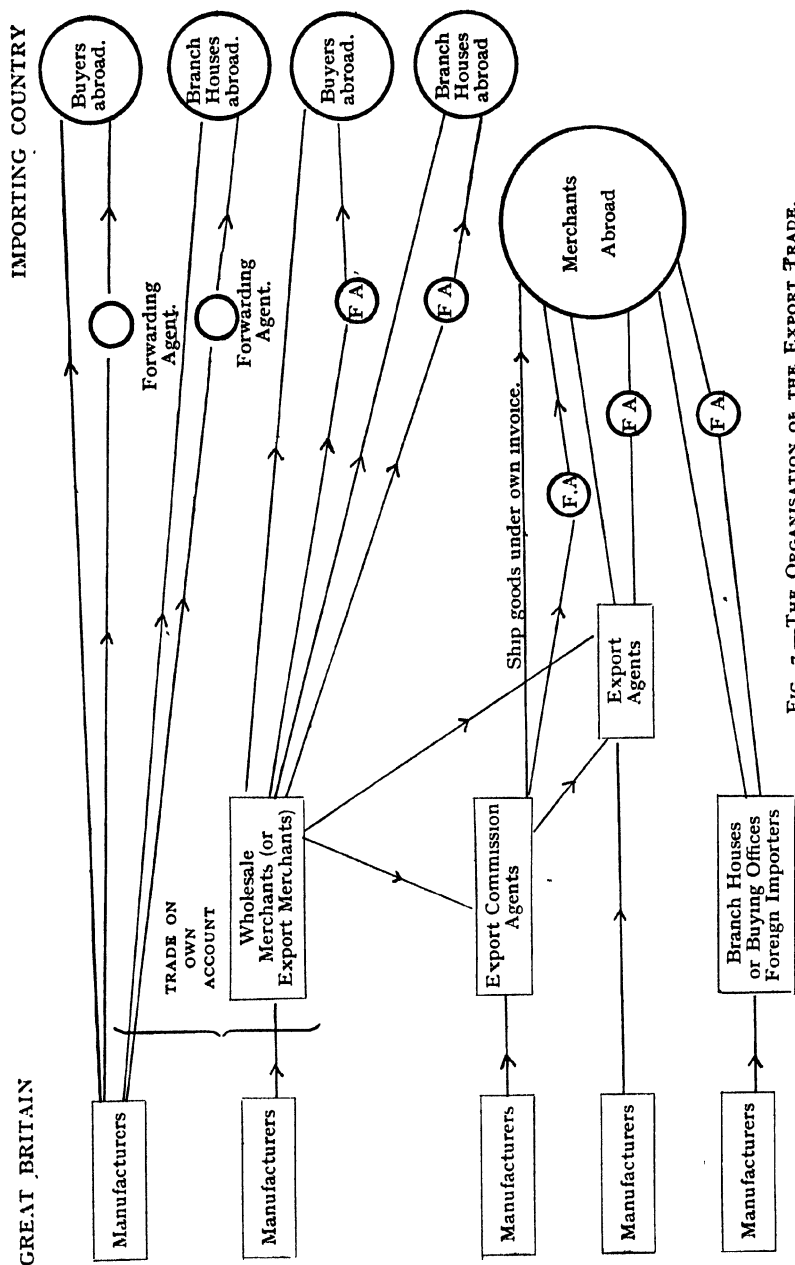


FIG 7 — THE ORGANISATION OF THE EXPORT TRADE.

merchanting activity after the War. Our national prosperity depends, to an extent greater than that obtaining in any other country, on foreign trade. Before the Second World War, Great Britain imported about 60 per cent. of her food, five-sixths of her wool, two-thirds of her iron, all her cotton and rubber, practically all her oil, petrol and non-ferrous ores; the only raw material of which there were sufficient supplies was coal. The total value of her imports was about £850 millions.

In order to pay for these imports, we have to send other things abroad in exchange. The value of the commodities exported came to £500 millions before the War; the remainder was made up by £200 millions in interest receipts on our overseas investments and by £150 millions in "invisible exports", such as the provision of shipping and financial services: the shipping companies give such services by carrying foreign goods in British ships; and insurance companies and banks provide services which are paid for in the money of the country receiving the services.

Foreign investment includes the export of goods as a loan, of which the principal and interest are to be paid for in goods over a period of years. An example will help to make the position clear. Suppose that the Argentine Government wishes to build a railway and wishes to obtain the material and rolling stock from Britain and to use the services of British engineers. A loan is negotiated by one of the finance houses in the City of London, and with the money the Argentine Government is in a position to give an order for the construction of the railway to a British contractor, who is paid by the money obtained from the finance house. He, in turn, pays out wages and salaries to his employees, so that the money, or purchasing power, remains in this country, while the railway, plus the added value given to the materials by the costs of production, goes to the Argentine.

In the City an Argentine Loan is floated, at so much per cent. interest, and is taken up by the banks and the investing public. The position is then that the Argentine has to make an annual payment of the interest, and this payment she must make in goods, so that Britain has to take imports to the value of the interest: a claim in foreign money on a country to which goods have been exported is a claim on a corresponding amount of goods or services, for money is merely purchasing power. If the creditor country is not willing to let the debtor country pay this debt in goods or services, the claim merely becomes a tool of

economic aggression—investments may be realised, and the money used to buy up the industries and obtain control of the economic and ultimately the social life of the debtor country. This was one of the means of aggression employed by Germany in her pre-war economic policy.

The *balance of trade* for a country indicates the difference between the value of the imports and exports, whilst the *balance of indebtedness* takes into account both visible and invisible trade. A country exporting more than it imported was said to have a "favourable balance of trade", but this latter phrase is mere jargon, and a truer view of the international position of a country is obtained by considering the balance of indebtedness. The position of Great Britain in the normal year 1935 was that there was an excess on balance of indebtedness due to Great Britain of about £30 millions. But the balance of indebtedness became an adverse one of £19 millions in 1936, and it has become clear that there is a serious problem in the sphere of foreign trade for this country.

Conditions after the 1914-1918 World War were deeply affected by several developments. Some countries which had been accustomed to receive manufactured goods from Great Britain were unable to do so as a result of war difficulties, and began to develop production for themselves. Thus, Indian mills increased their pre-war average of cotton piece-goods of 1,105,494 thousands of yards to 7,570,859 thousands of yards in 1935-36; the corresponding figures in thousands of lbs. for cotton twist and yarn were 646,757 pre-war to 1,058,297 in 1935-36. In iron, steel and copper production, Indian industrialisation was very marked. The competition of Japan became particularly severe; in cotton and cotton piece-goods, and in woollen and silk manufactures, Japanese industrialists invaded the market to a serious extent.

A second factor was the turning over to agriculture of considerable areas of land in the New World; at the same time, technical improvements increased productivity, so that when European agriculture began to recover, agricultural prices were very low, and agricultural producers were not able to buy as much of our exports as before.

Again, our invisible exports were greatly reduced. Tariffs and the collapse of markets reduced the earnings of shipping; and the quantity of investment abroad was much smaller than

what it had been before 1914. Colin Clark, in *National Income and Outlay*, gives the money value of our investments overseas as £138 millions in 1907, and £72 millions in 1924. The real reduction was, of course, much greater, since prices were much higher in the later years.

The industries whose products entered into the export trade were particularly hit by these changes. Credit difficulties, the disorganisation of foreign currencies, the attempts of countries to close their markets by tariffs, quotas, import prohibitions and exchange regulations exacerbated these conditions. In *Some Economic Consequences of the Great War* (1930), Dr. Bowley pointed out that the falling off of British exports was not only widespread geographically, but also extended over all the principal manufactures for export. The losses to Great Britain included not only the loss of labour in production, but also the loss of transport by sea and land and of the incidental business arising from foreign trade.¹

Britain's Post-War Export Trade.

What is likely to be the position in the post-war years? Manufacturing industries have been developed in other countries, e.g., Canada and Australia. In 1938 Australia had not manufactured a single petrol engine, nor an aeroplane; now she makes engines and motor-cars and aeroplanes. Most of our overseas investments have gone. Young and Bunbury, in the Oxford Pamphlet *Will the War Make Us Poorer?* (1943), make the guess, "taking a moderately cautious view", that the foreign currencies available to pay for imports will be, after the War, about £200 millions a year, instead of the pre-war £350 millions. To sustain the pre-war level of imports, additional exports worth £150 millions would be called for, necessitating an increase of materials imported whose value would be about £50 millions, so that exports would have to be increased by £200 millions, or about 40 per cent. But the production of home-grown food and industrial developments, as in plastics, may help to reduce imports; though it is certain that we cannot reduce them very much without reducing our standard of living.

In January, 1945, the Minister of Reconstruction, in the course of a speech in which he announced the details of the Govern-

¹ See A. C. Pigou, *The Transition from War to Peace* (Oxford Pamphlet No. H 3, 1943).

ment's plan to help the export trade of Britain by increasing the Government's liability under export guarantees from the pre-war figure of £75,000,000 to £200,000,000, emphasised the importance of developing Britain's export trade in the reconstruction of our economic life. The aim in the export trade has been officially stated to be an increase of 50 per cent. in value over the pre-war average: a total export of goods and services to the value of about £1,000,000,000 a year.

The value of the exports in 1938 was £471 millions. In 1944 the value was £258 millions; but it must be remembered that export prices in 1944 were 78 per cent. higher than they were on the average in 1938: the volume of exports in 1944, therefore, was under one-third of the volume in 1938. These figures refer to merchandise; the value of the "invisible exports" in 1938—shipping, banking, insurance and marketing services—was £130,000,000: a total nearly as great as that of the three largest items of merchandise exports, *viz.*, machinery, cotton and vehicles. Thus the "invisible exports" had a value between one-fifth and one-quarter of the total exports in 1938.

The recognition of the vital importance of developing Britain's export trade in the post-war years has found practical expression in the creation of an organisation to conduct market and consumer research in all parts of the world and to maintain a permanent trade intelligence service: the British Export Trade Research Organisation. This is a self-supporting but non-profit-making organisation, working on a co-operative basis as an association of undertakings whose objectives are "to obtain and place at the disposal of all its members, primarily by means of market and consumer research, such information—whether of a general or specific character—as may be necessary to enable them to appraise the existing situations in old markets and to develop them, to discover new markets overseas, and generally to re-establish and increase their overseas trade."¹

The Organisation Chart of B.E.T.R.O. is given as Fig. 8. Within a month after its formation in March, 1945, the Founder Membership of the organisation reached 70, the undertakings concerned representing some of the most important in the British commercial and banking world. The Department of Overseas Trade has expressed its approval of the scheme and its willingness to co-operate.

¹ Brochure of the B.E.T.R.O., p. 4.

B.E.T.R.O.

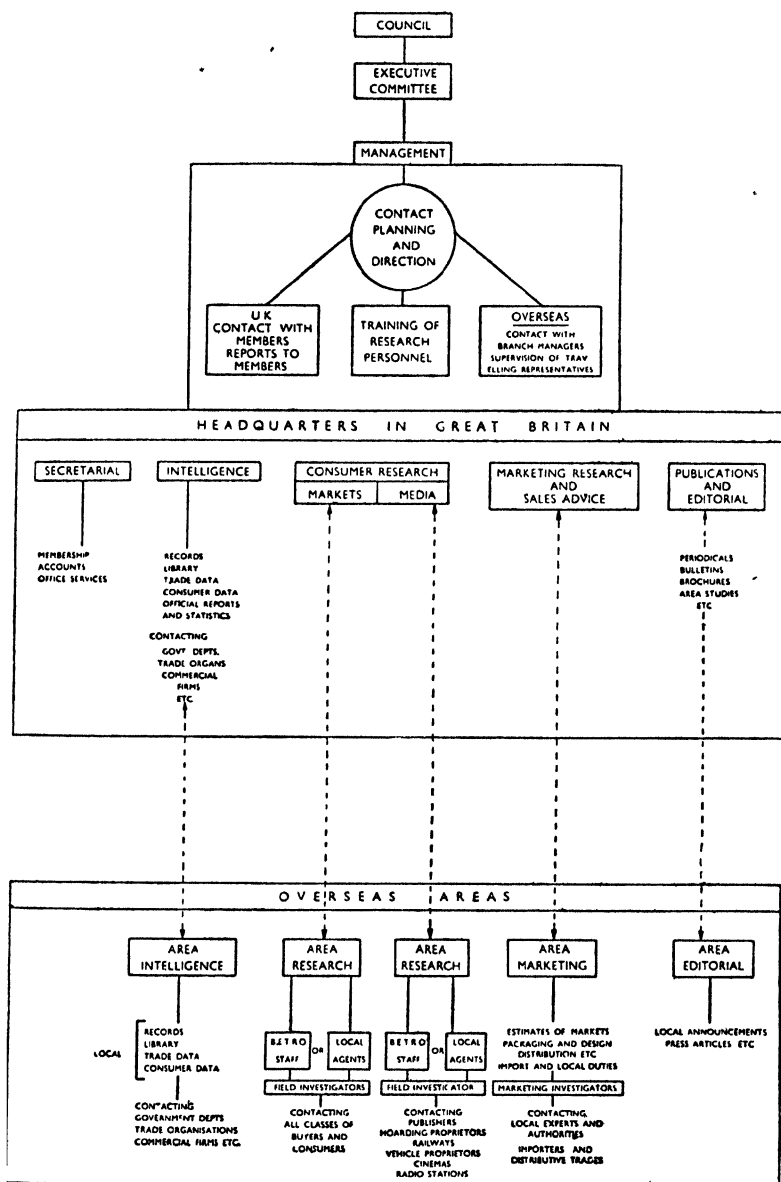


FIG. 8 —ORGANISATION CHART OF THE BRITISH EXPORT TRADE RESEARCH ORGANISATION.

The subject of Britain's export trade is of such great importance that the author draws the special attention of the student to Appendix II, *A Short Assessment of Changes in Britain's Export Trade brought about by the War*, reprinted, by kind permission, from the brochure of B.E.T.R.O.

The Lend-Lease arrangements between Great Britain and America were aimed at preventing a position analogous to that which arose at the end of the First World War, when the United States requested payment of a loan of about £1,000 millions from Great Britain. The latter could not pay in gold; the total world stock amounted to only about £2,000 millions, and of this the United States already had a large proportion. America was unwilling to take payment in goods and services, on the ground that this would cause unemployment in her own industries. Under the Lend-Lease arrangements, contributions have been made by the nations according to the resources of each, and each has received according to its needs, so that aid has been given and received without consideration of "balances". It is not possible to forecast at this stage what arrangements will be made for settling obligations, but the crimes and errors of the past must be avoided, and perhaps the idea of a common pool, which has worked so well under war conditions, will be developed.

In addition to the exports of services, overseas investments used to yield us about £200,000,000 annually before the war; these must inevitably be reduced by at least £100 millions, so that it will be all the more necessary to restore the exports of services to the highest possible level.

The essential condition for development of banking and insurance business is that the markets for commodities of world importance, such as rubber and grain, should be as wide and free as possible. In pre-War days it was always possible to sell any consignment of goods, and shipping companies who wanted to be sure of selling their cargoes could always direct the consignment to London, in spite of the high charges of the Port of London Authority.

In November, 1943, the London Liberal Federation organised a Conference on "London's Stake in Overseas Trade"; it was with the invisible exports rather than the visible exports that the Conference was concerned. On the general problem of world trade after the War, the suggestion was made by two notable speakers, Lord Leverhulme and Sir Andrew McFadyean, that

free trade should be introduced by instalments by international agreement, tariffs being reduced gradually over a period of years in order to avoid the dislocation which would result from a sudden abolition of tariffs in each country.

Speakers representing various commodity markets showed the importance of London's share in world trade ; Mr. J. D. Wolff, of the Metal Market, stated that it would be practically impossible to establish fair prices for metals in the absence of a free market : the only alternatives would be perpetuation of the system of Government control of prices and supplies, involving world-wide agreements amongst the Governments of the world, or monopolistic determination of prices and supplies by producers.

The latter alternative might well involve anti-social activity ; the former would introduce political significance into commercial transactions ; nevertheless, it has been urged in this book that the commercial system should be designed deliberately to function in the interests of the ordinary consumer, and it would be undesirable to avoid some sort of political significance in commercial control. Given a knowledge of economic affairs on the part of the people, the will and ability to concern themselves with economic affairs, so that goodwill between Governments is insisted upon by the people whom they represent, it is possible that the evils of Government control feared by those advocating completely " free " trade might be avoided. It would appear that authoritative international action in the realm of Commerce cannot be avoided in a planned world.

It was urged at the Conference that the element of gambling in the speculative activities of the commodity markets was not as serious as many people supposed ; that the machinery provided by the markets actually reduced the speculative risks involved in the production and distribution of the great basic commodities, and that the commissions earned by the London merchants, though moderate, represented a commonly under-estimated contribution to our invisible export services.

Let us consider the general organisation and working of these great commodity markets.

CHAPTER III

MARKETS AND MARKETING INSTITUTIONS

The Produce Exchanges.

In Volume I it was shown that the buying and selling of some commodities of world importance, such as cotton and wool and rubber, became centralised in great commodity markets or exchanges in commercial centres such as London and Liverpool, New York and Chicago. It is not necessary, of course, for a market always to be centralised in one place : there is a market wherever buyers and sellers are brought together ; it may be in a town or a street or in a particular shop, or it may extend over the whole world, as in the case of the Money Market. But the need for expert knowledge and experience in dealing in commodities of world-wide use and importance has resulted in the setting up of centres where buyers and sellers on a large scale may get together and conduct their business. Thus, the centre for the sale of general commodities, including sugar, tea, dried fruits, cocoa, coffee, spices, hides and skins, and rubber, is the Commercial Sale Rooms in Mincing Lane, London ; grain and oil seeds and general produce are sold at the Baltic Mercantile and Shipping Exchange ; metals are sold at the Metal Exchange ; provisions such as bacon, eggs, cheese, lard and ham are sold at the Home and Foreign Produce Exchange ; coal at the Coal Exchange ; the market for corn and fodder is at the Corn Exchange ; for timber at the Timber Exchange.

The dependence of Great Britain on raw materials has made the markets for such commodities as wheat, cotton, wool and tea of fundamental importance. A general survey of the operations conducted in various commodities will be useful to the reader.

The Marketing of Wheat.

The dependence of this country on imported wheat renders it necessary that the machinery of importation should be efficient. Wheat is one of the commodities which can be graded to conform with certain characteristics in respect of weight, soundness and milling quality. The grading of wheat from North America is done by the Governments of the United States and of Canada ; wheat from other countries is graded by committees of merchants

and millers at the ports of importation such as London and Liverpool; thus wheat may be sold by description before it arrives in this country.

Dealers in wheat belong to the Corn Trade Association, which standardises contracts for the sale of grain, lays down the conditions regarding the taking of samples by buyers (for the classification of wheat is not perfect), and arbitrates in cases of dispute regarding quality.

THE MARKETING OF

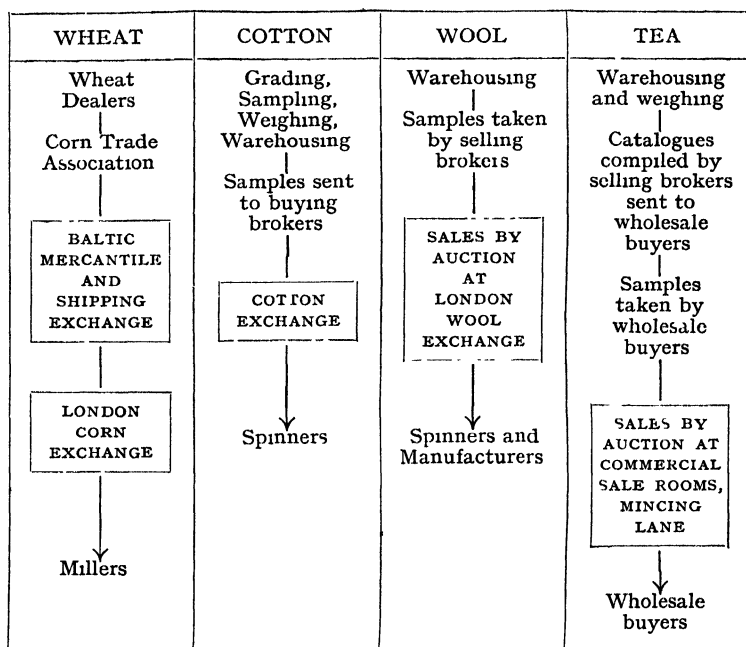


FIG 9 —THE MARKETING OF SOME IMPORTANT COMMODITIES

The principal European market for grain is the Baltic Mercantile and Shipping Exchange, which also is concerned with shipping business. Transactions take place on the basis of documents, and dealers in large amounts sell smaller quantities to dealers in the London Corn Exchange, where supplies of home-grown wheat are also sold. Samples are allowed in the London Corn Exchange; the dealers sell the wheat to millers. Members of the Corn Exchange are also usually members of the Baltic Exchange.

Transactions in the Corn Exchange are mostly "spot" transactions, cash being paid against delivery or within fourteen days. Spot goods may be rejected within a limited time, but goods sold "to arrive", as generally on the Baltic Exchange, cannot be rejected, differences in quality resulting in the making of allowances.

"Futures" in Wheat.

The study which is made of the wheat market, including the prospects of the harvests and the probable supplies, enables dealers to place contracts for future delivery at prices which are based on the forecasts made. There has sprung up a trade in "futures", and the spreading of future transactions among a number of dealers tends to stabilise prices and to avoid great fluctuations in supply. It is claimed, therefore, that legitimate speculation in futures is of real service to the community.

A wheat merchant who expects that there will be a scarcity will buy "forward", *i.e.*, buy to receive delivery at a future time, the money to be paid at the date of completion of the contract; for a scarcity will result in a rise in prices. On the other hand, an anticipated glut will induce him to sell wheat.

Speculation arises when the parties to a "futures" contract have no intention of making or accepting delivery; price movements are forecast, and buying and selling are carried on with a view to profit. This speculation is regarded as "legitimate" and of service to the community in so far as it tends to even out prices and prevent sudden rises or falls; a dealer who anticipated an increase in supply and a consequent fall in prices, and who offered goods for future delivery, expecting to be able to buy at a lower price to cover his commitments, would tend to bring prices down, thus stimulating demand and clearing present stocks, so that there was less chance of a glut occurring; the converse, of course, holds in the case of an anticipated scarcity.

The risks of speculation are that the estimate might be wrong, and that changes might occur in the technique of production involving changes in supply. In practice, the risks are spread evenly over the market, dealings in "futures" taking place between the market operators themselves; each dealer endeavours to cover himself by entering into contracts with other dealers for parts of the original contract.

Manufacturers and importers similarly guard themselves

against price movements by dealings in "futures"; a manufacturer may guard himself against a rise in prices during manufacture by placing orders with dealers for "futures", or by taking an "option" to purchase in the future at prices agreed now. There are thus considerable advantages in such dealings. The protection of hedging is secured at the sacrifice of the gain to be obtained from rising prices. There is also an advantage to the community, and merchants who act as "bulls", *i.e.*, buy for a rise, and "bears", *i.e.*, sell for a fall, claim that by minimising fluctuations in prices they are acting in the public interest.

"Hedging."

Most "futures" deals are settled by the payment of "differences"; a difference being that between the agreed future price and the "spot" price at the time for the fulfilment of the contract. "Futures" markets, such as that established at Liverpool, provide for the transfer of risks by means of "hedging" operations.

A flour manufacturer who buys grain for raw material runs the risk of a loss, since the price of grain may fall, and with it the price of flour, before his flour is marketed. He therefore covers this risk by making a forward sale, agreeing to sell grain in the future; if, then, prices do fall to such an extent as not to cover his costs of production, so that he loses on his flour, the corresponding fall in prices in the "futures" transaction will compensate him, for he will gain a profit on his "futures" deal, being able to buy "spot" grain at a lower price than that at which he has sold his "futures".

Illegitimate Speculation.

The danger to the interests of the community arises when without technical knowledge or interest in the commodities in which he is dealing, the outsider speculates for the sake of personal gain. Lack of technical knowledge is likely to result in wrong forecasting, and thus price fluctuations are accentuated. Lack of sufficient capital will result in the speculator's being unable to meet his obligations; if he cannot deliver the commodities on which his clients may be relying, he will involve other people besides himself in serious loss.

An anti-social practice deserving of the severest censure is the artificial production of price fluctuations by spreading false

reports of the state of the market, and operating, not in accordance with one's real forecast, but opposite to it. For example, a group or syndicate of these commercial robber barons may spread rumours of a coming jump in supply which will reduce demand, and thus cause prices to fall. By selling, and, by their example, inducing others to sell, the downward price movement is accentuated; and when prices have been forced down sufficiently, they buy secretly, and eventually openly, all they can lay their hands on. There results thus a sudden upward price movement, going far beyond what would have been in the case of any actual shortage of supply, and the profit margin of the speculator is extremely high. Certainly Society cannot afford the existence of such gentry as, *e.g.*, "cornered" the pepper market in 1935.

A planned social order cannot avoid the careful examination of the problem of illegitimate speculation. Diverse as may be the opinions regarding what powers the State should possess in fixing or regulating prices, no case can be made out for activities which exact a tribute from the community as a reward for imposing inconveniences upon it.

The Marketing of Cotton.

"Futures" contracts for cotton are made only for the "Middling" grades; the buyers are merchants and manufacturers who have undertaken to supply cotton or cotton goods for future delivery, and the sellers are importers of cotton or manufacturers or spinners seeking protection against a fall in price.

The variations in the quality of cotton have resulted in its grading into various descriptions. American cotton arriving at Liverpool is graded by the Liverpool Cotton Association. Samples are sent to the buying brokers acting for the spinners; the contracts are generally "spot", for immediate delivery, though spinners often buy "on call" at price quoted at so many points (hundredths of a penny) above or below the price of "futures" at the time of the call. C.I.F. (Cost, Insurance and Freight) contracts are made by merchants buying from American shippers, the C.I.F. price being that of the cotton when it arrives at Liverpool.

After arrival at Liverpool, the cotton is sampled and weighed and delivered to the warehouse of the importing merchant. The transactions are financed by drafts drawn by the American

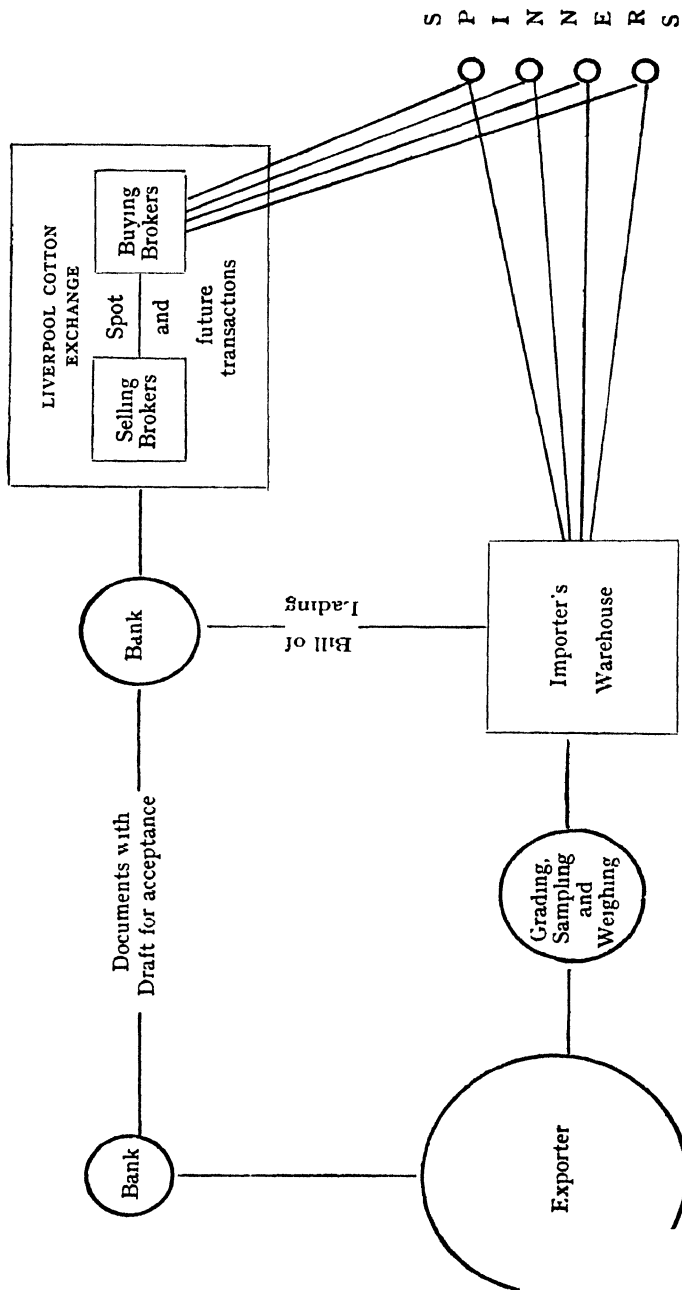


FIG 10 —THE MARKETING OF COTTON

exporters, the drafts being accompanied by copies of the bill of lading and by the insurance policy concerned. The American exporter hands the draft with the documents attached to his bank, who forwards it to the bank acting as agent in this country ; the latter accepts the bill of exchange on behalf of the importer, hands the bill of lading to the warehouse keeper with instructions to warehouse the cotton, and releases the cotton when delivery is required by the spinners.

Claims arising through the Clearing House of the Liverpool Cotton Association are settled at the Liverpool Cotton Bank, which is not an ordinary bank, but an institution for the settlement of claims. Payments from banks and from cotton firms are credited to the firms named in the instructions, the firms receiving credit certificates which are presented to the Clearing House, each firm stating on vouchers particulars of credit transfers issued to them by other firms and by them to other firms. The Clearing House sends a list to the Cotton Bank of the credits to be paid to the banks of the firms concerned.

The Marketing of Wool.

In the case of some commodities—*e.g.*, wool, tea and tobacco—grading is impracticable, and sales take place by private treaty or at auctions, being made on the basis of samples.

The chief European centre for the sale of imported wool is the London Wool Exchange. Colonial wool forms the major proportion of the supplies coming in ; these are warehoused in wool warehouses maintained by the Port of London Authority or by private firms. The selling brokers are sent sampling orders by the importers, enabling the former to draw 1-lb. samples to enable them to arrange the wool into lots, and a description of each lot is printed in a catalogue which contains also the conditions of sale. Prospective buyers may also inspect the wool.

Auctions in fine wool are held six times a year, and each lasts about three weeks. The buyers themselves bid—this is usually the case with the large woollen and worsted spinners and manufacturers—or a buying broker may act for the smaller firms. Prices are in pence per lb. Memoranda are made by the bidder and broker ; after the sale the buyer sends to the broker a list of the lots bought, whilst the broker sends a Sold Contract Note to the buyer, and later an Invoice.

The “ prompt ” day, or day of payment, is within fourteen days

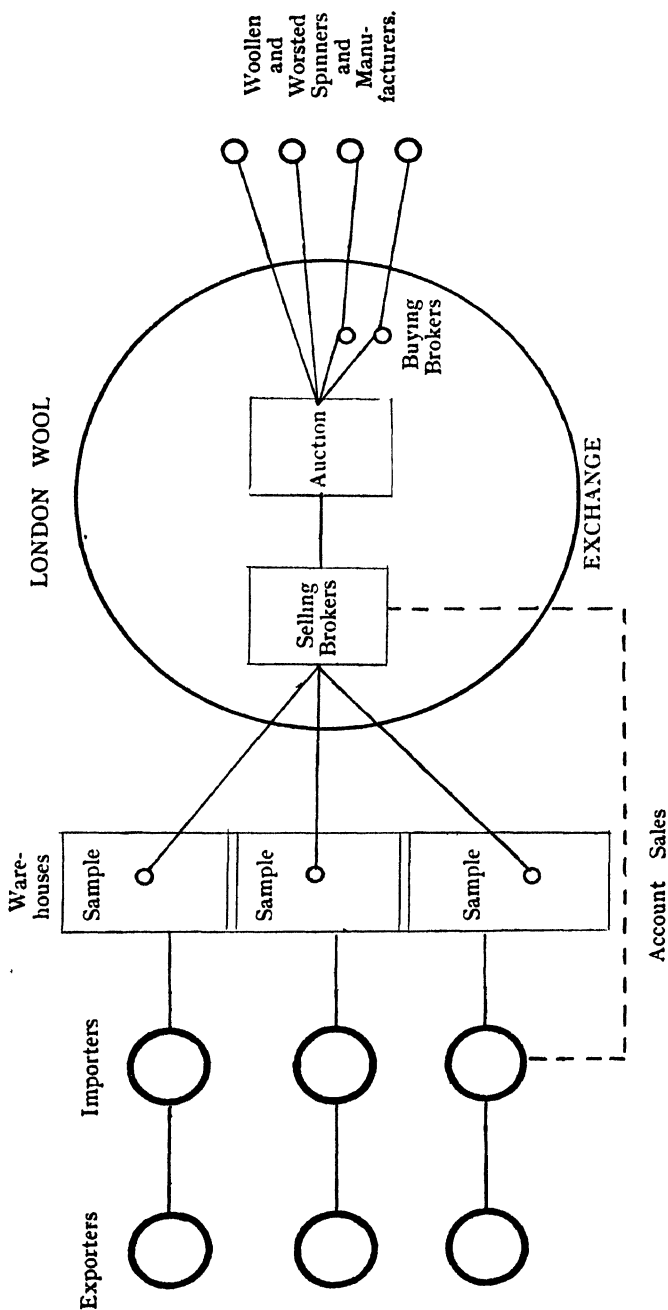


FIG 11 —THE MARKETING OF IMPORTED WOOL

of the date of the invoice ; it is an illustration of the high integrity of these dealers as a whole that default is practically unknown.

The selling broker sends the merchant on whose behalf he has been acting an Account Sales, showing the amount sold and the price, and his charges and brokerage. The net proceeds are remitted to the grower by the broker's paying the amount into the London office of the grower's bank or that of the merchant accommodating the grower by advancing him a loan on his consignment.

The procedure in the case of coarse wool is the same as that described above, but the dates of the sales depend upon the number of the fleeces available, and these arrive at irregular intervals.

The Marketing of Tea.

The bulk of the tea imported into this country is sold at the Commercial Sale Rooms in Mincing Lane. Because of the large number of varieties of tea, expert knowledge of the details of supply and demand is required of dealers. On arrival, the tea is stored in a bonded warehouse ; it is weighed by the Customs officials. The importer instructs a broker to sell the tea by auction. The broker, who may receive instructions from several firms, compiles catalogues of the teas, stating the quantity and description of each Lot, the name of the estate where the tea has been grown, and the conditions of sale. The catalogues are sent to the wholesale buyers, who will send samplers to the warehouses to obtain samples for testing.

Auction sales for teas are held weekly, particular days being set aside for the sale of particular varieties. The majority of the buyers, the blenders or wholesalers, use the services of buying brokers. Bids are in pence per lb., advances being made in farthings. Before paying his deposit or taking final delivery, the buyer may take a few lbs. of tea from bond, in order to compare this second sample with the first. On settling his account with the selling broker, the buyer receives a Warehouse Warrant which, as we have learned from Volume I, is a document enabling him to remove the tea from the bonded warehouse on payment of the Customs duty.

Blending is done nowadays mainly by the large distributor, who makes up the teas to suit the tastes of particular districts—there is considerable variation in local taste—and packs them in packets labelled to suit the requirements of the local distributor.

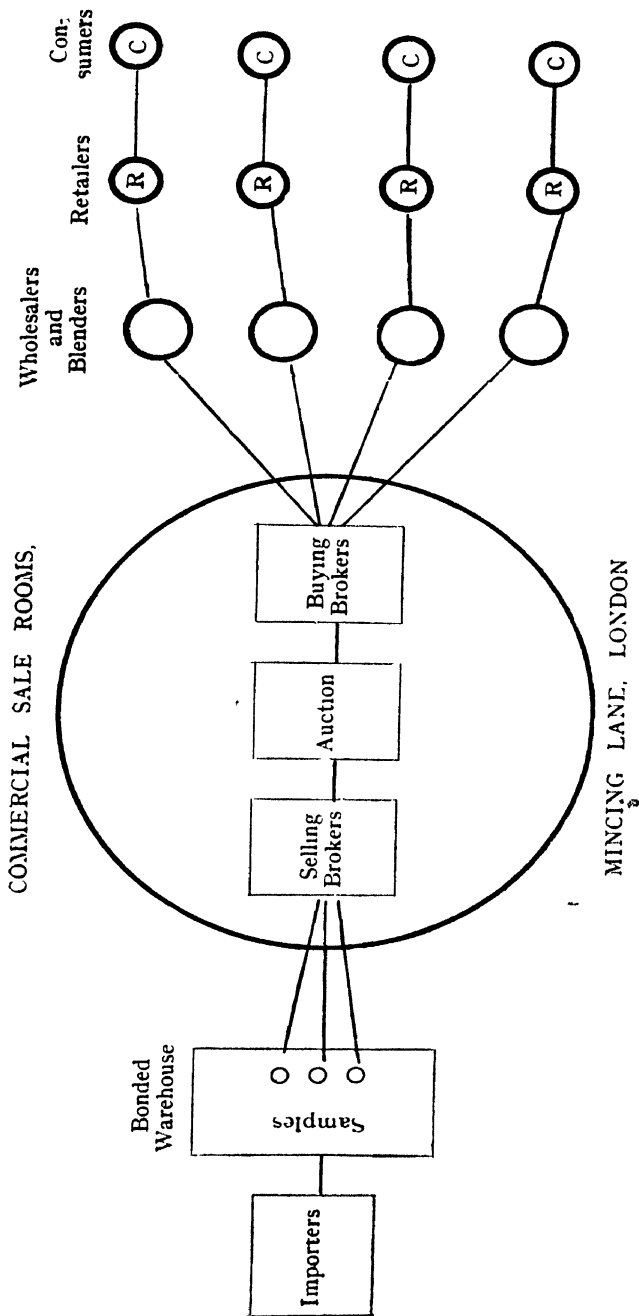


FIG 12 — THE MARKETING OF TEA

The Marketing of Meat.

London is the great importing centre for meat, and the large Meat Market at Smithfield has rail and road communication with all parts of the country. The marketing is in the hands of stall-holders holding their stalls on the basis of a weekly tenancy from the Corporation of the City of London. The stall-holders are importers, commission salesmen and jobbers, buying on their own account for resale. The invention of the process of refrigeration in the eighties of last century has resulted in the opening of cold stores and facilities for dealing with the thousands of tons of carcasses arriving annually from the great meat-exporting countries of the world, such as the Argentine and Australia and New Zealand.

Markets for home-produced meat are found in many of the large towns, most being owned by the local authorities.

The Marketing of Fruit.

As in the case of meat, imports from overseas have considerably expanded the trade of the marketing centres. London is a great centre; the chief market outside the ownership and control of the City Corporation is Covent Garden, where both home-grown and imported supplies of fruit, flowers and vegetables are sold. In spite of the congestion at Covent Garden, tradition seems to insist on the retention of this centre; but in 1928 a more up-to-date market, the London Fruit Exchange, was opened at Spitalfields. Selling is conducted by auction through the medium of brokers.

The marketing of produce in bulk is facilitated at Covent Garden by commission salesmen, who sell direct to the wholesalers and retailers in other markets. The commission salesmen also provide crates and baskets, and may pay the various charges involved in distribution. Provincial commission buyers and provincial wholesale distributors collect the fruit and vegetables for distribution to the retailers.

The Marketing of Fish.

Normally, most of the fish caught are sold by auction at the various ports. The great Fish Market at Billingsgate is supplied by the commission merchants on the coasts and at the ports, and representatives of the Billingsgate stall-holders also buy fish for forwarding to London, to which it is sent by rail and lorry.

The Marketing of Metals.

In 1881 a Metal Exchange was set up in London, and here dealings are made in the non-ferrous metals—copper, lead, tin and spelter. Business takes place by private negotiation between members, and much speculation occurs in metals. In 1928 a separate Iron and Steel Exchange was established for dealings in the ferrous metals; dealings take place not only in home manufactured metals, but also in imports and in world trade.

The Marketing of Manufactured Goods.

In the marketing of manufactured goods, which form the bulk of the exports of this country, the wholesaler plays an important part; he collects orders from retailers, and orders in bulk from the manufacturers, who are thus saved the trouble and expense of organising their own sales distribution. The functions of the wholesaler have been considered in Volume I; we must remember the tendency of the large-scale producers to set up retail houses of their own, and so eliminate the wholesaler. The student is referred to Chapters VII–IX of Volume I.

Branded Goods and Trade Marks.

We must note, too, the selling of branded goods under distinctive registered trade marks and trade names. Registration is a safeguard against the substitution of another product by a dealer in place of that of the manufacturer, whilst there is some protection for the consumer in that he is getting a genuine article and not a substitute, so that the legal protection of trade marks is of some importance. The law relating to trade marks is now contained in the Trade Marks Act, 1938, repealing and re-enacting with amendments the previous Acts. A trade mark is defined by the Act as a mark used in relation to goods for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person.

In effect, a registered trade mark is copyrighted, and a rival trader could be restrained from applying a similar name or mark to his goods, because he would be considered to be inducing purchasers to think that his goods were those of the other trader. The trade mark, therefore, denotes the producer of an article rather than the article itself.

Registration under Part A gives a greater protection against infringement than registration under Part B; those marks

registered in Part A are subjected to a stricter test as to their distinctiveness. No mark will be registered in Part A unless it contains at least one of the certain "essential particulars" described in the Act. In brief, these are .—

(1) The name of a company, individual or firm represented in a special or particular manner.

(2) The signature for registration of the applicant or some predecessor in his business.

(3) An invented word or words.

(4) A word or words having no direct reference to the character or quality of the goods, and not being according to its ordinary signification a geographical name or surname. The object of this clause is to prevent the registration of ordinary English words so that the public are deprived of using them in their ordinary meaning.

(5) Any other distinctive mark, but a name, signature or word or words not falling within the descriptions in (1), (2), (3) and (4) above, shall not be registrable except upon evidence of distinctiveness.

The policy of making the trade name as familiar as the article itself has been very successful in some instances, for example, the word "Kodak" is often used abroad as the equivalent of "camera".

The universally recognised trade mark is not a magic sign or talisman, but is the result of success. A well-established trade mark is one that gives some proof that the article it denotes is possessed of a certain prestige—otherwise it would not be well established. The fact of a certain commercial origin means something to the purchaser; it renders the goods desirable to him, more desirable than goods of another origin. The manufacturer, far from being ashamed of his goods, is proud of them. The trade mark is a means of securing to himself and of perpetuating the goodwill of his business.

Therefore, the business man must not confuse the right to a trade mark with the rights of patents and copyrights. The trade mark in itself, however effective as a design, is not an adequate protection against competition and does not ensure continued success. Only the quality of the goods can in the long run serve these ends.

Nevertheless, profits which can be attributed to the success

of a trade mark in increasing sales are due to the operation of a monopolistic element; the law enables such profits to become permanent, and to that extent makes competition less perfect.

In *The Theory of Monopolistic Competition* (Harvard University Press, 1933), E. Chamberlin suggests that there are no grounds upon which a producer may justly claim such protection. A producer has no right to exclude others from manufacturing and selling even the identical product, but he can claim the protection of the law for his trade mark, and it is the theory of the law that the function of the trade mark does no more than identify the product, to show its origin. But under the conditions of modern competition, the trade mark does more than that: it is the sign of a product of a certain quality, and the advertisements of producers show that they recognise this fact and even advertise it as such: *e.g.*, "Cadbury means quality", "Guinness is good for you", "He always comes back to Gold Flake", "Monk and Glass is jolly good custard", and so on. Here there is more than mere identification.

The law protects the consumer by protecting the monopolies so established. Chamberlin suggests that equally effective would be a policy of permitting imitation only if it were perfect, or of defining standards of quality by law: the latter certainly has the more practical possibilities.

The argument in favour of trade mark protection that it stimulates variety is considered by Chamberlin to be valid only within certain limits. The check to the creation of variety by allowing perfect duplication would not be without advantages, for there would be less attention paid to the creation of monopolies and more to production. He suggests that the exclusive use of a trade mark might be granted for a limited period under the same principle as that of the patent laws: after the expiration of that period anyone would be entitled to make the identical product and call it by the same name. He claims that by this means the first producers would be enabled to obtain "enterprise" profits, the waste of advertising in building up goodwill would be reduced; there would be more equal returns to all producers and the elimination of sustained monopoly profits; and, "all in all, there would be closer approach to those beneficent results ordinarily pictured as working themselves out under 'free competition'." ¹

¹ Chamberlin, *op. cit.*, p. 208, Appendix E.

Chamberlin's arguments have been considered here in order that the basis on which they rest may be recognised clearly: the premise that competition is good and monopoly bad, and that the restriction of trade marks regulations would "purify competition by eliminating monopoly elements"¹: "unfair" competition by infringement of trade mark protection should be permitted and even encouraged.

It may be suggested that Chamberlin's case rests upon the assumption that those producers who would be permitted to use a recognised trade mark after a limited period of protection would necessarily produce the identical product of those producers who by their efforts had made their trade mark a symbol of quality; so that the effect of the elimination of the trade mark rights would be to make possible a general raising of the quality of the product to that of the original product denoted by the trade mark. But there is nothing to prevent the equalisation of quality under present conditions, except that the weakening of the domination of the market by a well-known product might render possible greater economies of production and improvement in quality of product in the case of undertakings not protected. There seems to be an underlying assumption in Chamberlin's argument that non-protected undertakings could produce as high quality products as those enjoying the protection of a trade mark. There is nothing in the observed facts to justify this assumption: the high quality of many branded goods is well recognised—they are products characterised by distinctive features of a scarcity value nature, indeed, some years ago an employee of one confectionery undertaking was successfully prosecuted for offering to sell trade secrets to another. The position of such undertakings is analogous to those enjoying patent rights, if trade mark protection were limited in the way Chamberlin suggests, the consumer would have no guidance as to whether or not the product he was buying was that which he wanted or not. To protect the consumer by permitting imitation only if it were perfect is a course which Chamberlin admits is impracticable; to protect him by defining standards of quality, he states, has possibilities, especially in the case of staples "where trade marks and brands are patently useless so long as quality is assured".² This, surely, is just the point: it is with such articles as are protected by trade marks that the latter have

¹ *Op. cit.*, p. 204.

² *Ibid.*, p. 207.

proved an effective means of protecting both producer and consumer. No amount of advertising will serve to ensure constant sales of an inferior product over a long period. Withdrawal of protection would spell confusion to consumers and enable inferior producers to make quick but transient profits by entering the market and keeping there until the consumer found them out; presumably there would have to be some mark of identification by which he could do so, and this would be in effect a trade mark. The law does quickly and in a practical fashion what economic forces would take a longer time to do, at considerable cost to producer and consumer: the elimination of inferior products which would stand no chance against the best. The *output* of an industry might increase without protection, but not the *scale*; for smaller and inferior undertakings would enter upon production, and the average costs of production would increase, to the detriment of the consumer.

It is true that human beings act in many cases rather from habit than reason, that people buy particular brands from habit. The habit of the public of purchasing goods bearing a particular trade mark is an asset to the manufacturer, and the problem of the prospective seller of goods is to devise a trade mark that will induce the habit. This is a difficult enough task, for in spite of the facility with which we speak of the "average man", it is a commonplace to find that the particular likes and dislikes of any individual are not the same as those of a multitude of his fellows. Indeed, there are comparatively few people who can name the manufacturers of certain well-known brands of products; this is especially so in the case of the general public, but the statement applies to an astonishing extent to retail dealers.

The best kind of protection for a trade mark is not the legal kind, but continuous and successful advertising. The sales of a certain well-known product fell enormously some years ago because the manufacturers apparently felt it beneath their dignity to engage in the struggle of modern advertising. Their place in the public esteem was won back only after years of hard work, and perhaps would not have been won back at all had the product not been of excellent quality in the first place and had not its trade mark been already well established in the public mind. But the absence of advertising of the product and the more pushing methods of competitors had resulted in a half-formed

conviction in the public mind that the manufacturers had ceased to market the product.

Advertising.

The tremendous sums spent in modern advertising indicate not only the importance attached to this form of publicising by producers and distributors, but also the extent of the waste of the resources of civilisation resulting from free competition. The desire to "capture the market" has, too, led to trade federations and trusts which are concerned with profits rather than with the social good—and that quite unashamedly, even proudly, for sociality is a quality of which even the name is an unknown quantity to many millions.

In Great Britain before the Second World War, £125,000,000 a year was spent on advertising. The large firms advertise by newspaper advertisement, by poster, by slogans in which "the best" and "the only" are common phrases. In the U.S.A. the advertising agencies are very powerful; they "help to spend annually about \$2,000,000,000 of advertising money, mostly by newspapers, direct mail and magazines".¹ In America and on the Continent, broadcasting has been called to the struggle. Even in Great Britain, where advertising in itself is not regarded as a form of public good, the cinemas often manage to insert in their programmes a deceptive "short" or two.

Before the War the tendency was growing to increase sales by offering "free gifts" to the public in return for coupons. To such an extent did this practice grow that a Committee of the Board of Trade was set up to consider whether it was desirable that steps should be taken to curb it, retailers of the products given away having complained that their trade was suffering from the distribution of these "free gifts".

However, the Committee found that these complaints were exaggerated, the volume of trade affected being small; many of the gifts would not have been purchased in the absence of a gift scheme. There was some benefit to the consumer in that he obtained an article below retail price, the advertisers having obtained them at wholesale prices. On the other hand, in the tobacco trade the "coupon war" was developing to such an extent that grave disorganisation of the tobacco industry was threatened.

¹ Levy, *Retail Trade Associations*, 1942, p. 81.

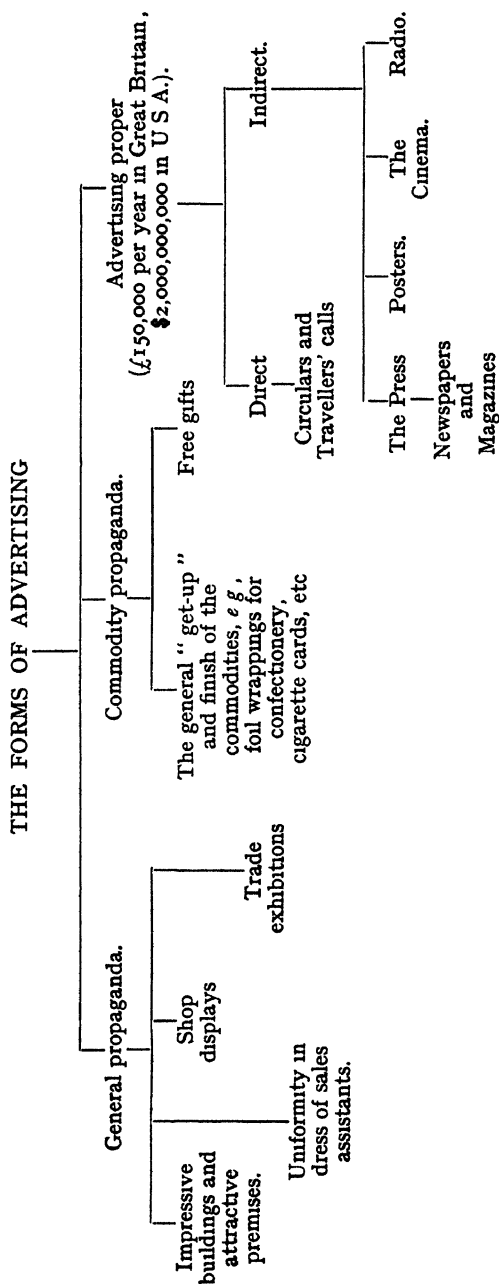


FIG. 13.—THE FORMS OF ADVERTISING.

A form of advertising of a higher type than mere newspaper, magazine and poster "boost", shop displays, the distribution of free samples and "gifts", and the urgings of travellers, is to be found in the fairs and exhibitions which formed such a colourful feature of pre-War commercial life. The famous Leipzig Fair was an international market attracting exhibitors and purchasers from all over the world. Although some fairs have lost their importance with the passing of the years and have developed into mere centres of amusement, such as the Nottingham Goose Fair, some were still of commercial importance on the Continent right up to the Second World War; in England, the commercial fairs were concerned mainly with the sale of agricultural produce and stock. An exception was the British Industries Fair, which became so large that it was held in two sections, running simultaneously in London and Birmingham.

Trade exhibitions are modern developments of the medieval fair. At these exhibitions producers exhibit their goods to wholesalers and to the general public. Local or specialised exhibitions, such as the annual Motor Trade Exhibition in London, serve a very useful purpose in displaying examples of up-to-date products in the local market; international exhibitions, such as the British Empire Exhibition at Wembley in 1924-1925 and the International Colonial Exhibition in Paris in 1931, entail great expense but reach a wide public, and, among other advantages, provide the business man with opportunities of obtaining information about trade conditions in foreign countries without the trouble and inconvenience of travelling.

Market Research.

The advantages of finding out to what types of customers one's goods are likely to appeal, the types of goods with the highest potential sales, and the areas in which these highest sales are likely to occur, are patent, both as a guide to production and to more purely commercial dealing. The B.E.T.R.O. brochure, to which previous reference has been made, shows how, before the war, market research helped British manufacturers, selling to the home market, to keep their old customers and acquire new ones:

"Market research gave them this help by enabling the individual manufacturer to determine what were the dimensions and character of the group of people who

already bought his product and what were the bases of their preference; it told him what were the dimensions and character of the group of people who, although in the field, bought somebody else's product, and what were the reasons for their preference. As a further contribution it identified and defined the people who were still completely outside the market and it indicated the probable terms on which they could be turned into consumers. Finally, market research, by a close study of the press, radio, poster sites, and films, was able to indicate the most effective channels for informing potential consumers what the manufacturer had to offer, and for convincing them that what he had to offer was something they should buy." ¹

One method of conducting market research is the questioning of consumers, somewhat on the lines of the investigations conducted by "Mass Observation" and the British Institute of Public Opinion. Another is the study of sales data, including existing competition, distribution methods, price levels. Changes in general attitudes of mind on the part of consumers, general preferences (such as the preference for Danish bacon as against British bacon which we shall note in the next section) come up for detection and analysis.

Market research is part of the general activities of all great industrial concerns. The facts are not easy to ascertain: they involve prolonged investigation, and their interpretation in terms of the activities of an undertaking necessitates expert enquiry.

B.E.T.R.O. gives the following as essential facts which should be in the possession of anyone who wants to trade successfully overseas; the list is described as "illustrative, but not exhaustive": ²

- (1) The nature of the particular market in terms of its general, political, financial, and social composition.
- (2) The main industrial, commercial and agricultural activities of that market, including its exports and imports.
- (3) The types of consumer available (nationality, colour, degrees of education, sophistication, etc.).
- (4) Habits of thought, religion, behaviour, clothing, alimentation, transportation, etc.

¹ *Loc. cit.*, p. 8.

² *Loc. cit.*, pp. 9-10.

- (5) The range of main income groups.
- (6) Evidence of any ambitions or desires for goods or services at present unsatisfied, or capable of being increased or developed.
- (7) Taste in structure, colour, design, etc.
- (8) Extent of purchasing capacity or willingness, in connection with the particular type of goods or services desired. Possibility of increasing this capacity or willingness.
- (9) Price range, presentation, shape, structure, colour, design, content, etc., of goods at present accepted. Gaps in, or omissions from, these.
- (10) Nature, range and prices of competitive articles, local and imported.
- (11) Tariffs and duties; rates and conditions.
- (12) Local credit terms, and usual customs relating to discounts, commissions, etc.
- (13) Existing methods of distribution and sale; opportunities for development of existing methods or creation of new ones.
- (14) Advertising facilities and media available.
- (15) Availability and type of merchants, local agents, representatives, salesmen, wholesalers, chain-stores, retailers.
- (16) Nature of port or dock (sea and air) facilities.
- (17) Nature and cost of international and local transport.
- (18) Possibilities of special terms for dock and harbour dues, and for railway, air and water freight rates.
- (19) Rates for marine and other insurance.
- (20) Banking and credit facilities.

Some of this information can be obtained from Government Departments or Chambers of Commerce, or from commercial undertakings. But the ascertainment of trends in consumers' habits, the determination of the suitability of particular goods or services, call for the making of precise and accurate investigation, and, as the brochure points out, "it is imperative that the results of such investigation should represent *facts* and not opinion, however enlightened."¹

Agricultural Marketing Boards.

The development of commercial organisation to keep pace with the development of civilised life in general must necessarily

¹ *Loc. cit.*, p. 10.

entail some measure of State control in the name of the community. In this country, agriculture, the oldest of our industries, came just before the outbreak of the Second World War into a position where the marketing of agricultural products necessitated some kind of supervision by the central authority. It will be interesting to discuss the developments that took place in the marketing of agricultural products.

The Small Holdings and Allotments Acts, 1908 to 1926, the Corn Production Acts, 1917 and 1920, and the Agricultural Wages (Regulation) Act, 1924 (subsequently amended by the Act of 1940 ; separate Acts applied to Scotland), were all inspired by the necessity of attempting some kind of reconstruction of British agriculture. State intervention, however, became most comprehensive and direct with the passing of the Agricultural Marketing Acts, 1931 and 1933 ; nevertheless, the aim of the State was to encourage producers to form their own organisations rather than to compel them to submit to the direction of officials, so that it was the marketing side of agricultural activity rather than the productive side which was the subject of legislation.

The 1931 Act gave producers themselves powers to draw up marketing schemes and impose them on all producers concerned, if the proposals were accepted by a two-thirds majority of registered producers. But no protection was afforded to farmers against the importation of low-priced commodities, and only in the case of hops was the scheme successful, largely because hop-growers were already protected by measures imposed during the 1914-1918 war. Under the Hops Marketing Scheme, started in 1932, the selling by individual growers to brewers was replaced by centralised selling through a Hops Marketing Board, which was given a complete monopoly of sales protected by a tariff of about 50 per cent. *ad valorem*.

This Scheme was to a large extent responsible for the selling of the whole of the 1932 crop at remunerative prices. The entry of new growers into the industry, attracted by this result, was discouraged by an agreement with the Brewers Society covering the five crops from 1934, the brewers undertaking to purchase from the Hops Board at least two-thirds of their estimated requirements of English hops ; the imports were not to exceed 15 per cent. of the total market demand for all hops. Producers were given a definite price, and quotas of production based on their average output in 1928-1932 were allocated to individuals.

The 1933 Act went farther than the 1931 Act : the State was given power to limit both the imports and the domestic production of any kind of agricultural produce ; and steps were to be taken to develop home production where desirable. The operation of the Act was to take place through Marketing Schemes for particular products, the initiative in drawing up any scheme to rest either with the Ministry of Agriculture or with the producers.

The first scheme to come into full operation after the passing of the 1933 Act was the Milk Marketing Scheme ; as finally introduced, it differed considerably from the original scheme drawn up by the Reorganisation Commission of 1932. A Milk

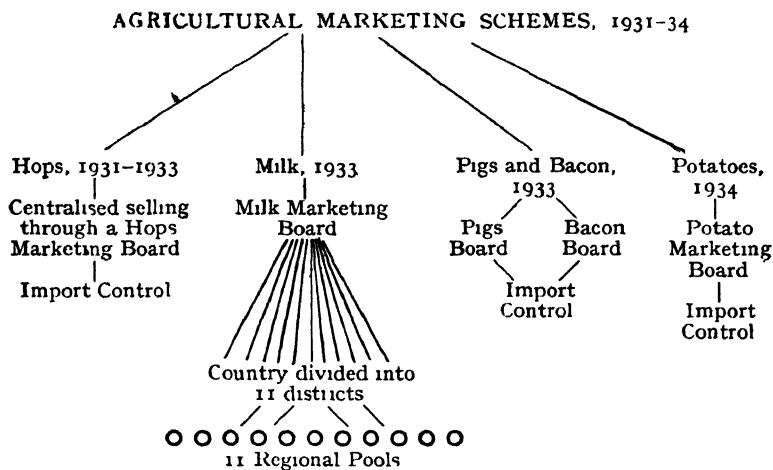


FIG. 14 —THE PRE-WAR BRITISH AGRICULTURAL MARKETING SCHEMES

Marketing Board was formed representative of all registered producers, and all milk produced by the latter became the property of the Board. The total annual retail turnover for England and Wales was about £33,000,000. Producers were allowed to arrange their own contracts with distributors, but the prices paid by the latter were fixed by the Board. Buyers paid the Board direct, the latter passing on the proceeds to producers, after deducting expenses and levies.

For the purposes of the Milk Marketing Scheme the country was divided into eleven districts, the total sum realised from the sale of milk in each district being credited to a "Regional Pool" and divided amongst the producers. The producers received

payment at the pool price for each district. The liquid-milk prices varied according to the district and the season ; milk used for purposes other than liquid consumption—*e.g.*, for manufacture—was sold at prices considerably lower.

The large and increasing surplus over requirements of the liquid-milk supply, the low prices received for this surplus, because of the competition of imported milk products, and the failure of the demand for liquid milk to expand to an extent corresponding with the increased supply, led to difficulties which Government aid attempted to overcome.

The Pigs and Bacon Marketing Schemes came into operation in 1933. Two Boards were formed—a Pigs Board, representative of producers, and a Bacon Board, representative of curers—which together fixed the price to be paid for bacon pigs ; bacon pigs only, and not those destined to be consumed as pork, were controlled. The encouragement of home produce and the restriction of imports were aimed at, curers being compelled to take a fixed supply each month at controlled prices.

The Scheme soon experienced considerable difficulties. The output of pigs exceeded the estimate, so that imports, restricted by an import quota scheme, had to be further restricted, the bulk of bacon consumed in Great Britain before the Second World War was imported. It was found that British consumers preferred Danish bacon to native ; and the import restrictions raised the price of Danish bacon.

Producers were reluctant to enter into contracts with curers when higher prices could be obtained in the unregulated pork market. In 1935 the curers experienced difficulties in obtaining an even supply of suitable bacon pigs.

The result of the Scheme was to increase the bacon supply produced at home from one-seventh to one-quarter of the total, but at a higher price for imported bacon and ham to British consumers, most of this increased total price for a decreased total import going to the Danish bacon industry. The Scheme was on the verge of dissolution when the Second World War broke out.

The Potato Marketing Scheme came into operation in 1934, and proved a great success. A Potato Marketing Board was established to regulate production and supplies. Producers and merchants were registered ; registered producers were to have dealings only with registered merchants. Producers were

restricted to a registered acreage, based upon their previous records. Imports were restricted, and the size of potatoes placed upon the market was regulated. The Board did not deal with payments to producers. The Scheme succeeded in preventing large fluctuations in supply, and in maintaining prices.

It was hoped that the putting into operation of the Eggs and Poultry Schemes would raise the proportion of the output of British agriculture subject to marketing schemes to one-half; and that Cattle and Sugar Beet Schemes would bring it up to two-thirds.¹

The coming of war changed the nature of the problems involved; but if war had not occurred, and if the terms of the problems to be faced after the close of the Second World War approximate to those obtaining before it, it is doubtful whether modifications could be introduced to make any scheme like the Pigs and Bacon Scheme work effectively, if by effectively is meant to the advantage of the consuming public. Only in the case of potatoes can a marketing scheme be said to have been an unqualified success. The precarious position of British agriculture in the years preceding the Second World War has been due to "natural causes"—the development of Great Britain as an industrial country. A. G. Street, in his *Farmer's Glory*, describes the great changes that have taken place in agriculture since the 1914-1918 war.

If the convenience and pocket of the British public are not to be considered, then all that is necessary to "revive" British agriculture is to place a tariff on all imported foodstuffs that could be produced in this country, restricting those imports, or paying the British farmer a subsidy. Such a policy succeeded in the case of a relatively "cheap" crop like potatoes. Pigs were a different proposition. To interfere with the delicate and well-tried mechanism of international trade, especially in the case of a specialist country like Denmark, with its natural advantages, was simply to penalise the British consumer. A Pigs and Bacon Scheme could be made to work effectively—at a price. The question arises as to whether the price is worth it to the British consumer. The doubling of British agricultural production since

¹ The pamphlet, "Agricultural Marketing Schemes in Action", published by the Ministry of Agriculture and Fisheries in 1935, although out of date as regards details, gives a good general idea of the purpose and working of the Schemes.

1939 has provided a new agricultural problem : we cannot just "go back".

Control will be "in the air" in post-war Britain, as in the post-war world as a whole. It is evident that the tendency is towards Government control of agricultural production. It is difficult to foresee the trend of control in Industry as a whole. Though in this book the necessity for control in the interests of the community has been stressed, the actual working out of the details of this control and the precise nature of the problems to be solved are far beyond its scope—indeed, beyond the scope of any one book. The task is one which will require not only the collaboration of teams of experts, but also the co-operation of the citizens as a whole ; and the process must inevitably be a long and difficult one.

CHAPTER IV

TRANSPORT AND INSURANCE

OUR next task is to examine the organisation of Transport and Insurance, the two auxiliaries so intimately connected with Trade, the exchange of commodities, in what one may regard as a physical sense. The modern development of Commerce has depended on the ability to move commodities quickly and safely over the earth's surface; and the bearing of the risk function is a convenience in this movement of the highest order of importance.

The main forms of Transport and the different types of Insurance have been indicated in Volume I.

In this chapter it is proposed to discuss in greater detail mainly the two forms of transport which are at present of greatest importance in Commerce, viz., rail and sea transport.¹

Carriage of Goods by Land.—Carriers.

Goods are carried for hire by two classes of Carriers, Common or Public Carriers, and Private Carriers, the latter making special contracts with the consignors. A Common Carrier is under an obligation to carry goods for all persons who choose to employ him and who undertake to pay his reasonable charges. He may, however, refuse to undertake carriage if his vehicles are already full, if the goods are such as to subject him to extra risk or are of a type which he is unaccustomed to carry, or if the destination is one not on his customary route. Bonded or Licensed Carriers are employed for dock transport; and there are special carriers connected with special trades, such as the fish and meat trades. Railway Carriers, such as Pickford's and Carter Paterson's, combine separate parcels into large consignments, and are thus able to make contracts with the railways advantageous to both parties. They deliver, but do not in all cases undertake to collect parcels.

Local carriers' services are valuable in that they serve districts frequently not reached by the railways. They connect towns with neighbouring villages, and bring agricultural produce to marketing centres, often carrying manufactured goods back.

¹ Official publications relating to air transport, including the activities of British Overseas Airways Corporation, are: *International Air Transport* (Cmd. 6561, 1944, 1d. net); *British Air Transport* (Cmd. 6605, March, 1945, 2d. net); and *British Air Services* (Cmd. 6712, Dec., 1945, 2d. net). H.M.S.O.

A Common Carrier insures the goods while in transit, being liable for their loss or damage in transit, even where accidentally caused, except for Act of God (*i.e.*, any unusual natural occur-

	Common Law	Liabilities of Common Carriers onerous Legal position of a common carrier that of an insurer.
1830	Carrier's Act	(Land Carriage) Limited liability of common carriers object was to prevent hardships from loss of valuable goods packed in small bulk (1) No liability of loss of articles over £25 unless value declared (2) Carrier entitled to make an increased charge for carriage
1854	Railway and Canal Traffic Act	No contract seeking to limit a Railway or Canal Company's liability valid unless— (1) it is in writing and signed by the consignor or his agent (2) the terms of the contract are "just and reasonable".
1914-1918	FIRST WORLD WAR—GOVERNMENT CONTROL OF RAILWAYS	
1919	Ministry of Transport established	Extensive powers over rates and charges of the railways
1921	Railways Act	Carriage of merchandise by rail regulated by the Railway Rates Tribunal the standard terms and conditions
1933	Road and Rail Traffic Act	Part I Road transport Licensing compulsory, and provisions for regulating hours of work and examination of vehicles Part II Rail transport "Agreed Charges" system introduced Part III. Transport Advisory Council set up to advise the Minister of Transport in the co-ordination of transport and its facilities.
1934	Road Traffic Act.	Classification and licensing of public service vehicles
1939-1945	SECOND WORLD WAR—GOVERNMENT CONTROL OF RAILWAYS	

FIG 15 —CHART SHOWING PRINCIPAL LEGISLATION AFFECTING LAND CARRIAGE IN GREAT BRITAIN SINCE 1830.

rence, *e.g.*, an earthquake), Act of the King's Enemies, inherent vice or defect of the goods themselves (*e.g.*, a tendency to spontaneous combustion), and negligence of the consignor (*e.g.*, faulty packing). Goods of high value in relation to their bulk, such as jewellery, must be declared, and an increased charge

paid. A carrier has a *particular lien* on the goods he carries—*i.e.*, he has the right to withhold delivery until the charges on that particular consignment have been paid ; but where carriers run accounts with consignors, the carrier may by agreement have a *general* as well as a particular lien (*i.e.*, the right to detain goods not only for debts in connection with those goods, but also for a general balance of account).

In 1919 the Ministry of Transport was established, and power was given to the Minister to establish and work transport services, if the Treasury consented. The Ministry did not establish a national transport service, but it obtained extensive powers over the regulation of rates and charges of the railways, and expended considerable sums in constructing and improving roads to make them more suitable for the greatly increased motor transport. The smaller amount of capital required by a road transport concern, and the convenience and comparative cheapness of road transport, caused the road transport undertakings to become formidable rivals of the railways. In 1930 the latter were empowered to conduct road transport and to acquire financial interests in omnibus undertakings. In 1933 the four Railway Companies acquired a controlling interest in Carter Paterson's and Pickford's, and by 1935 they had invested over £8,000,000 in omnibus companies. But the continued competition of road transport was causing them considerable uneasiness, and just before the Second World War their appeals for a "square deal" could be seen on numerous hoardings throughout the country.

Rail Transport.

A very heavy capital cost is incurred in railway construction ; the fixed charges, such as the maintenance of plant and equipment, are therefore very heavy ; the track is fixed, and runs between fixed terminals, so that the carriage of goods by rail is not capable of very great expansion ; the railway is dependent for its prosperity on that of the district through which it runs ; and maximum efficiency combined with minimum costs is obtained only with hauls of large consignments over long distances.

There are therefore special considerations governing the fixing of railway rates and charges. The lower limit is represented by the cost of the service, whilst the upper limit is represented by the value of the service. The cost of service includes (a) the

direct costs of running the engine and making repairs, the fuel costs, the wages costs, and the loading costs; and (b) the indirect costs, including the maintenance of the plant and equipment, interest on capital, salaries, and some part of the wages costs—*e.g.*, those of porters and signalmen. It is hoped that the costs shall be covered as a whole by the traffic carried; and in practice it is extremely difficult to determine the costs of a particular consignment, and even to distinguish between the costs of passenger and goods traffic.

To the extent that the competition of other forms of transport, and particularly of road transport, tends to influence the charges for carriage, these will tend to be fixed with reference to the cost of the service provided by the railways; but the large measure of monopoly enjoyed by the railways enables them to discriminate in their charges and to fix them according to the value of the service rendered—that is to say, “charging what the traffic will bear”, short of the point where the volume of traffic is diminished thereby. From one-half to two-thirds of railway expenses are relatively fixed, so that any increase in the volume of traffic reduces the proportion of these fixed charges per unit, with a corresponding increase in profit.

In practice, a classificatory scheme has been adopted, based on the principle that some types of commodities are able to pay a higher charge than others. Under the Railways Act, 1921, the Classification adopted was that compiled by the Railway Rates Advisory Committee, a body established by the Ministry of Transport Act, 1919; modifications were to be made by the Railway Rates Tribunal, and the latter body fixed charges which came into operation on January 1, 1928.

Commodities likely to be offered for carriage were divided into twenty-one classes, Class 1 containing the goods of lowest value, such as iron ore and slag, and Class 21 those of highest value, such as gold and silver articles. The charges increase with the classificatory number. Under the system of “Tapering Rates”, the charge per mile decreases as the distance increases, distances being divided into the first twenty miles, the next thirty miles, the next fifty miles, and the remainder.

The classification of any particular article depends on the evaluation of various factors—its value, its weight and bulk, the degree of perishability, the regularity of the traffic, the size of the consignment, its use and the method of packing; the same

article may be placed in different categories, according to the method of packing employed.

To traders whose consignments are regular the advantage of "Exceptional Rates" is offered; three-quarters of the traffic is sent at these rates. Part II of the Road and Rail Traffic Act, 1933, introduced a new system of "Agreed Charges", whereby a special rate could be charged for the goods of an individual trader for a definite or indefinite period and irrespective of the weight or class of goods and the distance, provided the approval of the Railway Rates Tribunal could be obtained. For example, in the case of Woolworth's, the rate was fixed at a percentage of the sale price of the commodities.

The Railway Companies are common carriers so far as regards the kinds of goods which they profess to carry generally for any member of the public, and must carry ordinary goods at reasonable rates, but a consignor may relieve them of part of their liability in consideration of some substantial inducement and if the contract is in writing, and the terms of the contract are "just and reasonable". Thus goods may be carried at "Company's Risk" or at "Owner's Risk", in the second case the company being liable only for damage or delay as a result of the "wilful misconduct" of its servants "Wilful misconduct" is difficult to prove.

In general, insurance of goods by the consignor is not necessary, but for certain articles of high value, such as gold and silver coin and precious stones, which must be declared, an increased rate is payable if the carrier is to be held responsible.

Except for very bulky and dangerous goods, the Railway Companies carry goods by passenger train; certain kinds of perishable goods they are bound to carry by passenger train.

The necessity of overcoming the difficulties of "through" traffic led to the establishment, in 1842, of the Railway Clearing House, where the claims of the various companies against one another are adjusted and co-operation of the four main groups of Railway Companies is achieved.

The losses in traffic of the railways due to increasing competition of commercial road vehicles led to the appointment in 1932 of the Salter Committee on Rail and Road Transport, and the recommendations of this Committee were largely followed in the framing of the Road and Rail Traffic Act, 1933. The Act was divided into three parts, Part I dealing with road transport,

Part II with rail transport; whilst Part III provided for the setting up of a Transport Advisory Council to advise the Minister of Transport in the co-ordination of transport and its facilities.

Part I laid down that in future licences were to be obtained by persons using a mechanically-driven vehicle to carry goods by road; licences could be refused to haulage contractors wishing to augment their existing fleet of vehicles. Particulars of the applicant's business, including the rates charged, were to be furnished on request by the Ministry, which was also empowered to regulate the hours of work, and to inspect vehicles to see that they were kept in a fit and serviceable condition; the licence-holders were obliged to keep a record of the hours of work of the employees and of the journeys done.

Part II extended the powers of the railways to quote competitive rates. Parts I and II have had the general effect of restricting competition amongst road hauliers and to some extent strengthening the position of the railways. But up to the outbreak of the Second World War, road transport continued to be a powerful rival of the railways.

The increasing success of the competition of road transport is not only an indication of the greater convenience and utility of road transport in many cases, but also of the fact that the public is not satisfied with the general organisation of the railway system. The classificatory scheme and the system of "tapering rates" would seem to be just and reasonable, and the control vested in the Railway Rates Tribunal goes a long way towards meeting the fundamental principle that transport of a national character should be under the direct control of the State, in order that the system shall best serve the public interest. But a system of charging what the traffic will bear cannot be reconciled with a system of competitive industry running on a cost basis. When the railways had a virtual monopoly they adopted a system of discriminating monopoly, and this is not necessarily in the public interest.

Where there is a body of shareholders who expect their investments to pay as well as possible, the principle of public policy must always be subordinated in some degree to that of shareholders' interests. The railways should be either quite frankly revenue-earning corporations, and revenue-earning for a limited section of the community—in which case the issue becomes perfectly clear—or they must be public utility corporations

entirely concerned with providing a transport system of maximum efficiency with minimum cost to the consumer. They can hardly be both.

Canals.

The railways checked the development of the canals in this country ; many fell into disuse. The total canal mileage is 3,639 in England and Wales, 183 in Scotland, and 848 in Ireland. 1,360 miles are controlled by the Railway Companies ; in 1938 the tonnage carried by these railway-owned canals was 1,479,055 tons, and by the other canals 15,407,087 tons ; about 2,500 miles of canals in Great Britain are still in use. In 1938 the largest tonnage was carried by the Manchester Ship Canal (over 6 millions) ; the Aire and Calder and the Birmingham came next in order, with over 2 millions each ; the Grand Union, the Lee Navigation, the Leeds and Liverpool and the Bridgewater carried over a million tons each.

The varying width and depth of the canals are a great disadvantage. They are used now only for the transport of cheap, bulky materials like salt and timber (between industrial districts and their hinterlands), where speed is not essential and where the low cost of carriage is important.

As in the case of the railways, canal charges are subject to classification, the maximum rates being based primarily on what the traffic will bear.

During the Second World War, a Central Canal Committee was set up by the Minister of War Transport to advise him on questions of policy regarding inland waters and to co-ordinate the work of six Regional Canal Committees which have been reconstituted to ensure the most efficient operation of the canals.

Ocean Transport.

In Volume I the various types of ships were discussed ; the shrinking of the tramp shipping trade, due to the 1929-1932 depression, and the aid given by the Government, were there noted. In the case of liners, the Conference System, the Deferred Rebate System and the Agreement System were explained.¹

In this country ocean transport is regulated by the Marine Department of the Board of Trade. Only ships owned by British subjects and registered in the Board of Trade Register

¹ Pp. 192-5.

may claim British nationality; the registration certificate, which must always be carried on board, and which states the name of the vessel, particulars as to construction, the tonnage, the name of the master, and the name of the owners, bears a number by which the ship is known.

The *gross registered tonnage* of a ship is based on its measurements, 100 cubic feet being taken as the equivalent of one ton; the *net tonnage* is arrived at by deducting from the gross tonnage the space occupied by crew and engines: the latter is about one-third for cargo vessels, but may be up to two-thirds in the case of passenger liners. The *cargo capacity* is expressed in

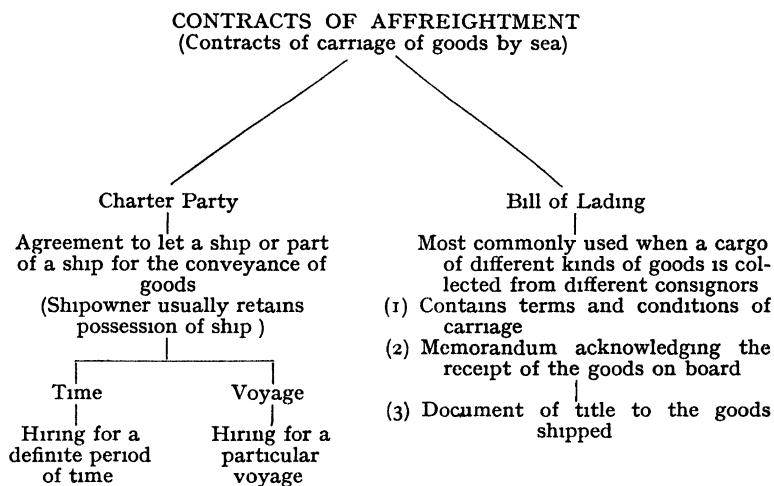


FIG 16 —CONTRACTS OF AFFREIGHTMENT

measurement tons, a measurement ton being the equivalent of about 40 cubic feet.

The carriage of goods by sea is arranged in a *contract of affreightment*. The agreement to hire a ship, or part of a ship, for a particular voyage, or for a specific period, is called a Charter Party; if the ship is hired for a voyage or a series of voyages, the document is a Voyage Charter; if the ship is hired for a specific period of time, the document is a Time Charter.

The Charter Party sets out the conditions under which the ship is chartered, the places between which it is to go, the cargo to be carried, the freight to be paid, and the number of days

allowed for loading and unloading, called *lay days* ; *demurrage* is paid by the charterer for days in excess of this period, and *despatch money* by the shipowner for lay days not utilised. The lay days may be either running days (*i.e.*, consecutive days, counting Sundays and holidays), or working days, excluding those days on which work would not ordinarily be done in the particular port.

The amount of freight to be paid is calculated upon a weight basis ; or, in the case of light, bulky goods, upon a ton measurement basis ; valuables are carried *ad valorem*. Under a Charter Party the amount of freight is usually paid at the port of destination.

Usually, if only a small consignment is carried in a ship which carries also the goods of other merchants, the document relating to the carriage of the goods is a Bill of Lading. It fulfils three functions :

(1) It sets out the conditions under which the goods are carried, their particulars and places of loading and destination, the cargo and freight, and the persons to whom delivery is to be made. Three copies are made, each containing a clause to the effect that one of the Bills of Lading being accomplished, the others to stand void. One part is retained by the master of the ship ; the others are sent to the consignee or his agent ; an unstamped copy is usually kept by the exporter.

(2) It acts as a receipt from the shipowner for the goods shipped, being signed by the master of the ship.

(3) The Bill of Lading is the document of title to the goods shipped under it, so that the master may deliver the goods to the first person presenting a copy of the Bill of Lading, whether this person is the original consignee or an endorsee, provided he has had no notice of any prior endorsement of any of the copies. But although a B/L is a negotiable instrument in the sense that the title to the goods represented by it is transferable by endorsement and delivery, it is not fully negotiable, since the transferor cannot give a better title to a transferee than he himself possesses : the transfer is " subject to equities ". Hence, a person who has no proper authority for holding a B/L cannot give a valid title to the goods to anybody who obtains it even though in good faith and for value.

In export transactions the consignee does not obtain possession of the B/L until he has paid or accepted the Bill of Exchange

attached to it ; the transaction is carried out through the medium of the banks.

The owner of a vessel has a lien on the cargo for the amount of freight due ; in the case of damage to the ship so that the captain is obliged to put into port for repairs, the captain has the power to raise money on the cargo. He may mortgage the ship and cargo or ship and freight for this purpose by means of a *Bottomry Bond* ; if the cargo alone is included in this Bond, it is properly called a *Respondentia Bond*. These transactions are of rare occurrence in modern times. Should the cargo or part of it be sold under these conditions, any loss incurred is payable by the underwriter under a *General Average Policy*.

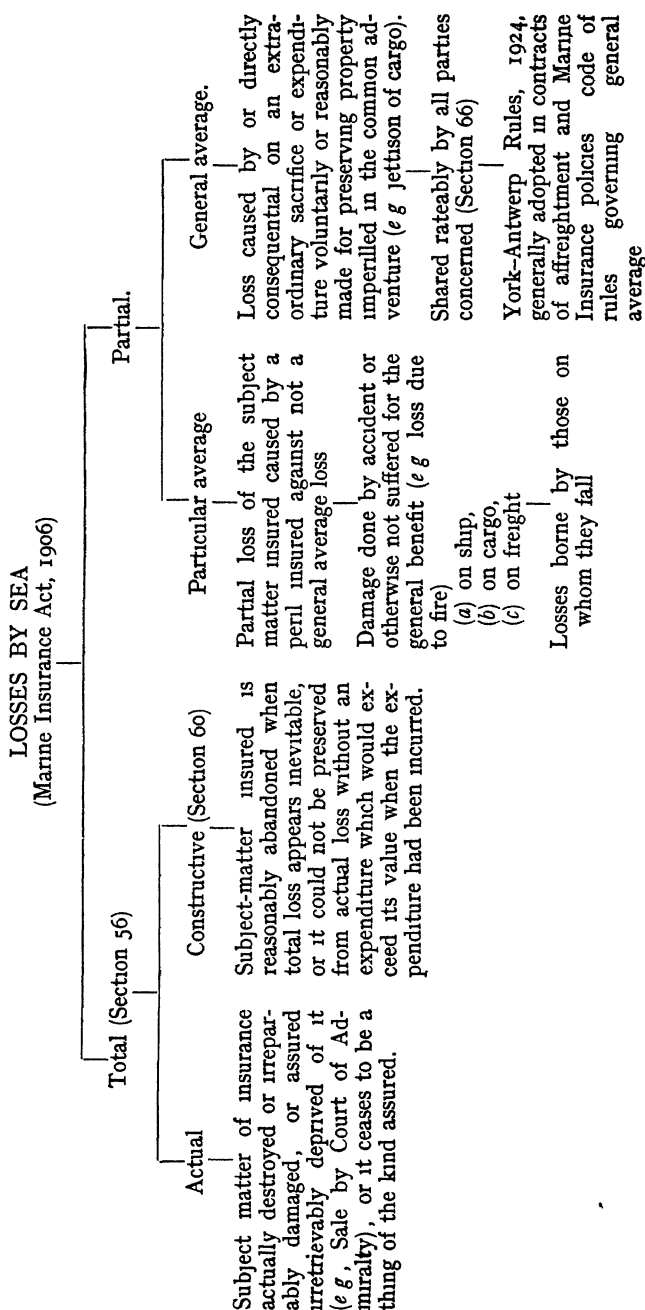
Marine Insurance.

As we have seen in Volume I,¹ the two main classes of Marine Insurance are either *Free of Particular Average*, insuring against total loss and general average loss only ; or *With Particular Average*, covering also loss or damage to the consignment not by way of *General Average*.

General Average occurs when sacrifice or expenditure is made, voluntarily and reasonably, to preserve the property in peril in a common adventure ; the conception has an ancient origin. The general loss suffered is made good by a General Average Contribution from all the parties interested in the adventure. Examples of General Average loss are the jettisoning of cargo (the amount of freight may also be involved on the sacrifice of cargo) ; the destruction of part of the ship, *e.g.*, the cutting away of masts or spars ; extraordinary expenditure would include the expense of putting into port for repairs.

The preparation of a General Average statement of claim is made by professional persons called average adjusters ; the adjustment is made at the end of the voyage ; frequently the shipowner releases the goods to the consignees on the guarantee by the underwriter that the General Average contributions will be paid ; for small amounts he may require the consignees, before release of the goods, to sign an *Average Bond*, in which they agree to pay the amount of General Average as may be found to be due ; in the case of a large amount, the shipowner collects a *General Average Deposit*, in exchange for which he gives the consignees a *Deposit Receipt* ; the money is paid into a bank in

¹ P. 202. See also the types of marine insurance policies issued



the name of two trustees, one of whom is appointed by the shipowner and the other by the consignees.

The underwriters are liable for the insured value of the property and for General Average damage, but the underwriter pays in the proportion which the insured value bears to the contributory value : for example, if goods of value £1,000 were insured for £900 only, and if the General Average contribution concerned was £100, the underwriter would pay not the full £100, but only nine-tenths of it—viz., £90.

Particular Average occurs when partial loss or damage is caused to the cargo or to the ship by perils which have been insured against, *e g.*, damage by sea-water or fire. It is borne by the owners of the property concerned. In the case of Particular Average on Ship, the basis of the claim is the actual and reasonable outlay for repairs. In the case of Particular Average on Cargo, the insured value is taken into account. The depreciation in the value of the cargo is assessed by brokers, or it is ascertained by public auction of the damaged goods.

English law does not recognise distance freight, *i.e.*, freight proportionate to the distance the goods have been carried, so that the shipowner cannot claim against the shipper on this account. But when freight has been payable in advance, the shipper has an insurable interest in it, and in his valuation of the goods for insurance he includes a valuation of the freight paid in advance.

In contracts of affreightment are often incorporated the set of rules relating to the adjustment of General Average drawn up by English and foreign jurists and commercial men and revised in 1924, called the York-Antwerp Rules. In insurance policies a clause is frequently inserted by which underwriters agree to accept adjustment in accordance with these rules, or in accordance with foreign law and practice.

Fire Insurance.

Fire insurance companies, as we noted in Volume I, are of two kinds : Tariff companies and Non-Tariff companies, the former being members of the Tariff Association, the members of which have agreed to fixed rates for different kinds of risks. We have seen, too, that every person desiring to insure should have an insurable interest in the subject-matter of the insurance. This interest may be legal, as where the insured person is the actual owner of the property concerned, or equitable, in which case the

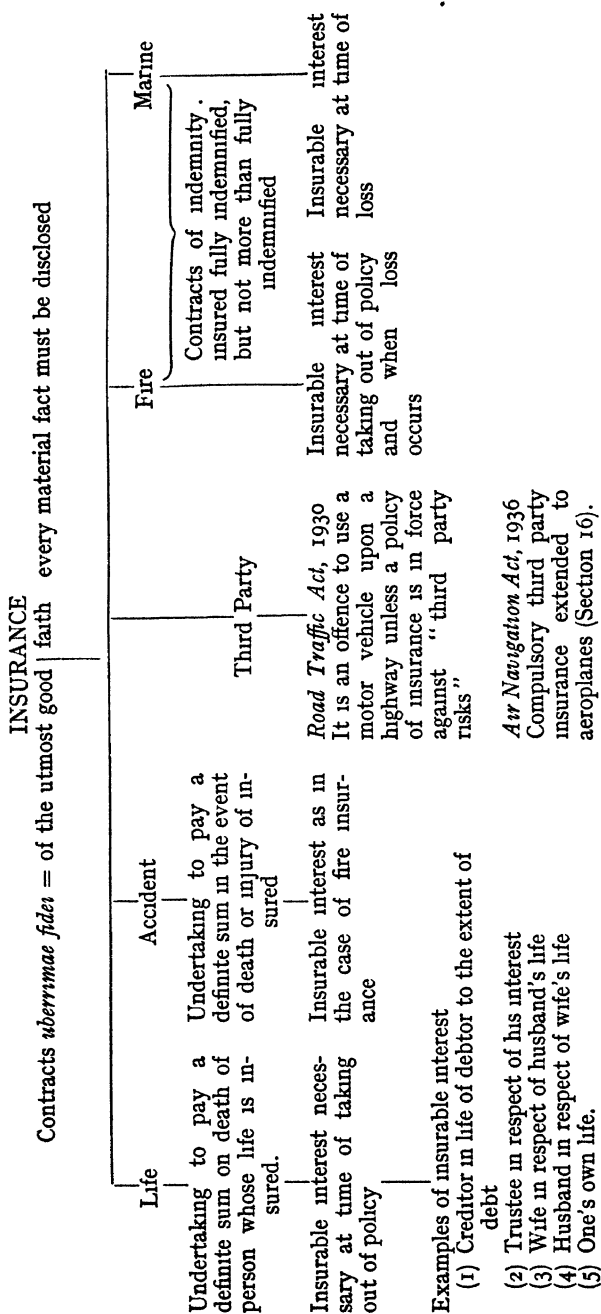


FIG 18.—THE CHARACTERISTICS OF LIFE, ACCIDENT, FIRE AND MARINE INSURANCE

insured is not the actual owner of the property, but will suffer loss in the event of the damage or destruction of the property, *e.g.*, a mortgagee. Thus a mortgagee may insure, as also may a trustee, or the executor or administrator of an estate. In the case of fire and accident insurances, the insurable interest must exist both at the time the policy is taken out and when the loss occurs; in the case of marine insurance, at the time of the loss only; in the case of life assurance, at the time the policy is taken out, but not necessarily when the claim is made.

Insurance contracts necessitate the utmost good faith (*uberrima fides*) on the part of both parties, the insured person being required to disclose any material fact that might influence the insurer in accepting the proposal, whilst similar good faith is required of the insurers. The principle of indemnity also operates, except in life, personal accident and sickness insurance: as far as possible, the insured should be placed as closely as possible in the same position after a loss as he was immediately before it; otherwise, insurance business would become the subject of much gambling.

As in the case of marine insurance, the principle of contribution operates in fire insurance, the claim against each insurer being determined by his rateable proportion; and, therefore, should an insurer have paid more than his fair share of a loss, he may enforce contribution from the other insurers.

The proposal is usually made out on a printed form. When the proposer has paid the annual premium fixed by the company, the latter issues a receipt for the premium; this acknowledgment protects the proposer until either the company accepts the risk and issues a policy or intimates that it is unwilling to accept the risk.

A marine insurance and life assurance contract must be incorporated in a policy, and this is usual also in the case of fire and accident insurance. Special or additional requirements are made out in an endorsement affixed to the policy in fire, accident and life policies. In fire and accident insurance, 15 days of grace are commonly allowed for payment of the premium, and 30 days in the case of life policies.

"Fire" means actual ignition, and only loss or damage resulting from such ignition is covered by a fire insurance policy, although if fire is a proximate cause, and, as far as the insured is concerned, accidental or fortuitous (as, for example, a fire in

neighbouring premises), the insured is covered. Such a risk is, of course, considered by the insurance company in fixing the rate of premium.

A fire insurance policy does not cover property held in trust, or on commission, unless expressly so described; amounts paid in respect of claims go to the real owner of the property. Deeds and bonds and similar valuables are not covered; and fire occasioned by such natural disturbances as earthquake, and such happenings as riot and civil commotion, are not covered.

It is natural, in view of the comparative strength of the temptation to benefit oneself at the expense of an insurance company, that fire insurance companies should scrutinise very carefully all claims made, and should challenge the claim on the slightest suspicion of fraud. Such an attitude benefits not only the company, but also the community, since an increase in premiums would result from a less watchful policy.

A further provision against fraud is the inclusion of a clause in the policy by which the company may reinstate property destroyed or damaged, instead of making a payment in money. Usually, companies and underwriters prefer to indemnify by means of a money payment, but after the 1914-1918 War a rise in prices resulted in the fact that indemnity based on the value of the property immediately before the fire proved inadequate. Reinstatement Policies were therefore devised to give cover on the basis of the actual cost of reinstating. This form of insurance is restricted to buildings and machinery; should the insured fail to reinstate, the indemnity will be on the ordinary basis.

Stocks of commodities may be of very high value, and in this case it is usual to effect a declaration policy. Under such a declaration, the trader declares the value of the stock on a specified day each month. The premium is calculated on the average for the year.

Life Assurance.

The usual object of life assurance is to provide a lump sum for dependents and old age, for the payment of death duties, for the repayment of capital on the decease of a partner, to provide a lump sum on the expiration of a lease, to meet the requirements of debenture repayment by means of a sinking fund policy, and to act as security for a bank or other loan.

Group life assurance, frequently combined with a pensions

scheme, is a modern development on the part of employers desiring to make provision for their employees.¹

Mutual Life Assurance Companies are owned and run by the members for their own benefit. The other companies transacting life assurance business are classed as proprietary companies: the latter devote a large percentage of the profits of their Life Department to bonuses for the "with-profit" policy-holders.

Although the risk increases with the age of the assured, a level annual premium is charged, these rates being actuarially calculated. By the method of over-estimating claims and under-estimating income, the British Life Offices have accumulated great reserves. But the choice of an insurance company by a client must be made by considering not only the amount of its reserves, but also its method of valuation, the amounts of bonus paid, and the conditions and *surrender value* of the policy—the amount which a life assurance company will pay to the holder of a policy who desires to cancel the contract. Not all policies carry a surrender value, but where it exists, there is also generally a loan value—the amount which the assurers are willing to lend on the security of the policy; it is usually about 95 per cent. of the surrender value. Naturally, surrender values are low in the early years of a policy.

Employers' Liability.

Liability in respect of employers is found in the Common Law relating to masters and servants, in the Employers' Liability Act, 1880, and the Workmen's Compensation Act, 1906, subsequently extended by further legislation. By the Workmen's Compensation Acts, 1925–1926, a statutory duty is imposed on an employer to compensate his employees for death or injuries suffered by them which arise out of and in the course of their employment. But there is no statutory duty to insure against this liability, except in the case of coal mines. Such great organisations as the Railways are able to carry the risk easily, but smaller undertakings find it wise to take out a Workmen's Compensation Act policy, which covers also liability under the Fatal Accidents Act, 1846, and the Employers' Liability Act, 1880.

Fidelity Guarantee Insurance.

The object of this form of insurance is to protect employers against loss arising from fraud or embezzlement on the part of

¹ See *post*, Ch. IX.

employees ; collective policies are issued to employers, who may therefore cover themselves in respect of the whole of their staff. A company issuing such a policy makes thorough investigations into the history of the employees concerned. The usual types of bonds issued are *Commercial Bonds*, guaranteeing the fidelity of such people as cashiers in a position of trust in a business house ; *Government Bonds*, issued to Government Departments, guaranteeing the fidelity of Government servants holding positions of trust, such as Inland Revenue and Customs and Excise officials ; and *Court Bonds*, guaranteeing the fidelity of those charged with the administration of an intestate's or lunatic's estate.

Modern Developments.

The powerful insurance companies possess such huge funds that the greater part of their dividends are met out of interest income alone. Fire and accident business yield the greater share of the companies' profits ; life insurance profits are generally low : the social matters involved are such that a Life Department of an insurance company cannot be regarded as merely a trading and profit-making undertaking.

Motor Accident Insurance has developed rapidly with the increase of road transport ; the liability to a third party, common to all users of motor vehicles, occurs with most forms of accident insurance. Aviation insurance was in its infancy before the outbreak of the Second World War, but will no doubt develop rapidly in the post-war years.¹

War Risks Insurance is a Government scheme started to cover risks against the hazards of war. Sea risks are covered in Part I of the scheme, and Part II is concerned with risks on land ; all owners of stocks valued at £1,000 or over were placed under an obligation to insure them. The war risks insurance business is a monopoly of the Government.

The War Damage Act, 1941, provided a scheme which extended cover by the Government over a very wide range of commercial and private life. The 1941 Act covered buildings and private chattels and the fixtures and equipment of the small business man.

The Government Export Credits Guarantee Schemes, controlled by the Department of Overseas Trade, were introduced shortly after the 1914-1918 War. The Schemes insure a British

¹ See footnote on p. 76, *ante*.

exporter against the risk of default by a foreign importer (the "credit risk") and the risk that the foreign country may, by legislation, prevent the importer from providing sterling to pay for the goods purchased (the "transfer risk"). The latter risk may well be considerably reduced by the setting up of such an International Monetary Fund as was discussed at the Bretton Woods Conference. The National Government's Export Credits Guarantee Bill of 1945 raised the limit of cover by the Export Credits Guarantee Department from £75 millions to £200 millions.

The Beveridge Scheme of Social Insurance and Allied Services was related to the other forms of Insurance in Volume I of this work. The entry of the State into the sphere of Insurance is a significant move in the social and economic history of the country, and the student of Commerce should follow its development with interest and care.

PART TWO

COMMERCE AND THE FINANCIAL SYSTEM

CHAPTER V

MONEY AND PRICES

IN Volume I it was pointed out that though Banking and Finance are to be regarded as Auxiliaries to Trade, in so far as banking and financial activities are essential for the functioning of the commercial system, and form part of the commercial system itself, yet these activities are part and parcel of the whole economic structure, and are made use of by and affect the lives of all the members of the community as a social whole. We cannot, therefore, separate the problem of the monetary system of the commercial structure from that of the monetary system of the social structure as a whole.

The Value of Money.

We have defined a commodity as an article having an exchange value in money which is called its *price* ; the problems of prices, therefore, intimately concern the social and commercial system.

Money is like other commodities, in that an increase in the supply of it tends to lower its value in respect of other commodities, whilst a decrease in the quantity of money available tends to raise its value. But money is also the measure of value of the other commodities and services ; and the value of money itself can be measured only by reference to the quantities of commodities that can be exchanged for it. When there is a great deal of money in proportion to the things that can be bought with it, the value of money will be low, and prices of commodities will be high ; and *vice versa*. The value of money, then, varies inversely as the general level of prices.

Not only the quantities of money and of commodities must be taken into the consideration of this particular problem, but also the *rate* at which the supply of money is turned over : that is, the number of times a money unit is used in a given time and the number of times the commodities change hands. The rapidity of circulation of money has the effect of increasing the supply

of a given quantity, in that the same unit is used many times over. Again, credit and credit instruments such as cheques and Bills of Exchange represent an addition to the legal currency and constitute in effect an addition to the supply of money. The number of exchanges which money is called upon to effect is an influence affecting the demand for money: a large number of transactions calls for a relatively large supply of money.

We see, then, that when trade is flourishing, and there are many transactions in the buying and selling of commodities, there is a large demand for money. If this demand is not met by an increased supply of money, the value of money will rise, and prices will fall. If the supply of money is increased more quickly than the demand, prices will rise.

Prices, then, are determined by the interaction of the demand for and supply of money relative to the demand for and supply of commodities. During the Second World War the reader will not have failed to observe that the increased supply of money and the decreased supply of certain commodities, for which there was a large demand, raised the prices of these commodities to a very large degree, the upward movement being stopped only by the fixing of prices on the part of the Government.

These fluctuations in the value of money have effects which have serious repercussions on the whole economic system, and ultimately on the social system. Some classes of the community benefit, at first, from rising prices. The stocks held by manufacturers and traders and farmers rise in value; higher prices are given for commodities, whilst such charges as rent and rates and wages, which respond more slowly to the upward tendency, remain for some time at their old level. The entrepreneur may therefore look forward to increased profits, and commerce and trade are stimulated. In the long run, more manufacturers and traders are attracted into the field by the prospect of gaining profits, and their competition will tend to force prices down again.

But in the meantime certain other classes of the community suffer as a result of rising prices. Those living on fixed incomes such as salaries and pensions and interest from investments find that their income is of less value in terms of commodities than before. Individual wage-earners—as apart from people who succeed in obtaining employment as the result of the increased commercial and industrial activity—similarly find that their

wages are not keeping pace with their expenditure, and industrial unrest and strikes may be seized upon as weapons to put the matter right. Once more, the student will have noted the increases in salaries and wages which took place during the course of the Second World War.

The effects of falling prices are the reverse of those of rising prices. Profits are reduced, production and trade tend to be discouraged ; those in receipt of fixed incomes benefit, and so do individual wage-earners, whilst for the wage-earning class as a whole there arises the dread of unemployment. Creditors benefit at the expense of debtors, for debts are repaid by money which has a value higher than that obtaining at the time the debt was contracted, since more commodities can be obtained for the same expenditure of money.

The Dangers of Inflation.

In times of rising prices debtors gain at the expense of creditors. The greatest debtor in the community is the Government, its internal debt consisting of the National Debt. Naturally, when the value of money is low, the burden of debt which the Government has to shoulder is reduced, so that it is under a temptation to inflate the currency.

Inflation occurs when there is an expansion of the supply of money beyond the amount which is necessary for the needs of the community *at the existing level of prices*. A tendency to inflation may be caused by a change in the supply of goods, but this is usually corrected by a corresponding change in that supply—high prices attracting more competitors into the field and thus themselves bringing about a tendency towards a fall in prices. The term “inflation” is often used to describe a deliberate expansion of the currency by the responsible authority.

Since the main purpose of money is to provide a medium of exchange, and thus to serve the needs of trade—using the word trade in its broadest sense to denote the system of exchanges practised by the members of a community—any rapid increase of money, or inflation, or decrease, or deflation, beyond what is required to serve the purposes of trade cannot but have harmful effects upon the economic life of the community, and therefore upon its social life. The printing of inconvertible paper currency by a Government trying to get out of financial difficulties leads to disorganisation of the economic life of the community to which

it is responsible. Soaring prices not only have the economic result of benefiting some classes of the community at the expense of others ; they make also for ill-will and resentment on the part of those suffering from the high prices, and cause social unrest. Attempts to meet the situation by increases in salaries and wages intensify the disturbance, for higher wages mean higher costs of production, and still higher prices. Governments have to pay contractors and others for the goods and services they need to carry on the government ; and by printing more notes in order to put itself in a position to buy, a Government merely makes the situation worse—the “ vicious spiral ” goes spiralling on.

Externally, the value of the currency falls in relation to the currencies of other countries. After the 1914-1918 war, in the course of a few days the German mark fell from a pre-war value of 20 to the £ to thousands to the £ ; the Russian rouble fell from a pre-war value of 10 to the £ to 10½ millions.

Financial History Since 1914.

During the 1914-1918 war, so much of the industrial effort of many countries went to the making of war materials, and imports fell off to such an extent, that there was a shortage of many commodities. Prices and wages and salaries rose. In Great Britain the Government tried to meet the situation by issuing Treasury Notes, which it made legal tender. There was no increase in production corresponding to these notes, so that their effect was inflationary.

This issue by the Treasury through the Bank of England of £1 and 10s. Treasury notes was authorised by the Currency and Bank Notes Act, 1914. They were promises to pay on the part of the Government ; but the supply of gold, on which the British currency system was based, was kept in reserve at the Bank of England, or used to pay for imports of food and raw materials. As much as possible of the gold coins in circulation, estimated to be about £130,000,000 in value, were gradually withdrawn.

As a result of the provisions of the Bank Charter Act, 1844, which allowed the Bank of England to take over two-thirds of the lapsed issues of other banks, the Fiduciary Issue had risen by 1914 to £18,450,000. In 1914 the full Gold Standard system was in operation : notes stood at absolute parity with gold coins of equivalent face value, and both notes and gold coins stood

at parity with bullion. Notes were convertible into gold coin, or *vice versa*, and holders of gold bullion were entitled to receive gold coin in exchange. On the outbreak of war, the Gold Standard disappeared throughout Europe.

The Currency and Bank Notes Act, 1914, resulted in a dual system of note issue : the Bank of England issued notes of £5 and upwards, and the Treasury issued currency notes of £1 and 10s. The Act also authorised the Bank of England to increase its Fiduciary Issue beyond the legal limit of £19 $\frac{3}{4}$ millions, subject to the approval of the Treasury.

By the end of 1918, the amount of Bank notes in circulation was £98 millions, and of Treasury notes £323 millions ; by March, 1920, these figures had risen to £130 millions and £335 millions, respectively.

The creation of these currency notes issued by the Treasury meant that the supply of currency was increased enormously ; the circulation of currency notes in 1920 was two and a half times that of 1913, whilst the index for wholesale prices, taking 100 as the 1913 index, had risen to 321·8 (Board of Trade Statement, Cmd. 734). The rising prices were a warning of the existence of inflation. A Committee, the Cunliffe Committee, was appointed to consider the question of currency ; in its report, published in 1918, it was recommended that the maximum Fiduciary Issue of any one year should be the maximum amount attained in the previous year, and that when the Bank of England gold reserve had reached £150 millions, the Fiduciary Issue should be finally fixed, and that the whole of the currency issue should be taken over by the Bank of England.

The former recommendation was soon followed : in December, 1919, a limit of £320,600,000, the maximum figure reached in 1919, was fixed as the total amount of currency notes not backed by gold. Between 1920 and 1923, the Government, by means of economy, was able to destroy £50 millions of currency notes and to collect over £20 millions in silver and Bank of England notes to hold as a reserve against the Treasury notes still in circulation.

In 1925 the Gold Standard Act was passed, restoring Great Britain to the Gold Standard, though this was not the old Full Gold Standard of pre-war days : anyone was enabled to demand cash in notes from the Bank of England at the old rate of £3 17s. 9d. per standard ounce, but fine gold could be purchased at the old buying rate of £3 17s. 10 $\frac{1}{2}$ d. only if a minimum of 400

ounces was demanded. In effect, however, the paper pound and the gold pound reached parity, for a fall in the value of the former would induce those who could do so to exchange their notes for

1914	Full Gold Standard System in operation
1914-1918	First World War. Rise in prices Inflation Currency and Bank Notes Act, 1914 10s and £1 Treasury Notes
1918	Cunliffe Committee.
1920-1925	Deflation. Falling prices Production checked Unemployment and distress.
1922	Genoa Conference.
1925	Restoration of Gold Standard <i>gold bullion standard</i> . Fall in world prices Trade improvement
1928	Currency and Bank Notes Act Issue of Treasury Notes and Bank Notes amalgamated. Fiduciary Issue fixed at £260,000,000.
1929	(Macmillan) Committee on Finance and Industry.
1931	Gold Standard abandoned. Fiduciary Issue £275,000,000 Publication of Macmillan Report
1932	Exchange Equalisation Fund established Sterling bloc 1932-1939 Bank Rate unchanged at 2%. Bill rates declined to $\frac{1}{2}$ % Government borrowing at low rates
1933	World Economic Conference
1933-1939	Deterioration of international situation Artificial stimulus given to prices by re-armament
1939	Breaking out of Second World War Planned inflation Rise in prices Exchange restrictions adopted by sterling bloc countries Lend-Lease arrangements with USA Savings campaign intensified Fiduciary Issue over £1,000,000,000
1940	Exchange restrictions tightened Control of capital transfers Payments agreements with nearly all allied and neutral countries Proceeds of exports to Great Britain in form of "blocked sterling balances" these could be spent by exporting countries only by importing British goods Depreciation of sterling prevented Lend-Lease arrangements with USA enabled Britain to import from USA after dollar resources used Government borrowing at low rates of interest Planned inflation and controlled economy, to avoid depreciation of sterling and rise in prices or raising of interest rates to high levels
1944	Bretton Woods Conference
1945	Withdrawal from legal tender of Bank Notes of £10 and upwards Dec 6 Signing of Loan Agreement Gt Britain to receive a credit of £1,100,000,000 from U S A

FIG 19—CHART OF THE MAIN POINTS IN BRITISH MONETARY HISTORY SINCE 1914

gold, thus reducing the number of notes remaining and raising their value.

The process that went on from 1920 to 1925 was the reverse of the inflationary process from 1914 to 1920: it was *deflation*. Deflation meant falling prices and a check to production. Prices

were low not because things to buy with money were plentiful, but because money itself was scarce: the notes were destroyed as they came into the Bank. As a monetary policy, it proved even more disastrous than the inflation of the war years, for it lacked the stimulus of war production.

The recommendation of the Cunliffe Committee that the whole of the note issue should be taken over by the Bank of England was not carried into effect until 1928 when, under the provisions of the Currency and Bank Notes Act, the issues of Treasury notes and Bank notes were amalgamated, the Bank being empowered to issue £1 and 10s. notes. The stock of gold held against the Treasury notes was handed to the Bank; and the Fiduciary Issue was fixed at £260,000,000, though the Bank might apply to the Treasury for permission to increase the amount, the time for application being fixed at two years, after which permission was to be sought from Parliament.

In 1931 the country went off the Gold Standard again; the Fiduciary Issue was raised to £275 millions; it was reduced to £200 millions in 1936, raised to £220 millions to provide for the Christmas expansion in December, 1937, and reduced to £200 millions again in January, 1938.

Meanwhile, in Europe and America, attempts were also being made to deal with the monetary chaos left by the 1914-1918 war; efforts were being made to restore the credit of the most damaged countries. The Genoa Conference of 1922 recommended a return to gold. The League of Nations undertook the reconstruction of the finances of Austria and Hungary. In Germany the currency was stabilised in 1924 by means of the Dawes Loan. Sweden preceded Great Britain in reverting to the Gold Standard in 1924. France succeeded in stabilising her currency in 1926. But whilst Great Britain and Czecho-Slovakia and Sweden pursued a deflationist policy, France, Hungary and Italy attempted to solve their problems by inflation.

America had become the great creditor nation as a result of the loans made to the belligerent nations; by 1928 the U.S.A. had lent nearly 5,000 million dollars to other countries.

In 1925-26 there was a pronounced improvement in trade, and by 1928 there was a stock-market boom; in the second half of 1928 the amount of new loans to Europe fell to very small proportions. Instead of America continuing her rôle as the chief exporter of capital, capital flowed to the U.S.A. to earn the high

interest rates there. Finance houses in Europe sent large sums to New York.

Then there came the great Stock Exchange crash ; the manipulations of the currency had put too severe a strain upon industry. The heavy transfers of funds under the Reparations demands had been a serious impediment to trade and had had damaging effects upon the structure of the currency and credit systems. The substitution of short-term bank loans for long-term investments was a policy not very encouraging to industry and commerce. Trade diminished, unemployment increased ; industrial share prices fell all over the world. Prices fell ; by 1931 the financial cataclysm had fallen full upon Europe.

By 1931 Great Britain's relative share of the declining world's export trade was itself declining, and earnings on invisible exports had been reduced. At home, trade was reduced and unemployment was growing ; taxation had increased. The increasing nervousness in Europe turned to panic, and in May the Austrian Government announced the impending insolvency of the Credit Anstalt. Large withdrawals of funds were made. The effect of President Hoover's proposal of a one-year moratorium of war-debt payments was lost because of French delay in accepting. The Bank of International Settlements (established as a result of the Young Plan of 1929 and appointed to receive and allocate the Reparations payments transferred by Germany), the Bank of England, the Federal Reserve Bank of New York, and the Bank of France granted 100 million dollars to the Reichsbank. But this was insufficient to stop the withdrawal of funds from the German banks ; there was a two-days' closure of the banks and of the Stock Exchange in Germany.

The spreading fear caused heavy withdrawals of foreign balances from Great Britain, and there was an outflow of gold ; in July, 1931, the estimated probable Budget deficiency was reported to be £120 millions. There was disagreement in the Cabinet on the unemployment benefit question. The Labour Government resigned, and a National Government was formed, arranging a credit of 80 million pounds jointly with France and America. But heavy withdrawals of gold continued, and in September, 1931, Great Britain suspended that Section of the Gold Standard Act of 1925 which required the Bank to sell gold at a fixed price.

The Stock Exchange was closed for two days, and, except for

Paris, nearly all the foreign Bourses also closed. On the day Britain went off the Gold Standard, the pound fell in terms of the dollar, but later recovered.

It was evident that a new era was dawning in financial affairs. Modern nations, caught up in the complex web of international commercial and financial relationships, cannot abandon themselves to the doubtful delights of warfare with the light-heartedness of the medieval barons. The rhythm and balance of trade and of commercial relationships are very easily disturbed by the dislocation in economic and social life resulting from an outbreak of war on the scale of modern technical efficiency. From the close of the 1914-1918 war the Western world entered upon a phase of financial uneasiness and monetary crises which could not but have the most profound effect upon trade and commerce.

The economic welfare of a modern community depends upon its trade and the efficiency of its commercial organisation. If the medium of exchange, money, is not stable, if confidence in the credit system is destroyed, trade and commerce suffer; and the whole intricate and delicate mechanism built up to facilitate the exchange of commodities and to aid the economic and social development of communities is thrown out of gear. In effect, of course, the whole of the Western world forms one community as far as the economic structure is concerned; and the United States have found that isolationism in economic affairs is wholly undesirable, even if possible.

From 1914 to 1931 the history of money shows the evil effects of inflation and deflation. The relinquishment by Britain of the Gold Standard in 1931 was welcomed by the trading community in Britain; British goods were bought with sterling, and the cheapening of sterling meant that their prices were cheapened in terms of foreign currency. Great Britain's reputation in the financial world was such that several other countries decided to tie their currencies with sterling; they adhered to the "sterling bloc" even after Britain went off the Gold Standard in 1931.

There were economists who, before the return to the Gold Standard in 1925, had opposed this return; they advocated a *Managed Currency*. They believed that the level of prices at home should be maintained at a steady level by means of an inconvertible paper currency the issue of which should be regulated according to the needs of trade; those needs would be determined by the preparation and examination of index

numbers based on the production of commodities, enabling a comparison to be made between the value of money at different times and places. Such index numbers have been compiled by the Board of Trade and the *Economist*. The Board of Trade index number is based on the wholesale prices of forty-five commodities, the year 1900 being taken as the standard; the movements of retail prices have been found to be so great that no satisfactory standard taken with reference to them has been evolved. The Ministry of Labour published index numbers based on retail prices in July, 1914, including the principal food-stuffs, rent, clothing and light; but in April, 1936, the Ministry were obliged to accept the fact that the constituent items no longer represented the purchases of an average working-class household. This difficulty of managing a currency in accordance with index numbers remains a very real one.

Fluctuations in international exchange values could be avoided only by international agreement to adopt a Managed Currency system; certainly the Gold Standard was unable to bear the strains which led to its abandonment in 1931. The fall in world prices which occurred from 1925 to 1931 reflected the appreciation in the value of gold. As an argument in favour of the claim of the advocates of a Managed Currency that it would keep stable the internal price level over a long period, it may be remembered that this was just what the Bank of England has been accustomed to do over short periods.

It had been believed that if the Gold Standard were operated properly, prices would be automatically adjusted to the supply of money. But within any country there are so many factors influencing price tendencies (not only wholesale and retail price indices, but prices of labour and property, of stocks and shares, and of all goods and services capable of being bought and sold are among the data required for estimating with reasonable accuracy the real level of prices) that the term "general level of prices" is a somewhat vague one. There remains, too, the difficulty of stabilising both the internal price level and the external price level simultaneously.

Nevertheless, difficult as it may be to obtain a price index accurate enough to enable an authority to regulate the currency supply with automatic accuracy, prices cannot be allowed to rise and fall and upset trade conditions apparently as they will. Statistical research is going on, and during the past ten years some

progress has been made in the solution of the problem of a Managed Currency to the extent that the producer and the consumer may not be discouraged, the one from manufacturing and the other from consuming. The control exercised during the Second World War is an indication of how much may be attained by the application of a strong, determined policy in price control.¹

The Macmillan Report.

In 1929 the British Government appointed a Committee under the chairmanship of Lord Macmillan to enquire into the working of the monetary and banking system. Its Report was published in 1931.

The Report stated that the main purpose of the monetary system was to maintain a stable price level :

“ The task of the monetary system, as we see it, is, therefore, to balance, as far as it can, by changes in the quantity and terms of credit, the effect on the price level of certain fluctuating factors which, whether we prefer to call them or their underlying causes monetary or non-monetary, are largely outside the *direct* control of the monetary system.”
(Para. 211.)

The Report expressed the view that the provisions of the Currency and Bank Notes Act of 1928 for the control of the Bank of England Note issue were inadequate, and that more elasticity was required. It recommended that the Bank be given power to put into active circulation notes to the value of £380 millions, the amount to be increased to £400 millions if necessary. The gold reserve of the Bank should not be allowed to fall below a statutory minimum of, say, £75 millions except with the permission of the Treasury ; the Bank's normal reserves of gold or gold exchange should be increased, but the Bank should have increased resources and greater freedom, and should be allowed to reckon as part of its gold reserves any balances held by it with the Bank for International Settlements (paras. 322-346).

It is important to note that throughout the Report the view was urged that the proper use of gold is not to back the issue of notes, but to meet deficiencies in international payments. The internal stability of prices could be secured only by regulation —by the institution, in fact, of a Managed Currency.

¹ See *Price Stabilisation and Industrial Policy* (Cmd. 6294), 1941, H.M.S.O., 1d. net.

Nineteenth Century.	The Gold Standard Stability in exchange achieved at the cost of internal monetary stability. Purchasing power and productive capacity limited: "scarcity economics".
Twentieth Century. 1914-1918	The First World War. Inflation. Rise of prices. Restriction on normal trade. Exchange rates controlled. Prevention of speculative activities
<i>The Twenties</i> 1920-1925 1922	U S A became a great creditor country Attempts to restore credit of devastated countries Genoa Conference on stabilisation of currencies return to gold recommended Restriction of activities in foreign exchange opposed Speculation in foreign exchanges.
1923	Inflation in Germany.
1924	Dawes Loan to Germany
1925	Great Britain gold bullion standard.
1926	Stabilisation of currency in France Great Britain, Czecho-Slovakia, Sweden deflation. France, Hungary, Italy inflation
1925-1926	Trade improvement
1928-1929	Stock-market boom in U S A Flow of capital to U S A. Accumulation of gold in U S A and France
1928	Stabilisation of French franc
1929	Wall Street crash. Diminishing trade Increase of unemployment Fall in prices.
1929	Bank of International Settlement established under Young Plan.
<i>The Thirties</i>	U S A ceased to lend surplus money abroad, withdrawal of short-term funds abroad. The Great Depression Bilateral trade agreements adopted in many countries, especially Central and S E Europe Germany used this method for economic aggression economic penetration of British Dominions by refusing to pay for purchases unless her goods were accepted in exchange Exchange restrictions, bounties, subsidies world commercial warfare Currency depreciation on the part of many countries to improve exporting capacity Flow of funds to U S A
1931	Britain off Gold Standard
1932	Crisis in Germany France flight from the franc Exchange Equalisation Fund established in Great Britain Exchange Equalisation Account system adopted by U S A, Holland, Switzerland and other countries with substantial reserves Ottawa Declaration Sterling bloc to secure stable exchange rates Dollar bloc
1933	Banking crisis in U S A World Economic Conference
1936	Tripartite Currency Agreement (Great Britain, U S A, France)
1938	French franc stabilised
1939-1945	Second World War War economy Destruction of much material wealth in Europe Development of manufacture in countries previously concentrating on agricultural and pastoral industries, e g, Australia
1944	United Nations Monetary and Financial Conference (Bretton Woods)
1945	Anglo-American Loan credit of £1,100,000,000 to Great Britain

FIG. 20.—MONEY AND INTERNATIONAL TRADE SINCE 1914

The Report is invaluable to the student as a descriptive and historical survey of the finance and industry of the country and as an explanation of the relationship between money and prices. Its chief recommendations are yet to be followed, and it remains a modern and up-to-date volume of expert pronouncement on the problems of currency.

Money and Trade Since 1931.

We have seen that the 1914-1918 war brought about a great change in the old system of international trading relationships. Before the war, Great Britain—or, rather, British people—had lent large sums to people in America in order that the industries and transport system of the United States might be developed, and the interest on these loans had been paid, as ultimately they had to be paid, in the form of goods. In the early part of the war, the British Government secured the funds necessary for carrying it on by buying American securities from their British owners for pounds, and selling these pounds for dollars, with which it bought war material. When America came into the war, this source of supply had been exhausted, but goods were supplied to the British on credit, and by the end of the war, the debt owing to America had reached enormous proportions. Meanwhile, the American manufacturers had taken advantage of the situation to secure the home trade for themselves, as well as the trade in some neutral markets. To continue to enjoy this advantage after the end of the war, the Americans obliged their Government to put up tariff walls against the inflow of European goods, so that Europeans had to pay for their imports from America not by exports of commodities but by exports of gold; on top of the inflow of gold paying for war debts was this inflow of gold paying for commodities: America began to pile up a tremendous gold stock.

But not even America could escape the fundamental fact that Mankind does not live by gold alone. The possession of gold does not bring the millennium; rather does it bring an intolerable burden. Some of it America got rid of by lending large sums to Germany, which were used for building unproductive structures like town halls and gymnasias; the feverish thoroughness that went into the building of the replanned Germany had as its result the filling of the pockets of the few at the expense of the community. Speculators in land made fortunes overnight; a

good proportion of the "invariable costs" of German industry went to enrich the unscrupulous. By 1931 Germany was in the midst of a crisis from which was born the despairing nationalism of Nazism.

The worsening position of trade led to exchange restrictions, bounties, subsidies, and sheer inability to buy. The falling of prices in an importing country means that countries exporting to her do not obtain as much for their products as before. Should the exporting country be paying interest on investments made by people in the importing country, this interest has to be met by increased exports. This happened, for example, in the case of Argentina; and the Argentines responded by deciding to pay interest in pesos, not in pounds. The Dominions, too, found it difficult to do business with Britain; British manufacturers found it difficult to sell there.

In order to protect and stimulate trade, direct and indirect bounties and subsidies were adopted. The New Zealand Government, for example, gave an export bounty on butter. Germany gave indirect assistance to exports by granting a favourable rate of exchange to foreign buyers and visitors, so that they were induced to buy from Germany and so bring her foreign currency.

These attempts to stave off coming disaster found expression in the convening of a World Economic Conference in June, 1933, to study especially money and credit policy, price levels, movements of capital, tariffs and quotas, and cartels and producers' agreements. But the Americans objected to the plans for the stabilisation of the currency, and the French were nervous of the whole scheme.

The World Disarmament Conference was an equal failure; Germany resigned from it in October, 1933, and from the League of Nations a few days later. 1933 saw a banking crisis in America, and America went off full gold parity in April of that year. It seemed that Mankind had given up hope of repairing the economic structure, and was unwilling to make a co-operative effort to reconstruct it to meet the new conditions which the changes precipitated by the last war had brought about. Economically, the nations moved towards self-sufficiency. Politically, there arose dictatorships, the sure sign of people who have lost their grip on the control of their environment and with it their self-respect.

On the monetary aspect, by 1936 Britain and the British

Empire (except Canada and Newfoundland) and the Scandinavian countries were linked together in a sterling "bloc"; France, Belgium, Switzerland, Holland and Czechoslovakia adhered to the gold standard; the United States was off gold; Italy and Germany had evolved systems of strict regulation of foreign trade whilst still being technically on gold. Germany pursued her own plan of reaching national self-sufficiency whilst preparing for a war that would give her control of the material resources of the earth. France was trying to increase her exports whilst increasing wages and shortening hours of work; inexorably, the increased costs of production due to these social reforms and her clinging to the gold standard were sending up French prices and making it difficult for foreigners to buy in the French markets.

The French were in deadly fear of inflation; to go off gold, they felt, would result in a "flight from the franc"; people would have sold francs in order to obtain what they felt was safer money in the form of foreign currency. Moreover, the opportunity would have been given to those deadly parasites, the speculators in currency, to clutch at their profits and make matters worse. Fortunately, the U.S.A. and Britain came to the aid of France; it was agreed that France should devalue her currency (that is, the gold equivalent of the unit of currency was to be reduced), to an extent which was announced as somewhere between 34·3 per cent. and 25·2 per cent., and that the U.S.A. and Britain would do all in their power to see that the value of the franc should not fall below the limit corresponding to this reduction. It was hoped that by this means the confidence of people holding French money would not be unduly impaired, and that the speculator would be discouraged from depressing the exchange still further by selling forward, that is, selling francs for, say, dollars, and then, when the value of the franc has fallen still further to its lowest level (a process helped by his own sale of francs), buying with dollars, which he may not even possess, a much greater quantity of francs.

Under this Tripartite Currency Agreement of 1936, France was to establish an Exchange Equalisation Fund similar to that possessed by Britain and the United States¹; this was a fund which would be used to keep the exchanges stable. Thus, if a large number of francs were to be offered for sale in London, as

¹ See *post*, p. 149.

soon as the price of francs had reached an agreed level, the Fund would be used to buy francs, which would be changed into gold. The Equalisation Funds were to be used to buy and sell gold amongst themselves.

Very soon after the establishment of the Agreement an opportunity was given to test its effectiveness: a million pounds sterling were offered for sale in New York, and this amount was taken up at once by the United States Equalisation Fund, which thus protected the value of sterling.

But the international political situation was getting steadily worse. Italy invaded Abyssinia, and there was civil war in Spain. There were strikes in France and the obstinate pursuance of a policy of spending money on reforms which could not be afforded. Germany was pursuing her own plan of self-sufficiency, reaching a high stage of efficiency in the production of synthetic substitutes for natural products, and strictly controlling the export of German currency. Foreign currency obtained for the sale of German goods (permission to export which had to be obtained from the German Government) had to be sold by German nationals to their Government, which paid them marks, while paying the foreign currency into reserves scattered in various places abroad. German importers similarly had to obtain permission to buy goods from abroad, paying marks to the Government, which paid the foreign seller in his own currency out of the collections of foreign currency it had established.

A large proportion of the foreign currency thus brought under the control of the German Government was spent on armaments: guns came before butter, in the German estimation of social values.

The German nation, its soul captured by the new religion of nationalism which had replaced the Christianity so fervently professed and so lightly practised by the Western world, was moving towards an attempt at a solution of its economic difficulties and social sickness by the force of arms. Ever intellectually unsound and unstable, the German nation was unable to see that even a successful war creates more problems and difficulties than it settles. Ever obstinate and resistant to change, and jealously guarding a social and economic system which provided wealth and influence for a privileged minority, the Western Great Powers attempted to avoid the now evident danger by ignoring it.

In 1939 the storm broke. Long before the conflict had reached

its final stage, and the unexpected tremendous weight of German material power of destruction had been broken, large numbers of people in the democracies had begun to focus their attention on the problems of trade and finance, by the sheer necessity of circumstances. It had begun to be generally realised by all who had discharged part of their duty as citizens by studying the commercial structure, that if a new world order was to arise on the economic ruins of Western Democracy, one established in the interests of the community, some control of the system was necessary.

It must be our next task to examine the fundamental part played in this structure by the banking system and the financial system generally.

NOTE FOR CHAPTER VI.

The Labour Government Bill for nationalising the Bank of England was introduced in October, 1945. In general, the Bill merely gives legal effect to what has been current practice as described in the following text, but concern has been expressed at Section 4 (3), which states that, if it thinks it necessary in the public interest, the Bank may " request information from and make recommendations to bankers, and may, if so authorised by the Treasury, issue directions to any banker for the purpose of securing that effect is given to any such request or recommendation ".

Fair compensation is provided for the present stock-holders. The Governor and Deputy-Governor are to be appointed for five-year terms and sixteen directors for four-year terms, four of them retiring every year, the appointments to be made by the Crown.

CHAPTER VI

THE BANKING SYSTEM AND THE MONEY MARKET

VOLUME I must again be referred to, this time for a general introduction to the structure of the banking and financial system. In this volume it is intended to discuss more closely the functions of banks and other financial institutions as they relate to the activities of the commercial community and to the needs of Commerce in its wide meaning as it is employed in this work.

The Functions of the Banks.

In this country there is no legal definition of a bank such as appears in the codified legislation of most other countries. Like so many other British institutions, the banking system has grown rather than been created; and within the United Kingdom itself there have been different lines of development followed by different communities: Scottish banking has developed along lines different from those of the English, though in practice there is agreement in the main functions.

In Volume I we traced the development of the English banking system, the settling of the position of the Bank of England as the Central Bank of the country, and the rise of the "Big Five" joint-stock banks. We noted that the primary function of the commercial banks is the receipt of funds from clients and the providing of facilities, through the cheque system, by which these funds may be transferred from one person to another—that is, they are engaged in deposit banking; that is the primary function of banks in the United Kingdom and in the United States of America. They are borrowers and lenders of money, and in pursuance of this function other functions have been developed, such as dealing in Bills of Exchange and Promissory Notes, lending money upon security, acting as agents for customers in the collection of dividends and the purchase of securities, and the safeguarding of the valuables and documents placed in their care by clients. Then, again, the granting of credit for the carrying on of the functions of the commercial and industrial system is a function which has become of the greatest importance in the modern world.

The savings banks we have already distinguished from the

commercial banks; the small class of private banks included under the title of commercial banks has become practically extinct, their disappearance being due to the loss of public confidence in them, the increasing use of cheques in place of the notes issued by them, and the greater demands of industry and commerce as the economic system developed in scale and complexity.

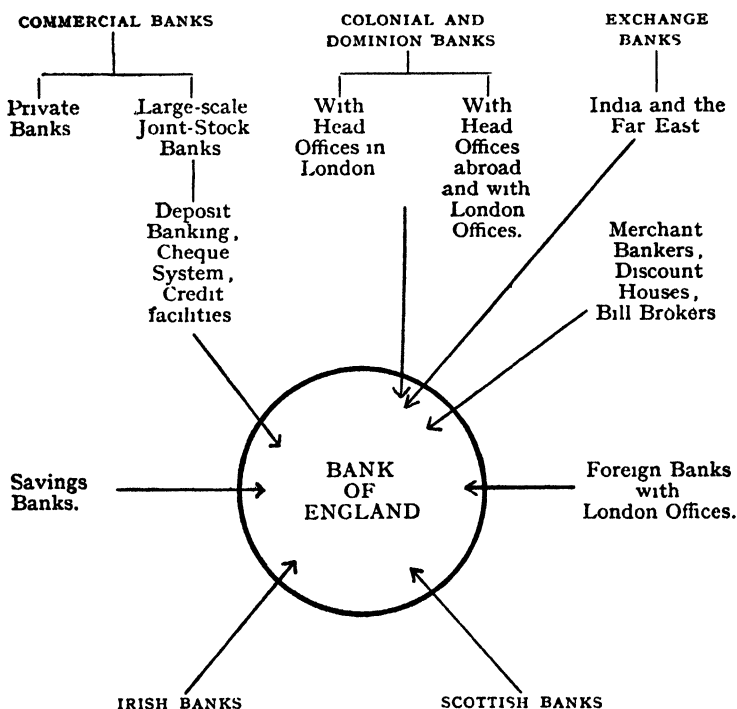


FIG 21 —THE BRITISH BANKING SYSTEM

The growth of commercial banking was accompanied by a tendency towards amalgamation; the fear of the creation of a "money trust" resulting from this tendency led to the appointment of a Treasury Committee in 1918 to consider the matter, and its report recommended legislation making any further amalgamation subject to the approval of the Treasury and of the Board of Trade. Although specific legislation was not adopted to further this recommendation, Treasury approval is in fact obtained for any amalgamation. Since the Treasury Report, a

number of amalgamations have taken place, a notable one being that in 1927 of the Lancashire and Yorkshire Bank and the Bank of Liverpool and Martins, resulting in the formation of Martins Bank, an important bank approaching in rank to the Big Five.

There has been a development, too, in the operation of banking through branches. The combination of these two tendencies is well illustrated in the case of the absorption of Parr's Bank by the London County and Westminster Bank in 1918, the former having the majority of its branches in the manufacturing districts of the North, Midlands and West, the latter in the agricultural counties around London. The industrial districts needed credit and the agricultural districts had plenty of deposits, so that the amalgamation was profitable to the customers of both banks, whilst the operating expenses were reduced.¹

Development in Scotland has been along different lines ; there is no Central Bank special to Scotland, the Bank of Scotland having been founded to help commerce and industry and not to act as a central banking institution : this function is carried on by the Bank of England. Eight banks exercise the privilege of issuing notes ; and Bank of England notes also circulate in Scotland. Clearing houses for the clearing of cheques and the exchange of notes have been established in the principal towns, and the note-issuing banks have offices in London, where the final clearing takes place. The English and Scottish banking systems work side by side ; though the Scottish banks are outside the Clearing-House system, they are in close touch with London through their offices there, and London banks own shares in Scottish banks, and Scottish banks own shares in London banks.

As in Scotland, several of the Irish banks issue notes, the Eire Government also issuing notes. Bank of England notes are legal tender in Northern Ireland, but not in Eire. English Clearing banks hold shares in some of the banks in Northern Ireland, and several Irish banks have branches in Eire as well as in Northern Ireland.

In England the large joint-stock banks are grouped around the Bank of England ; they are the London Clearing banks, including the " Big Five ". With the London and country banks are linked the Overseas banks, comprising the Colonial banks, some with head offices in London and others with head offices in the

¹ Truitt: *British Banks and the London Money Market* (Cape, 1936), pp. 63-64.

Dominions and Colonies and with London offices, the whole associated in the British Bankers' Association ; and the Exchange banks, dealing chiefly in the financing of trade between Great Britain and India and the Far East.

In London, also, foreign banks have their offices.

On the Continent, deposit banking lagged behind in development as compared with British and United States banking. The Great Powers of Europe, France and Germany, were slow to make use of the cheque system—much use being made of Bills of Exchange. The Bank of France and the Reichsbank became Central Banks, like the Bank of England.

In the United States the functions of the banks were laid down by law, the banks being corporations chartered either by the Federal Government as "National" banks, or by a State Government. In 1914 the United States was divided into twelve districts for banking purposes, each with a Federal Reserve Bank ; these Federal Reserve Banks were placed under the control of a Federal Reserve Board. The National Banks became member banks of the Reserve Banks, and the State banks were encouraged to join. Federal Reserve notes were created. Official inspectors were appointed to see that banks were carrying on business strictly in accordance with the terms of their charter.

Nevertheless, there is a strong tradition of provincial autonomy in America, and no Central Bank was established with a position analogous to that of the Bank of England, nor was there a movement similar to that of amalgamation and concentration in a capital city such as occurred in Britain. The Reserve Banks were able to establish an efficient system of co-operation and a satisfactory distribution of credit and currency, but they were not able to save the country from the effects of the speculation and panic which followed the boom of 1929 ; from 1933 onwards the Federal Government has had to exercise a stricter control over American banking.

The laying down by law of the functions of a bank has not been followed in this country, but we may distinguish from banks engaged mainly in deposit banking the accepting houses, or "merchant bankers" and the discount houses, which would be regarded on the Continent as carrying on typically banking business.

Deposit banking, as has been pointed out, is the main

function of the British commercial banks. Their chief service to customers is the safe keeping of their deposits; and intimately bound up with this function is the provision of facilities, by means of the cheque system, by which money can be transferred easily, quickly, and safely from one person to another. Though in effect it is credit that passes, and not actual currency, the banks must be prepared to meet customers' demands for currency; they therefore follow a first rule that they must maintain a minimum ratio between the amount of their deposits and the cash they should have ready to meet demands for currency made by their customers. This ratio of cash to deposits ("cash" consisting of currency and balances at the Bank of England which can be immediately turned into cash) is about 10 per cent.

This ratio of 10 per cent has not been laid down by law; it is the figure arrived at from the experience of bankers as being that sufficient to enable them to meet day-to-day demands of their customers. The increasing tendency to make payments by cheque instead of cash would seem to indicate that a lower percentage could be fixed; and, indeed, in November, 1936, the ratio fell for the first time for many years below 10 per cent. *The Economist* has suggested that 8 per cent. might be adequate.

The banker deals with the country's spare cash which is put on deposit temporarily; the money is temporarily invested with him, and he lends money to people who are in need of loans for short periods: the banker's business is with "short money". There are five million active banking accounts in England, and in the course of a year the bankers handle about 450 million cheques. There are deposit accounts held by about three million people on which the cheque system does not ordinarily operate, and there are some millions of small savings accounts.¹

In London and the south it was the custom not to allow interest on current accounts, whilst in the north of England and in Scotland interest was normally allowed on current accounts, the banks charging a commission on the total sum withdrawn by cheque during a given period. On deposit accounts, interest was allowed varying with the notice required for withdrawal, which was anything from seven days to twelve months. The rate of interest for money deposited for seven days is called the "bank deposit rate", the interest being about 2 per cent. below the current Bank

¹ Rt. Hon. Reginald McKenna: *What is Banking?* (Waterlow and Sons, Ltd., reprinted from the *Bankers' Magazine*, December, 1942.)

BALANCE SHEET OF THE MIDLAND

LIABILITIES

	£	s.	d.
Share Capital Authorised			
2,869,079 Shares of £12 each	34,428,948	0	0
2,000,000 Shares of £2 10s each	5,000,000	0	0
5,771,052 Shares of £1 each	5,771,052	0	0
	<u>£45,200,000</u>	<u>0</u>	<u>0</u>
Share Capital Issued			
2,869,079 Shares of £12 each, £2 10s paid	7,172,697	10	0
1,921,677 Shares of £2 10s each, fully paid	4,804,192	10	0
3,181,731 Shares of £1 each, fully paid	3,181,731	0	0
			15,158,621 0 0
Reserve Fund			13,410,609 0 0
Dividend payable on 1st February, 1944			606,344 16 9
Balance of Profit and Loss Account			682,829 18 9
			<u>29,858,404 15 6</u>
Current, Deposit and other Accounts, including provision for Contingencies	838,017,904	15	10
Balances due to Affiliated Companies	21,674,276	16	0
Acceptances and Confirmed Credits on account of Customers			2,976,077 10 5
Engagements on account of Customers			10,478,545 11 11

The Bank has contracts running for the sale of Foreign Currencies to the value of £1,940,089 12s 6d which are covered by purchases to a corresponding amount

The total sum paid to Directors as remuneration for their services is as follows

Fees and Income Tax thereon paid by the Bank	£	s.	d.
	48,275	17	3
Fees and Income Tax thereon paid by Affiliated Companies to such Directors of those Companies as were also Directors of the Bank		6,200	11 1
Total	<u>£54,476</u>	<u>8</u>	<u>4</u>

£903,005,209 9 8

rate, *i.e.*, the official rate of the Bank of England charged for discounting "first-class" or the best type Bills of Exchange.¹

The 10 per cent. ratio of cash to deposits is the bankers' first line of defence. As a second line, they keep, or did keep before the War, an amount of at least 20 per cent. of deposits in short-term bills which were ultimately discountable at the Bank of England, and in loans "on call" to the money market, *i.e.*, loans immediately convertible into cash; these include Treasury Bills (a Government security), trade or commercial Bills, and bank Bills (Bills of Exchange accepted by a bank).

We may now study by means of a bank Balance Sheet the functions of the banker as a borrower and lender of money. In

¹ Since October, 1939, the Bank Rate has been 2% and the deposit rate $\frac{1}{2}\%$ to 1%. In October, 1945, the deposit rate was fixed at $\frac{1}{2}\%$. The banks do not now allow interest on current accounts, but only on deposit accounts, subject to fourteen days' notice of withdrawal, at $\frac{1}{2}\%$.

BANK LIMITED, 31ST DECEMBER, 1943.

ASSETS

Coin, Bank Notes and Balances with the Bank of England			£	s	d
Balances with, and Cheques in course of Collection on other Banks in the British Isles			92,368,917	2	0
Money at Call and Short Notice			35,685,635	3	7
Bills Discounted			33,111,507	8	6
British Treasury Bills	£	s	d		
Other Bills	31,377,069	0	0		
	1,602,869	19	1		
Treasury Deposit Receipts			32,979,938	19	1
Investments at or under Market Value (including £50,000 lodged for Public Account)			291,000,000	0	0
War Loans and other British Government Securities	226,912,071	1	9		
British Corporation and County Stocks	740,767	4	2		
Dominion and Colonial Government Stocks and Bonds	700,410	19	10		
Sundry Investments	363,759	15	7		
			228,717,009	1	4
Advances to Customers and other Accounts, less provision for Doubtful Debts			712,863,007	14	6
Midland Bank Executor and Trustee Company Limited Loans on behalf of Clients			157,984,204	9	7
Liabilities of Customers for Acceptances, Confirmed Credits and Engagements			617,720	3	0
Bank Premises and other properties at cost, less amounts written off			13,454,623	2	4
Yorkshire Penny Bank Limited	£	s	d		
93,750 Shares of £5 each, £3 paid	281,250	0	0		
187,500 Shares of £1 each, fully paid	187,500	0	0		
Proportion of Reserve relative thereto	468,750	0	0		
			937,500	0	0
Shares in Affiliated Companies					
Belfast Banking Company Limited					
200,000 Shares of £12 10s each, £4 paid	800,000	0	0		
Reserve and Undivided Profits	1,205,442	13	0		
			2,005,442	13	0
The Clydesdale Bank Limited					
100,000 Shares of £50 each, £10 paid					
30,000 Shares of £10 each, fully paid	1,300,000	0	0		
Reserve and Undivided Profits	2,157,540	17	4		
			3,457,540	17	4
North of Scotland Bank Limited					
163,000 Shares of £20 each, £7 paid	1,141,000	0	0		
Reserve and Undivided Profits	1,499,429	17	3		
			2,640,429	17	3
Midland Bank Executor and Trustee Company Limited					
200,000 Shares of £5 each, £1 5s paid	250,000	0	0		
Reserve and Undivided Profits	203,921	10	9		
			453,921	10	9
			£903,005,209	9	8

Volume I it was shown that the banks do not control the amount of bank cash, which is increased or diminished by the operations of the Bank of England. The banks have nothing to do with controlling the volume of money; their main business is with the receipt of money on short term from customers and its profitable investment, also on short term. A study of a typical bank's Balance Sheet will make the position of the joint-stock bank clear as far as this point is concerned.

The Balance Sheet of a Joint-Stock Bank.

THE LIABILITIES SIDE.—In the example given, the first item on the Liabilities side shows the *Share Capital Authorised* to be approximately £45 millions; the actual *Share Capital*¹ issued is

¹ Note that in the Balance Sheet given, the £12 shares are £2 10s. paid up, with £2 10s. callable, and reserve liability of £7 per share which is callable only in the event of liquidation.

only about £15 millions, so that a substantial amount of capital remains unissued.

A *Reserve Fund* is also provided out of previous profits to set against any contingencies that may arise.¹ In 1932, for example, the depreciation in the price of their holdings of British Government Securities caused the banks to draw upon their Reserve Funds.

The *Dividend Payable* and *Balance of Profit and Loss Account* are easily understood.

The late Reginald McKenna has told us in his booklet, *What is Banking?* (reprinted from the *Bankers' Magazine*, December, 1942, and published by Waterlow and Sons, Limited), that the number of shareholders in the "Big Five" banks is about 300,000, with an average holding of £220 of capital, worth about £760 at the market price in December, 1942. The dividend received by the average shareholder is about £31 a year, subject to tax. The true capital of the banks, belonging to the shareholders, is, Mr. McKenna pointed out, not the published figure of paid-up capital, on which the rate of dividend is calculated, but the whole of the capital and reserves, the dividend paid on the true capital coming, probably, to about 4 per cent.

Nevertheless, it must be suggested that 300,000 is a small number of people to be responsible for control of the financial affairs of millions. Mr. McKenna has stated that "as a rule the election of a director recommended by the board is not challenged. . . . To leave well alone is a sound maxim, and is happily observed by shareholders so long as a bank shows every sign of good and successful management."² It is not suggested here that the joint-stock banks are well and successfully managed with the welfare of the shareholders rather than that of the community in view; but it must be noted that the soundness of the principle of allowing banking to remain in the hands of joint-stock concerns has been questioned.

To turn to the specimen Balance Sheet again: the liability of the bank to the public, as distinct from its liability to its shareholders, is shown in the item *Current, Deposit and other Accounts*; it is the most important of the liabilities of the bank. Included in "Other Accounts" are items not set out by the banker;

¹ This is not the only provision for contingencies, since the Balance Sheet itself expresses that advances are given "less provision for doubtful debts". Deposits are also stated as "including provision for contingencies". Moreover, the stated reserve fund has been derived from other sources besides profits, particularly premiums on new issues of capital.

² McKenna, *op. cit.*, p. 21.

reserves such as provision for bad and doubtful debts and for depreciation of investments; some are set off against Advances to Customers on the other side of the Balance Sheet.

Acceptances and Confirmed Credits on Account of Customers is an item showing the liability of the bank in respect of acceptances of Bills of Exchange and of the guarantee of letters of credit for customers; the latter are in turn liable to the bank, and thus a corresponding entry appears on the Assets side.

Engagements on Account of Customers include such liabilities as the bank may have incurred in carrying out forward exchange contracts for its customers: *i.e.*, contracts relating to the buying and selling of foreign currencies for delivery at an agreed future time at a rate fixed at the time of the contracts.¹

THE ASSETS SIDE.—The cash reserve which the bank holds in order to meet the demands of customers, its "first line of defence", is *Coin, Bank Notes and Balances with the Bank of England*. This is the item which is preserved at the constant rate of approximately 10 per cent. of deposits: the "cash ratio". The *Balances with, and Cheques in course of Collection on other Banks in the British Isles* represents cheques in course of clearance and amounts due from other banks; it is not quite "cash", but nearly so, since the bulk of it will be turned into cash in the course of a day or two; but cheques may be dishonoured, and cash with another bank is, of course, not the same thing as cash with the Bank of England.

Money at Call and Short Notice consists of money lent to members of the Money Market, such as bill-brokers and stock-jobbers, at a low rate of interest, at periods varying from overnight to seven days, against security consisting almost entirely of short Government securities, Treasury Bills, etc.

Under the heading of *Bills Discounted* a distinction is made between *British Treasury Bills* and *Other Bills*. Treasury Bills have become of great importance since the 1914-1918 war; they are forms of short-dated loan to the Government. Commercial bills have lost a considerable amount of popularity as a means of short-term finance, traders preferring overdrafts. The bills are usually not for longer periods than three months.

After *Treasury Deposit Receipts* (a form of Government borrowing) come *Investments*. These include Government securities,

¹ For a fuller discussion of these last items two, see H. C. F. Holgate, *Contingent Liabilities of the English Commercial Banks* (Gee and Co.), which gives a useful critique of British Bank Balance Sheets.

together with Colonial and Dominion stocks and bonds. They are now generally short-dated, providing a sound and semi-liquid investment at a small but steady return. In normal times they are easily saleable, but the issue becomes somewhat doubtful in times of crisis ; in times of depression there is little demand for money.

Advances to Customers and other Accounts are the most important of the banker's assets, for from these items he obtains the greater part of his profits. The ratio of Advances to Deposits was traditionally 1 : 2, but in the slump of the 'thirties this ratio was reduced considerably.

Liabilities of Customers for Acceptances, Confirmed Credits and Engagements we have already met with as a *per contra* entry on the Liabilities side of the Balance Sheet.

Bank Premises need not detain us ; they are the least realisable of the bank's assets, and are usually shown in the Balance Sheet at a figure far below their market value.

The *Shares in Affiliated Companies and investments in other banks* came about after the 1914-1918 war. Affiliations were a convenient form of association between countries with differing monetary legal and banking systems, one which would not mean the absorption and abolition of known and honoured institutions in Scotland and Northern Ireland. The banks, therefore, continued to work under local management and under their old names. The Companies Act of 1929 made it compulsory for the banks to set out the amount and nature of their holdings in other companies. The figures given, therefore, show the extent of the holdings of the great joint-stock banks in other banks ; and we may note once again the raising of the question as to how far the process of private enterprise should be allowed in the case of an intricate financial system which, under a planned world, should exist for the sake of providing financial machinery for the community. Once again, the question is one of principle ; it is not suggested that the great joint-stock banks are running the system solely in the interests of their shareholders.

These, then, are the liabilities and assets of the banker ; the statement shows where the banker gets his money from, and what he does with it. The banker makes his profits by lending money and obtaining the interest on these loans. Nationalisation would doubtless eliminate the profit *motive* ; but, as has been pointed out, the motive of the bankers to-day cannot fairly be described as merely profit-making.

The Central Bank—The Bank of England.

The Macmillan Report observed that the banking system formed a vital link between the two aspects of the complex financial structure ; on the one hand there are the problems of the price level, and on the other, and related to them, there are the problems raised by the control by the banks of the mass of purchasing power which they have created.

The financial market organisation comprises several markets : there is a call-loan market in which funds available for very short periods are lent out ; a short-period market for short-term loans ; a capital market for long-term loans ; an organisation for transferring rights in already existing securities, *i.e.*, the Stock Exchange ; and organisations dealing with savings problems of a special character, including the savings banks, insurance companies, and agricultural mortgage banks. The necessity for some kind of organisation for keeping the whole financial structure stable was recognised early in the development of the financial system. In this country this central institution, the Central Bank, is the Bank of England.

The importance of avoiding the over-issue of paper money renders it necessary that a Central Bank should possess a monopoly of the note issue. But a monopoly of the note issue does not of itself secure control over the money of a country, for, as we have seen, " money " in the modern world is a word of elastic connotation, comprising " representative money " in the form of such documents as cheques and Bills of Exchange—credit instruments. Over the Government issue of money—the currency—the Bank of England has very little power of control ; it manages the currency on behalf of the Government, and is paid for its services, but it is the Government which, acting through the Treasury, is responsible for the expansion or contraction of the currency.¹

It is the business of the Bank to watch the reserve of gold ; under the normal gold-standard system, the quantity of gold held by the Bank depends on the issue of notes—not *vice versa*, as is sometimes thought : if more notes are required, the Bank has either to obtain more gold or increase the Fiduciary Issue. In 1936, when large numbers of Bank of England notes were bought by French people under the fear of a fall in the franc, one or other of these alternatives had to be chosen, and as a result of a conference between the Treasury and the Bank, it

¹ See note on p. 110, *ante*.

was decided to buy more gold, in order to back the increased issue of Bank of England notes.

The possibility of control of the volume of credit arises when a Central Bank holds the reserves of the commercial banks of the country, for then an expansion of credit on the part of the Central Bank increases these reserves of the commercial banks, and they are able to increase their loans to the trading community. The control exercised by the Bank of England of the credit of the country is a consequence of the practice of four functions : the issuing of the currency notes of the country ; the holding of the reserves of the commercial banks ; the practice of buying and selling securities ; and the discounting of Bills of Exchange.

We have seen ¹ that the power of the commercial banks to make loans is limited by the amount of their cash, and that they have no power of control over the total of bank cash, which is increased or diminished by the Bank of England by the methods of raising or lowering the Bank Rate (the rate at which the Bank will discount first-class Bills of Exchange) and of " open market operations ". Should a contraction of credit be thought desirable, the Bank will raise the Bank Rate ; the other rates in the London Money Market will be correspondingly raised, according to the custom of the Market, and borrowing will be discouraged. The effect of raising the Bank Rate is reinforced by the Bank's selling securities to the Market, the cash given in exchange for these securities depleting the reserves of the commercial banks, and so restricting their power to grant credit. Bearing in mind the " 10 per cent. ratio ", it will be realised that a £100 reduction of cash at the Bank of England suffered by a commercial bank means that its power to grant loans is reduced by £1,000.

It is important to realise that these financial tools are not methods by which the Bank can expand or contract the volume of the trade and industry of the country, that the Bank cannot save us from depression and set the wheels of industry turning by waving the magic wand of discount-rate policy and open-market operations. The process works the other way round. As yet, very little is known about the possibilities of control of the alternation of boom and slump known as the " trade cycle ". No doubt wider powers given to the central banking institution of the country would go a long way towards evening out the rhythm of trade industry, and a firm planning policy on the part of an authority endowed with sufficient powers would do much

¹ Volume I, Chapter XII.

to avoid the wretched progression of unhealthy "boom" and searing depression. What, under present conditions, the Bank can do by its special methods of controlling the volume of credit is to look ahead and provide for contingencies. When it does decide to take up its tools, it does so after consultation with the Treasury and with other interests involved.

The Bank may find it necessary to restrict credit in the very midst of a boom; the speeding up of industry and the building up of traders' stocks under boom conditions will very likely result in relative over-production and over-stocking through an unduly optimistic estimate of future conditions. It will then be the business of the Bank to endeavour to adopt means of checking the boom in order to avoid a slump. It is not certain that the efforts of the Bank will be successful, but at least pressure is exerted in the right direction.

The general consequences of the tightening or relaxation of the volume and terms of credit as a result of "Bank Rate policy", and the limitations to its usefulness, have been well set out in the Macmillan Report.¹ These are :

(1) Raising the Bank Rate relatively to rates elsewhere means "dear money", and dear money tends to diminish the amount a country lends abroad or to increase the amount which it borrows from abroad. Short-term funds are attracted to the country immediately, and long-term funds are also affected in this way, so that a favourable effect is exercised on the country's balance of international payments and hence on the foreign exchanges and on its gold reserves. We shall be dealing with the question of foreign exchanges later in this volume.

(2) At home, enterprise is curtailed and there is a diminution in the volume of purchasing power put into circulation. Some part of this purchasing power would have been spent on imports, or on home-produced goods. Thus, imports are curtailed, and home-produced goods released for export. A favourable effect is thus exercised on the country's "visible" balance of trade, and thus on the balance of international payments, and hence on its foreign exchanges and on its gold reserves.

(3) The effect on producers and traders at home of causing money to become "dear" is to lower prices : the stocks of wholesale dealers are financed by short-term loans, and a rise in the short-term interest rates increases the cost of holding stocks; they therefore curtail their orders to producers, who restrict their

¹ Paras. 214-221.

output and lower their prices in order to sell their products. Such a fall in prices is again favourable to the country's "visible" balance of trade.

(4) The fall in prices as the result of dear money is not accompanied by a fall in costs, so that if it continues for some time the producers are impelled to reduce their costs by reducing the payment going to the various factors of production, including wages. The lowering of prices when costs themselves have fallen causes the gain to the visible trade balance to be more durable and reliable.

The framers of the Macmillan Report state that in their judgment Bank Rate policy "is an absolute necessity for the sound management of a monetary system, and that it is a most delicate and beautiful instrument for the purpose". Nevertheless, they are careful to point out that this policy is a means of maintaining the stability of the exchanges rather than the stability of business, and a consequence of its performance of this function is that serious disturbances which may be affecting the rest of the world are transmitted to the British credit system. In order that the whole system of commerce and industry should function with the least possible disturbance, international co-operation in keeping a steady rate of industrial activity is necessary.

One limitation of the usefulness of the Bank Rate policy is the uncertainty which often prevails in the business world as to the significance of a change in the Bank Rate in any particular instance. Such a change may be made in order to contract credit, and thus curtail over-optimistic production; or it may be made merely as an attempt to correct a temporary maladjustment in the international short-loan position by equalising funds between the various international markets. The study of the relevant facts and the ability to interpret them on the part of the business public, and a readiness on the part of the Bank to inform that public of its views on the matter, would go very far to correct this limitation.

A fuller knowledge of economic factors and more complete scientific and statistical information about economic activity on the part of the banking authorities, together with power to act given to some responsible authority, would correct the tardiness necessarily consequent upon movements of gold, themselves only a late symptom of a situation which has been taking place for a considerable time.

For the regulation of the expansion or contraction of enterprise

and the accommodation of costs to changes in the internal situation or in the international price level, Bank Rate policy by itself is efficacious only to a limited extent. The restriction of output and business profits and subsequent reduction of wages and increase of unemployment are not effects to be regarded with equanimity from a social point of view. Once depression has begun, moreover, no deliberate policy is necessary to make money dear. When substantial changes in the value of money are in question, and changes in the level of our industrial costs are correspondingly necessary, other supplementary means are necessary to maintain the international value of our currency. To reduce costs by causing unemployment and distress is to substitute one maladjustment for another.

The immediate effect of the carrying out by the Bank of England of its Bank Rate policy and its "open market operations" falls on the commercial banks' more liquid assets—*i.e.*, their bills and their loans to the money market; and next on their investments. The first advances the bankers will cut down are those of a financial or personal character; the banks regard the accommodation to their customers for normal business purposes as having the first claim on their resources, and they will be reluctant to refuse advances for normal business requirements in the way of liquid resources. It is new investment which will suffer from a contraction of credit; and the demands for accommodation on the part of industry and trade will be affected only indirectly, *i.e.*, by the effect of credit contraction on the volume and profitability of business as a whole.

There is thus ground for controversy as to the precise nature of the effects of the increase or decrease of credit by the banks on the volume of business activity in general, and thus of the efficacy of discount-rate policy. Perhaps it would be true to say that discount-rate policy has the effect of encouraging the movement of events in a particular direction, rather than of initiating such movements. The student cannot do better than refer to the Macmillan Report itself for a full discussion of the problems of the relation between Finance and Industry.

The Bank of England Return.

We have seen that one of the primary functions of the Bank of England is the issue of notes as legal tender; it is in regard to this power and in regard to its granting of loans to the State, that the

BANK OF ENGLAND RETURN, WEEK ENDED JUNE 28, 1939.

Issue Department.

Notes Issued .		Government Debt .	£11,015,100
In Circulation . .	£498,979,676	Other Government Securities .	288,193,906
In Banking Department . .	27,434,441	Other Securities .	78,411
		Silver Coin . .	712,583
		Fiduciary Issue . .	300,000,000
		Gold Coin and Bullion (at 148s 6d. per oz. fine) . .	226,414,117
	£526,414,117		£526,414,117

Banking Department.

Proprietors' Capital .	£14,553,000	Government Securities .	£113,856,164
Rest . .	3,390,275	Other Securities .	
Public Deposits * .	15,385,208	Discounts and Advances . .	6,836,851
Other Deposits .		Securities . .	22,877,545
Bankers . .	101,441,994	Notes . .	27,434,441
Other Accounts .	36,955,143	Gold and Silver Coin .	720,619
	£171,725,620		£171,725,620

* Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

BANK OF ENGLAND RETURN, WEEK ENDED MAY 17, 1944

Issue Department

Notes Issued		Government Debt .	£11,015,100
In Circulation . .	£1,126,290,595	Other Government Securities .	1,138,182,219
In Banking Department . .	23,951,123	Other Securities .	788,731
		Silver Coin . .	13,950
		Fiduciary Issue .	1,150,000,000
		Gold Coin and Bullion (at 168s. od. per oz. fine) . .	241,718
	£1,150,241,718		£1,150,241,718

Banking Department.

Proprietors' Capital .	£14,553,000	Government Securities .	£210,492,151
Rest . .	3,198,273	Other Securities .	
Public Deposits * .	16,571,051	Discounts and Advances . .	5,120,811
Other Deposits .		Securities . .	15,902,935
Bankers . .	167,236,213	Notes . .	23,951,123
Other Accounts .	54,439,443	Gold and Silver Coin .	530,960
	£255,997,980		£255,997,980

* Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

Bank as a private institution was subjected to legal control. Some further consideration of this note-issuing function of the Bank is necessary.

The Bank Charter Act of 1844 laid it down that the issue of notes by the Bank should be kept distinct from its banking business, and that the accounts of the Bank should be published weekly in the form of a Return showing two balance sheets, one for the Issue Department, and the other for the Banking Department. The balance sheet of the Issue Department shows the amount of the notes issued, the amounts of those in circulation and those in the Banking Department being shown separately. On the other side, the Government Debt of £11,015,100 is the Bank's original loan to the Government. The Government pays $2\frac{1}{2}$ per cent. interest on this loan, and if it were ever repaid, the Bank, according to the 1844 Act, would lose its charter. The total of notes, less the amount of gold coin and bullion backing these notes, gives the amount of the *Fiduciary Issue*; the *Other Government Securities* consist of Government stocks, while the *Other Securities* consist of securities such as commercial bills, foreign currencies and foreign securities; in 1928 the Bank was allowed to include silver coin to a value not exceeding £5½ millions in value among the securities held against the Fiduciary Issue.

The Bank Charter Act fixed the original Fiduciary Issue at some £14 millions; as the Bank took over the lapsed issues of the country banks to the extent of two-thirds of those issues, the Fiduciary Issue was increased (it reached £18,450,000 in 1914). It was not until 1921 that the whole of the private issues had lapsed; the Fiduciary Issue of the Bank then stood at £19¾ millions. The Bank was then in the position of not being able to increase the circulation of notes except by increasing its stock of gold. Gold could be attracted by raising the Bank Rate, thus holding out the prospect of profitable investment at a higher rate of interest.

Except for suspensions due to the crises of 1847, 1857 and 1866, the system worked well, until the outbreak of war in 1914 brought a fresh crisis. The creation of Treasury Notes and their subsequent amalgamation with the Bank of England issue in 1928, raising the Fiduciary Issue to £260,000,000, have already been discussed in Volume I, where was traced also the subsequent increase of the Fiduciary Issue to over £1,000 millions.¹

¹ Vol. I, pp. 165-8.

The Banking Department is a deposit bank, so that the balance sheet resembles that of an ordinary bank. The *Proprietors' Capital* is considered by the Macmillan Report too small; it should be increased in order to augment the resources of the Bank (Para. 370). The *Rest* is a reserve not normally allowed to fall below a figure of £3,000,000. The *Public Deposits* are money deposited with the Bank by the Government, including the Exchequer Account and other accounts held in connection with the National Debt, the collection of taxes and various Government funds. *Bankers' Deposits* illustrate the rôle of the Bank of England as the bankers' bank; they relate exclusively to British banks conducting their main business in this country. Included in the *Other Deposits* are the deposits of British banks whose main activities are in the Dominions (including the Bank of Ireland) and in foreign countries; the balances of foreign central banks, Colonial banks, merchant banks and financial houses, Indian and Colonial Governments; the dividend accounts for securities administered by the Bank of England managed by the Bank but not the direct obligations of the British Government; and, finally, the accounts of the Bank of England's private customers.

On the assets side, the Return shows various *Securities*, besides *Gold and Silver Coin*, and Bank notes not in circulation but in the hands of the Banking Department and, of course, corresponding in amount to the figure shown in the Liabilities side of the Issue Department. The *Government Securities* include the direct obligations of the British Government, including Treasury Bills and any Ways and Means Advances made to the Exchequer.¹ *Discounts and Advances* comprise Bills of Exchange and Treasury Bills discounted at the Bank, and advances made to the money market covered by first-class bills or other securities of equal value; the usual practice relating to these bills is that they should carry at least two approved British signatures of which one should be that of the acceptor, and that the bills should have not less than 14 days to run before maturity.

Other Securities may include stocks guaranteed by the British Government, Indian, Colonial or foreign securities, miscellaneous securities and commercial bills.

The Bank of England Return, though its form may be criticised (the amalgamation of the two statements is recommended

¹ See *post*, p. 246.

in the Macmillan Report), and though its details may be appreciated only by the expert, does give broad information intelligible to the general student. In outline, it shows the state of the national currency and the position of the Bank as the Government's banker and as the bankers' bank.

The proportion of the notes and coin held in the Banking Department to the total of Public and Other Deposits is known as "the Proportion". The percentage of gold holdings in both Departments to the total of deposits and notes in circulation is called the "Reserve Ratio".

The partial independence of the Bank of England is some safeguard against the danger of inflation, which might arise if the banking system were to be nationalised and the Government were to yield easily to the temptation to issue notes in order to provide itself with money. As matters stand, the Treasury does now exercise a considerable control over the Bank of England.

Certainly, as has been shown in Volume I,¹ the joint-stock banks do not control the volume of money in the country. It would be well to examine here the statement that bank loans create deposits so that in effect the volume of credit is determined by the banks.

The Banks and the Credit System.

Advances to bank customers are made either by way of overdraft on current account or by a fixed loan. In the former case, the customer is authorised to draw cheques up to a given limit on his current account, interest being charged on the balance. In the case of a loan, the customer's current account is credited with the amount of the loan, and a "Loan Account" is debited. Interest is paid on the loan; and, therefore, in many respects, borrowing on overdraft is more advantageous to the customer, since he pays interest only on the amount of credit he actually utilises, and remittances paid into his account reduce the extent of his indebtedness; the method is often used to finance the sale of goods on credit.

Advances to customers are made against "collateral security"; the term is used to denote security in addition to the banker's right of action against the customer personally, and, also, security additional to that already provided, as when more than one type of security covers the same debt and security is given

¹ Pp 185-7

by a third person, such as a guaratee. Securities are usually stocks and shares, life policies, documents of title, and land.

The money which is entrusted to a banker by his customers is withdrawable either on demand or at short notice, so that he is under a constant obligation to maintain the liquidity of his advances; in British banking it has not been considered wise for the banking system to finance new enterprises and for bankers to become involved in industrial undertakings, as was the case on the Continent. Bank loans are for a limited period only, and a discrimination is made against "speculative" advances.

When a bank grants a loan to a customer, the customer is enabled to draw cheques to the amount granted. He uses this money to pay his own liabilities, and the persons to whom he pays it pay their cheques into their own banking accounts. The cash reserves of the bank granting the loan will thus be lost to other banks (for in considering this problem it is necessary to treat the clearing banks as forming one whole), so that in creating the original deposit the banker has to have regard to his 10 per cent. ratio. In his balance sheet, "Advances to Customers" is increased, and "Cash in hand and at the Bank of England" decreased.

The bank does not create something out of nothing, simply by writing the particulars of the loan in its books. It has created purchasing power, virtually by lending its credit, convertible into money; it has, in a sense, created a deposit. But in practice this power is very strictly limited by the necessity for keeping reserves of real resources, as distinct from book-keeping entries, against advances. The ability of the banks to grant loans to customers depends on the provision of an adequate basis of cash by the Bank of England. No single bank can grant loans without regard to the policy of the other banks, for an adverse balance with respect to other banks decreases its reserve at the bankers' bank, the Bank of England; and even if all the banks decided to increase their loans together in exactly the same proportion, they are still dependent on the cash reserves provided at the Bank. Thus, it is the Central Bank which ultimately determines the supply of credit.

The Merchant Bankers.

In this discussion of the British banking system it is necessary to consider the important part played by the Merchant Bankers

or Accepting Houses. They are not bankers in the technical sense of being deposit banks, but rather banks performing special functions which have grown up with the deposit banking system.

Nearly all these merchant bankers have a foreign origin, having been drawn to London by the growth of England's trade and industry during the nineteenth century, but they have been established in London for so long that they have come to be regarded as thoroughly British institutions. Unlike the private deposit banks, they did not become absorbed into the joint-stock banking system, but carried on specialised functions of their own.

Originally they were traders on their own account, dealing in such commodities as cotton, wool and timber. Their reputation grew to such an extent that they developed the business of accepting Bills of Exchange for undertakings not so well known—for, in practice, the extent to which a Bill of Exchange may be negotiated depends on the reputation of the acceptor. This extension of their functions became so profitable that it became their main function, and the names of Baring, Rothschild, and Schroeder became prominent as those of great financial houses. They charge a commission for lending their good name, and by their activities in causing Bills of Exchange to circulate enable the international payment of debts for goods and services to be made without the use of currency until quite recently, international trade was financed mainly by Bills of Exchange drawn on banks or banking houses, the transactions being carried on through the banks of the importer and exporter respectively. The merchant bankers also acted as financial advisers to foreign Governments, and arranged credits on their behalf in London. The weight of their liabilities has caused them to turn to the limited liability joint-stock organisation for the sake of security; *e.g.*, in 1920 C. and J. Hambro and Sons amalgamated with the British Bank of Northern Commerce to form Hambro's Bank.

The war of 1914-1918 disorganised the connections of the acceptance houses with their associations on the Continent, and the practice arose of granting credits only through the intermediary of and with the guarantee of foreign banks, the English banks giving credits to the foreign banks, whose clients drew on the foreign acceptor to whom the foreign bank had given a guarantee. In consequence of this procedure, English and American and foreign deposit banks have entered into competi-

tion with the acceptance houses. The Colonial banks, with offices in London, finance trade between England and the Colonies ; and the Exchange banks finance trade with India and the Far East.

The Discount Houses.

We have seen (in Volume I, Ch. XII), that in its widest sense the London Money Market comprises the whole machinery for the provision of credit and finance to the British Isles and the Empire,

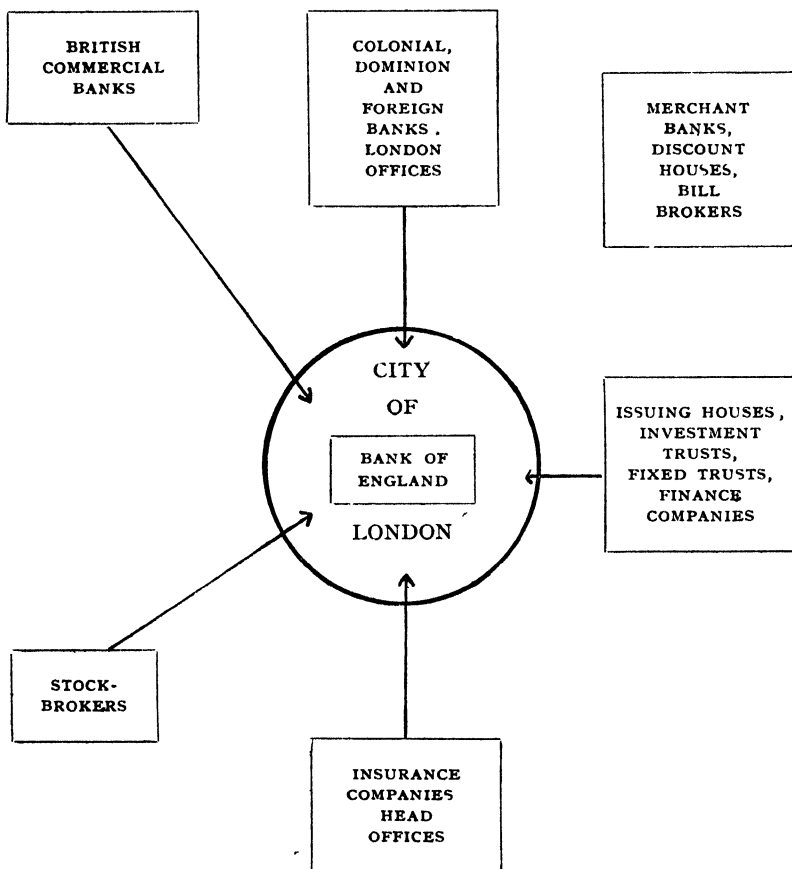


FIG 22 —THE BRITISH FINANCIAL SYSTEM

and, indeed, to the world. At the hub is the Bank of England ; the system embraces the British clearing banks and other joint-stock banks, and the Dominion and foreign banks, the acceptance

houses and merchant bankers—described as one or the other in so far as their main business is the acceptance of bills or the floating of long-term loans—and the discount houses and bill-brokers. To a certain extent the Stock Exchange, the insurance companies and all those engaged in industry and shipping and, in fact, all potential borrowers and lenders, may be included in the London Money Market, London having become the centre of the world's financial business.

We have described broadly the functions of the Bank of England, the joint-stock banks and the merchant bankers, and it remains to fill in the other parts of the picture presented by describing the functions of the other institutions functioning in the banking and financial system; already it has become apparent that the banking system is closely connected with activities other than deposit banking alone.

In its narrower sense the Money Market is regarded primarily as the market dealing in Bills of Exchange, and it is then often referred to as the Discount Market. It is now necessary to describe briefly the methods by which Bills of Exchange are used as an international means of payment in trade.

When a trader abroad, say in America, sells goods to a customer in this country, he draws a Bill of Exchange on the British merchant, ordering him to pay the sum of money concerned. The bill will probably be drawn in sterling, in view of London's pre-eminence in the financial system: it will be a "sterling bill". The documents giving the consignee the right of possession to the goods will not be transferred to the British customer until the bill has been accepted. The Britisher may accept the bill himself, but, as we have seen, if he has not a very great reputation in the financial world, he will probably get it accepted by one of the acceptance houses—which, of course, is in a position to secure favourable rates of discount (see Fig. 24).

Alternatively, the importer may get his own bank to finance the transaction, the bank issuing a letter of credit in favour of the exporter authorising him to draw bills on the issuing bank up to the amount of the transaction.

Whatever the method of financing the transaction—either by trade bills drawn and accepted by merchants or by bank bills drawn by a merchant (usually the seller of the goods) and accepted by a bank or accepting house—the position is that there is a bill on the market entitling the holder to pounds in London. Where

a joint-stock bank accepts, it is usual for the facilities to be granted through the channel of and under the guarantee of a foreign bank, the customers of the foreign bank drawing sterling bills on London.

For the purposes of this section, it is sufficient to note at present that the discount houses are houses specialising in Bills of Exchange; they may hold them until maturity, but they may sell them when there is a prospect of making a profit. This opportunity arises when somebody is looking for a bill in order to make a payment abroad. An American trader may have bought goods from a British exporter; he will buy for dollars a sterling bill offered for sale in the Money Market.

Before turning to the bill-brokers, who may be regarded as the key to the Money Market, we may note that their functions are also carried on by the discount houses. The larger undertakings also are deposit bankers, their depositors consisting of foreign banks, leading traders, and merchants; payment is made on withdrawal by giving the depositor a cheque on their own bankers. Their resources consist of their paid-up capital and the deposits of clients, and they borrow money in the short-term market.

The inland Bill of Exchange has not been dealt in by the discount houses and bill-brokers, but by the joint-stock banks. Both the inland bill and the foreign bill have not been used so greatly of late years, and to offset the decline of their business in Bills of Exchange, the discount houses have taken up large holdings of Treasury Bills, which are short-dated Government securities; the Government invites financial institutions to "tender" for these bills. They are an ideal form of investment, and are a method of finance adopted by other countries. Since the 1914-1918 War, the total volume of Treasury Bills outstanding has exceeded that of commercial bills. For some time the system of subscribing by tender was replaced by one of offers at a fixed rate, which was often varied, whilst the rate and period were also varied—hence the name of bills "on tap". The system of fixed rates ceased in 1921, but agreement between the banks and the discount houses as to the rate at which the Government could discount bills enabled some stability to be attained.

The discount market is the link between the Bank of England and the commercial banks, it forms the first outlet for the surplus funds held by the banks, and it is to this market that the

banks first turn when they have need to replenish their reserves, by withdrawing their funds. If by this withdrawal a shortage of funds is caused in the market, the latter borrows from the Bank of England.

The Bill-Brokers.

The bill-brokers buy and sell bills, making a profit on the difference between the average rate earned on their transactions and the average rate they pay for short-term loans from the banks. They may sell the bills they acquire to the banks outright, or the bills may be left with the banks as security for the loans. In so far as the discount houses borrow funds from the banks and use them for discounting bills, they act as brokers; hence these houses are also described as bill-brokers.

The money lent by the banks to the bill-brokers is for short periods only, usually a week, and sometimes only overnight.

In order to understand what the bill-broker does, it is necessary to remember that the discounting of a bill is equivalent to lending money on the security of the bill; by discounting a bill one lends to the holder the amount of the bill less the amount of discount deducted. The discount brokers, then, perform one of the functions of the joint-stock banks: they lend and borrow money. Their special knowledge of the financial standing of drawers and endorsers and acceptors makes them analogous to the brokers on the produce exchanges; instead of dealing in ordinary commodities, they are dealers in loans of money for short periods. They provide the holders of bills with ready cash, either holding the bills until they mature, or disposing of them, or selling them again to the banks, thus acting as specialists in credit on behalf of the banks.

The discount market in London consists of three large public companies, with capital and reserves amounting to over £6 millions, four private companies with a capital of over £1,600,000, a number of private firms, and a few "running brokers", of whom there used to be eight, but who have now almost entirely disappeared. These running brokers acted as intermediaries, obtaining a commission by putting parties with different types of bills in touch with one another.

The method of dealing is for representatives of the discount-market firms to call on the banks, and to arrange for loans maturing on the day to be renewed or repaid, to determine

whether additional loans shall be made, and to consult regarding the bills which the discount broker has for sale. The bankers

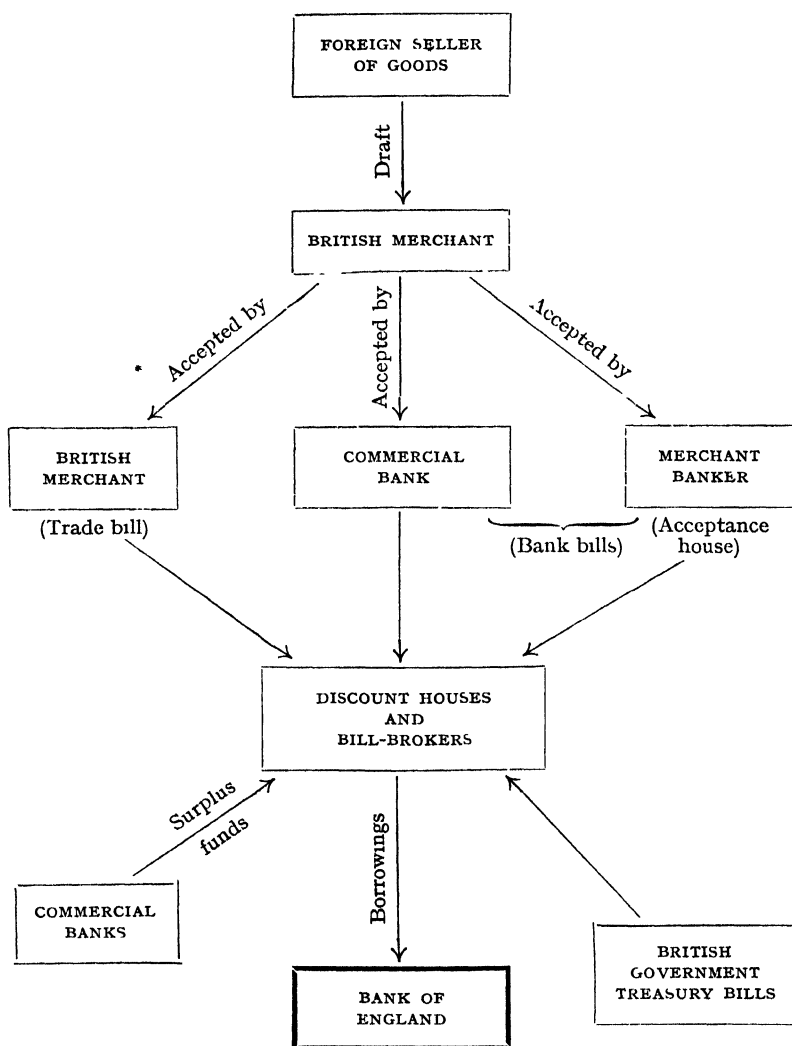


FIG. 23 —THE DISCOUNT MARKET.

have to meet heavy demands for cash at certain periods, *e.g.*, at the end of the year, and it is a convenience for them to have bills maturing a day or two before. The brokers fulfil a very useful

function to the banks in holding bills until the bankers want them; in addition, they guarantee the bills they discount with the banks. Thus they build up a reservoir of funds. Walter Leaf, in *Banking*,¹ describes the function of the bill market, from the banker's point of view, as that of a shock absorber, spreading out evenly the strains resulting from the irregularity of the needs of international trade, and taking from the banks the more speculative part of these chances.

Because, too, in case the level of bank cash threatens to fall below the level of safety, the banks can fall back on their "reserve line", and call in from the discount houses enough of the "money at call" to restore the position, the discount market enables the banks to hold smaller reserves of cash than would otherwise be the case. The banks charge a very low rate of interest (normally about $\frac{1}{2}$ per cent. per annum) for this type of loan. When the calls of the banks are heavy, the discount market has to go to the Bank of England, the ultimate reserve of the whole system, in order to borrow money to repay the loans; it either "rediscunts" or sells approved bills or Treasury Bills at Bank Rate to the Bank, or borrows for about a week on the security of bills at $\frac{1}{2}$ per cent. above Bank Rate. In this case the discount brokers make a loss, for they can buy bills only at just over $\frac{1}{2}$ per cent. The margins on which the bill-broker work are, therefore, fine ones, and call for a high degree of skill and foresight.

The trade barriers and instability of currencies of recent years have caused the volume of commercial bills on London to fall very much below its former level, and the most important part of the discount market's business has been in the discounting of Treasury Bills of the British Government, no skill or special knowledge is needed for this type of discounting, so that the skill and experience of the bill-brokers have counted for little in recent years.

As for the future of the "bill on London", this will depend on the opportunities available for foreign banking business after the Second World War. The revival of trade after the immediate post-War period will give opportunities for the banks to re-establish contacts with former markets and once more set up a body of information about the trading and commercial conditions. In the 1920's the grants of large credits to German and Contin-

¹ *Op. cit.*, pp. 223-224 (fourth edition, 1943).

ental banks at low rates had an element of speculation in them, in that the banks were not in direct touch with the merchants and shippers using the financial facilities, and the reward was seen in the defaults of the 'thirties, causing such losses to British and American banks. Perhaps the lesson has been a salutary one, and the field will be developed rather by the merchant bankers and acceptance houses, working mainly on their own resources. The Macmillan Report recommended an extension of the commercial bill in the home business (Para. 391), and there is not lacking support for the commercial bill on London as one of the main features of finance after the Second World War. Just before the outbreak of the Second World War, the amount of commercial bills sent to London for discount ran into hundreds of millions of pounds a year.

The Other Banks.

In order to complete our survey of the banking system, we shall glance at the other banks in the London Money Market system—with which, of course, the banks are intimately connected. The Colonial and Dominion banks, *e.g.*, the Australian and New Zealand Banks, operate mainly in their respective Dominions, the Exchange banks are concerned mainly with the financing of trade with India and the Far East, *e.g.*, the Mercantile Bank of India, which pursues its activities not only in India, but also in Malay, China and the Dutch East Indies.

Besides dealing in short-term funds on the London Money Market, these banks play an important part in the trade of the Empire and the World; they finance exports from the Empire to London, act as transfer agents and clearing-houses for settlements in sterling between the branches, act as bankers to Dominion and Colonial industrial and commercial undertakings which have head offices in London, and issue Dominion and Colonial loans.

The "Anglo-Foreign" banks are British banks operating abroad—mainly, except for an important South American group, on the Continent. The depression of the 'thirties affected their activities a great deal; and since the outbreak of the Second World War these activities have been still further restricted.

Foreign banks operated in London usually through a branch, sometimes by a representative keeping in touch with their London correspondents, and sometimes by a subsidiary formed under the English law and thus obtaining the favourable rates

accorded to a British signature. The foreign banks working in London before the War comprised mainly French, American, Japanese and Italian banks.

Summary of the Banking System.

It will be profitable as well as interesting to survey the scene again in brief, in order to tie the various strands together and build up a serviceable picture of the fabric of the banking system.

The heart of the whole system lies in the City of London, where are situated the head offices and foreign departments of the "Big Five" and other English banks; the London offices of the Scottish, Dominion, Colonial and foreign banks; the offices of the merchant banks and discount houses; the Stock Exchange and offices of stockbroking firms; and the head offices of the great insurance companies. In the centre, the heart within the heart, is the Bank of England. The square mile of the City of London, the "City", comprises the centralised headquarters of the group of financial institutions making up the machine which enables payments of money to be made quickly, easily and safely, without the necessity of transporting coin or notes, which undertakes the financial arrangements necessary to enable national and international commercial transactions to be carried through expeditiously; which safeguards and provides for the investments of the savings of the community; and which provides a market for the exchange of the money of one country into that of another.

At the hub is the Bank of England, regulating the monetary system of the country, enjoying the monopoly of the note issue and preserving the nation's store of gold, and acting as the banker to the Departments of State. It acts as the banker of the other banks in the system, holding their cash reserves, and, in the exercise of this function, controlling the credit structure of the country.

The commercial banks comprise the great joint-stock banks, the "Big Five"; a number of smaller banks; the Scottish banks; and a few private banks. Their main function is the safeguarding of their clients' deposits: they are engaged mainly in "deposit banking", and out of this primary function has developed the system under which payments are made by cheque. The deposit banks keep a proportion of their total deposits in cash in notes and coin and "cash at the Bank of England", equivalent to cash, withdrawable immediately.

Another proportion is lent to the Money Market for short periods of from a day to a week on the security of Treasury Bills or Bills of Exchange; some of their resources are invested in Treasury Bills and in commercial bills having not more than three months to run; some are invested in Government and other high-class securities; and some are lent out to customers borrowing for private or business purposes.

Cheques by one bank on another are cleared through Clearing Houses; there are local clearing houses, but the London Clearing House provides the machinery for settling nearly the whole of the clearing business of the country. The banks which are members of the London Clearing House, and many other banks, including Empire banks and foreign central banks, keep an account with the Bank of England; the eleven clearing banks are the "Big Five" (Barclays, Lloyds, Midland, National Provincial and Westminster), and Coutts and Co., District Bank, Martins, National, Glyn, Mills and Co., and Williams Deacons. The Metropolitan and Country cheque clearings now form one single clearing with a large part of the Town clearing.

The Merchant Bankers or Acceptance Houses have as their primary function the financing of trade (that is, the arranging of the settlements of payments concerned with commercial transactions) between Great Britain and other countries, and trade between foreign countries; they do this by negotiating Bills of Exchange. The market dealing in Bills of Exchange is the Discount Market, a term once synonymous with Lombard Street because of its associations with that area. The Merchant Bankers and the Discount Houses are associated in the business of dealing in international bills, and thus together provide a means of short-term investment for the commercial banks.

This is the mechanism of maintaining the currency system which is vital for the carrying on of trade. Watching the working of the machine, and engaged in trying to maintain its steady and smooth working, is the Bank of England. In its wide sense, the Money Market comprises all those banks and other financial institutions engaged in the borrowing and lending of money. In its narrower sense, the Money Market is the Discount Market, the market engaged in the buying and selling of the international means of payment, the Bill of Exchange.

It is now necessary for us to examine more closely the method of financing commercial transactions in the modern world.

CHAPTER VII
INTERNATIONAL TRADE AND THE FOREIGN
EXCHANGES

The Financing of International Commercial Transactions.

We must now consider in greater detail the methods by which international payments are made in commercial transactions. Suppose that an exporter in the United States has sold a quantity of cotton to a Liverpool importer. The seller is anxious to obtain payment as soon as possible, and the buyer wishes to have the use of the cotton as soon as possible and be allowed credit so that he will not have to make payment until he has sold an adequate proportion of what stocks he has ; he thus avoids locking up his capital.

Both parties to the transaction agree that payment is to be made in sterling in London, by means of a Bill of Exchange payable ninety days after sight (*i.e.*, ninety days after presentation in London plus three days of grace). The American firm consequently draws a Bill of Exchange on the British firm for the amount of the consignment.

The importers may arrange with their bankers for the latter to accept bills drawn upon the banking house by the American firm in respect of this shipment, on the understanding that their clients will provide the funds to meet the amount when it falls payable. Alternatively, the acceptance may be made by the importer himself or by an acceptance house, or by the British importer's agent in America.

Foreign bills are often drawn up in sets of two or three, each bill being a part of the set ; one part only requires stamping. The parts are sent by different mails, for the sake of safety ; and one part may be sent for acceptance while the other or others are being negotiated.

The wording of such bills will therefore refer to the others ; in the case of two parts, one bill will order payment of " this First of Exchange, second of same tenor and date unpaid ", whilst the other will order payment of " this Second of Exchange, first of same tenor and date unpaid ".

To the bill are attached the shipping documents—the Bill of Lading, the insurance policy, and the invoice. These documents

Another method is by means of a *documentary credit*. The importer approaches a bank in his own town, and when the latter has satisfied itself with regard to the marketable nature of the goods, it may agree to purchase the exporter's bills drawn on the importer up to a certain amount, the bills being accompanied by the shipping documents. The bank thus acts as the intermediary and advances the money on the joint security of the importer and the exporter. Some banks require the exporter to sign a *Letter of Hypothecation*, which states that the Bill of Lading is lodged as collateral security for the acceptance and payment of the draft, that the holder is authorised to dispose of the goods in case of dishonour, and that the drawer holds himself liable for any deficiency.

The advantages of documentary credits are that they enable an exporter to obtain payment for his goods immediately they are ready for shipment, and that the importer can obtain delivery on acceptance or payment of the bill.

Another method is for the importer to arrange with his bank to issue a *letter of credit* on the bank in favour of the exporter, the latter being authorised to draw bills on the issuing bank up to a certain specified sum. In this credit, the importer's bank promises that the exporter's bills will be honoured if presented on or before a certain fixed date, provided that the shipping documents are surrendered against payment in the case of bills drawn at sight or against acceptance in the case of bills of longer term.

Such credits may be *confirmed* or *unconfirmed*, or, as they are also called, "irrevocable", and "revocable" (though some American writers on finance deny that these pairs of terms are of exactly the same meaning). An unconfirmed credit is subject to revocation, whilst a confirmed credit carries the issuing bank's absolute guarantee of acceptance and cannot be cancelled except by the consent of the exporter, who has the written undertaking of the bank that it will accept his bill on presentation. In the case of a confirmed credit, the exporter is no longer concerned with the payment of the bills once they are negotiated, the importer's bank honouring the bill in due course after having made arrangements with the importer to be put in funds to meet the bill on or before maturity. In the case of an unconfirmed credit, the bank gives no guarantee of acceptance.

Letters of credit give detailed instructions to the exporter in

METHODS OF FINANCING INTERNATIONAL COMMERCIAL TRANSACTIONS

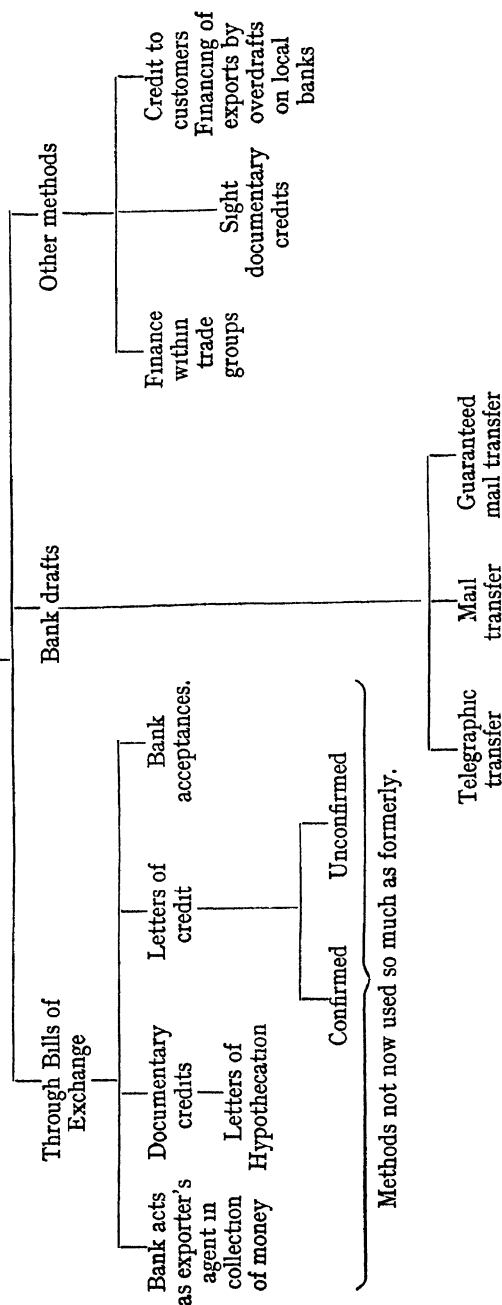


FIG. 25 —METHODS OF FINANCING INTERNATIONAL TRANSACTIONS

preparing his documents, which are carefully enumerated ; the usance (or period of currency) of the bills is also stated. Nearly always, and particularly in the case of confirmed credits, the period for which the credit is available is stated ; details regarding insurance are also to be observed.

Financing by means of bank acceptances may be done in one of two different ways. By one method the exporter draws a bill upon the importer, and this, together with the shipping documents, is handed to his banker in London, who regards the bill and documents as collateral security and allows the exporter to draw a bill on the bank for the same amount. The bank accepts the bill, which the exporter can discount at low rates on the London Money Market or at a bank. The London joint-stock banks, as we have seen, do a great deal of this type of business.

The second method is by what is called a " London acceptance credit ", issued by the London branches of the foreign and colonial banks. This is a variety of a confirmed banker's credit, the bank confirming to the exporter that he may draw bills up to a specified limit and within a prescribed time, in this case the bills being drawn and accepted in London. These credits are frequently used by exporters who consign goods to one of their foreign branches, and they may also be used when the goods are consigned to agents. The bill drawn by the exporter on the banker is sent to the latter with the shipping documents ; the banker accepts the bill and returns it to the exporter, the shipping documents being forwarded by the banker to his own branch abroad for delivery to the consignee. The exporter hypothecates the goods to the banker, a separate Letter of Hypothecation being sent in with each bill drawn. Commission of a small amount, say 2 per cent. per annum, is charged for this service, the commission being paid to the banker each time a bill is drawn and accepted. Naturally, the standing of the firm will determine the possibility of getting shipments financed by London bankers' acceptances.

A word may be said here about the *Telegraphic Transfer*. This is a method of paying debts by transferring money by cable from one country to another. A person in London who desires to pay, say, a certain number of rupees to a Calcutta firm on a particular date would pay into a London bank the amount in sterling calculated at the transfer rate of the day, the bank then cabling to its Calcutta branch to pay the Calcutta nominee.

We have now seen how the problem of settling international payments is solved by the use of the Bill of Exchange as a medium. It is not even necessary for the actual bill relating to one particular transaction to be held by the drawer until it matures ; he will sell it to a bill-broker, and it enters the discount market as a universal unit of currency. The banks of the various countries concerned deal in these international units, and a person abroad wishing to send money to England can do so by purchasing bills for the amount, and remitting the bills.

We have noted, too, that the commercial bill is not used now so frequently as it has been in the past, being replaced by bank drafts. The order to pay a person abroad may be made by means of a *Telegraphic* or *Cable Transfer*, by a *Mail Transfer* (a mailed form of Transfer) ; by a *Guaranteed Mail Transfer*, which obviates the risk of delay in the foreign centre by means of a guarantee by the bank that payment will be made on a definite date, instructions being sent to the bank overseas by deferred cable ; Stock Exchange securities, such as Government bonds and railway and industrial bonds and stocks and shares, may also be bought and sold, and the interest coupons may be cashed at centres abroad.

The rates charged for these various remittances will depend on the nature of the bill and the time the remittance is to be paid. Sight remittances will be quoted dearer than bills which have some time to run, because the better the bill, the dearer it will be. Telegraphic Transfers will be quoted dearer than sight bills or cheques. A bank bill, again, will be dearer than a trade bill.

The decline in the international acceptance business which we have noted has been due to the emergence of a number of alternative forms of financing foreign trade. One important factor in this decline has been the growth of trade controlled by a single group of undertakings ; for example, the trade between this country and West Africa is now almost wholly financed within the Unilever group, which controls this trade, without the help of banks ; and the same thing occurs in the case of the export of Colman's mustard to their Argentine subsidiary.

Even in the case of documentary credits, there has grown up the practice of operating them without drawing bills, sight documentary credits being used—*i.e.*, credits payable 'at sight on presentation of documents.

Then, again, many exporters now give credit to customers of

whose financial stability they are well assured, the exporters themselves often being financed by overdrafts from their own local banks.

The buying and selling of foreign currencies is done in the Foreign Exchange markets of the various countries by bankers and financial houses as principals through the medium of brokers. The great fluctuations in the exchanges following the 1914-1918 War led to a development of future dealing in exchanges to cover possible losses.

The Foreign Exchanges.

It will be interesting to consider here in brief outline the factors which determine exchange rates. What determines the value of francs in relation to pounds, or pounds in relation to dollars ?

We have seen that international indebtedness is settled by the remittance of money in various forms, by Telegraphic Transfer, for example. These debts arise because of the commercial transactions that have occurred in the various commodity markets. They are settled by Bills of Exchange which are accepted by the buyers of goods and sent to be collected by the creditor when they fall due, the bankers buying these bills in the discount market, and also by the transfer of other claims to money in foreign centres, such as bankers' drafts, telegraphic transfers and maturing interest coupons on investments. Similarly, the bankers sell rights to foreign currency to debtors in their own country, so that a London banker will have funds at his disposal in, say, New York, which will enable him, through his agent there, to sell dollars in New York to his London customers wishing to pay creditors there.

We have seen, too, that the spread of British commerce and its development abroad have resulted in London's becoming the pre-eminent centre of finance, so that the London banks are able to offer rights to currency in almost any part of the world.

Of course, it is essential that each party should know the rate at which his own national currency exchanges for that of the currency of the other party. This rate is called the *rate of exchange*, and the Foreign Exchanges constitute the organisation by which the various currencies of the world are exchanged with one another.

The old exchange market before the 1914-1918 War was one in

which a few brokers conducted business for the London offices of the foreign and Colonial banks and for a few exchange banks. After the war the place of bills was taken by the transfer of bankers' credits; and the telephone, cable and telegraph were called into service for the buying and selling of rights to foreign currencies existing in the form of balances or credits with banks abroad, bills and cheques, securities, and bullion. The payments were conducted by the banks through the medium of dealers and brokers in constant touch with one another by telephone and cable.

The rates of exchange are expressed either in terms of *£.s.d.* per foreign unit (*e.g.*, the United States dollar is worth so many English shillings and pence); or, more usually, the value of the foreign currency is expressed as so many units per pound sterling (*e.g.*, $£1 = \text{so many U.S. dollars}$).

What determines the rate at which currencies exchange with one another? Before the 1914-1918 War, about 90 per cent. of British trade and about one-half of the world's trade were financed by sterling bills, so that the rate of exchange of the pound sterling with other units of currency was determined primarily by the demand for and supply of such bills.

Under the Gold Standard, where the gold content of each unit of currency is determined by legislation, the relative values of the standard coins of two currencies can be calculated by comparing the amount of pure gold each contains *e.g.*, an English sovereign contained as much pure gold as $4.86\frac{2}{3}$ United States dollars; this was the *Mint Par of Exchange* between pounds sterling and dollars; though this did not mean either that gold coins were actually in circulation or that the movement of gold was free and unrestricted: it was merely a comparison of the gold content of the two currencies, and the Mint Par expresses the actual rate of exchange only when the demand for each currency is equal.

In practice, the balance of indebtedness between two countries is constantly changing, following the fluctuations of the volume of trade and commerce. There may be a heavy demand for sterling, or a heavy demand for dollars, according to the direction in which the heavier volume of goods has passed between the two countries. If the demand for bills in London were great enough, it would result in such a high rate that it would be cheaper to send gold to New York, and to pay the costs of transport and insurance

of the gold, than to buy a bill ; and, similarly, a demand in New York in excess of the supply would result in its being cheaper to send gold than to buy a bill. There was, therefore, a point above the Mint Par and a point below the Mint Par at which gold tended to flow ; these are called the *Gold Points* or *Specie Points*. Under the old Gold Standard system, the rates of exchange between two countries would vary from the Mint Par only by the extent of the cost of transporting gold.

The balance of indebtedness between two countries depends, as we have seen, not only on the amounts of the " visible " exports and imports, but also on the payments due for investments and services, *e.g.*, shipping services and the services of the London Discount Market itself.

The crisis of the 'thirties upset the effect of gold movements, the Gold Standard no longer operating. The rates of exchange were left to be determined by the conditions in the demand and supply in the foreign exchange markets, in the same way as the rates of exchange of commodities, *i.e.*, their *prices* relative to one another, are determined by the conditions of demand and supply. Thus, the relative purchasing power of two currencies determined, in the long run, the rate at which they would be exchanged.

The relative price levels in the two countries, and the value of paper money as influenced by the operations of the Central Bank, trade conditions, the costs of transport, tariffs, and financial factors such as the payment of interest and Stock Exchange operations, induce variations in the rate of exchange. Another influence has been the activities of speculators in currency and the selling of national currency for reasons of fear, as happened in France, where, as we have already seen, with an increasing adverse trade balance and a financial position steadily growing worse, Frenchmen were seized with panic and began to sell francs.

The Exchange Equalisation Fund has been already mentioned. We are now in a position to consider its operation in more detail.

The Exchange Equalisation Fund.

The Exchange Equalisation Account was established in April, 1932, for the purpose of evening out fluctuations in the £, and so preventing unduly high or unduly low rate variations, thus counteracting the effect of speculative operations.

Under the Gold Standard system, the value of the pound

sterling could vary internally only by the difference between the price at which the Bank of England was obliged to exchange notes for gold offered to it at the rate of £3 17s. 9d. per ounce Troy, $1\frac{1}{2}$ fine, and the price at which the Bank was obliged to sell gold at the rate of £3 17s. 10½d. per standard ounce—a difference of about 1 per cent. In terms of foreign currency, the value of the pound sterling would vary only by the difference between the Gold Points—in the case of U.S. dollars, for example, between about \$4.85 and \$4 89.

If, therefore, the pound sterling tended to fall in value, gold tended to flow out of the country, and prices would tend to fall ; the fall in prices would attract more buyers of goods here, causing a demand for sterling, which would cause the value of the pound to rise again

Thus, the tendency for gold movements to take place, aided by the Bank of England's employing its tools, the Bank Rate and open-market operations, provided an automatic control of the exchanges.

But when Britain went off the Gold Standard in September, 1931, this automatic check no longer operated. The Bank of England was no longer obliged to sell gold at the statutory price, though it was still obliged to buy gold at the statutory price (such offers were unlikely, of course, because the price of gold rose steadily), and the pound rose.

In 1932 the flight from the franc took place, and the pound began to rise in value because of a huge demand for sterling from French and other capitalists, who were buying pounds because of the fear of the fall in value of their own currencies. If allowed to proceed unchecked, this great influx of foreign money would have upset the normal trade and finance of the country ; British exports would have been checked and imports abnormally stimulated. Currency relations cannot be allowed to suffer the influence of such flights of capital seeking a safe place : " hot money " or " funk money ", as it has been called, is no proper basis for currency rates.

The method by which the Exchange Equalisation Account was to " iron out " fluctuations was by buying and selling pounds ; if, for example, sterling were being demanded heavily, the Fund would sell sterling to equalise demand and supply and keep the exchange rates stable ; such exchanges of sterling were to be made only into foreign currencies easily convertible into gold.

International capital movements had to be neutralised so as to preserve the internal financial structure.

Originally, the Fund, comprising Treasury Bills, contained only sterling resources ; but as soon as it was able to sell pounds, gold or foreign currencies could be obtained to enable it to work both ways, the Fund buying pounds to prevent the pound falling, and selling pounds to prevent the pound rising. The inflow of foreign "hot money" became so persistent that the Fund was in danger of losing all its sterling and comprising too much gold, so that it was increased, and gold was sold to the Bank of England, which issued bank notes against it. In 1937 the total Fund was raised to over £500 millions. The Currency and Bank Notes Act of February, 1939, involved adjustments in the Fiduciary Issue ; the estimated total resources of the Fund then amounted to over £700 millions.

We have noted that similar Equalisation Funds were adopted by the U.S.A., France, Switzerland and Holland. The Tripartite Declaration of September, 1936, and later technical arrangements, have aimed at co-operation in the restriction of currency fluctuations ; thus there is in process of evolution a Managed Currency System whose form is at present obscure, but which will almost certainly involve international co-operation.

At first, implementing its policy of preventing undue speculations, the transactions of the Fund were kept secret, but up to the outbreak of war its position was published at six-monthly intervals. On the outbreak of the Second World War, gold was held to the amount of £509½ millions, and it held also foreign currency, Treasury Bills and other Government securities. The heavy liabilities arising from the War seriously depleted its resources, so that its influence is now less than it was before the War. A return to the Gold Standard would revive the usefulness of the Fund ; under the Gold Standard system, a weakness occurs, in that a drain of gold is likely to result from the movement of short-term funds attracted by a rise in the rate of interest at a foreign centre, and such a drain might cause an undesirable contraction of credit. The main object of the Exchange Equalisation Fund was to counteract the effects of the movements of such short-term funds, or floating balances. It must be noted that its object has not been to restore equilibrium in the balances of payments due to an excess of imports over exports ; such a correction is the function of the Bank Rate.

CHAPTER VIII

THE CAPITAL MARKET AND THE STOCK EXCHANGE

WE have now examined the constitution and features of the organisation involved in the meeting of the demand for money for short periods—the Short-Term Market—and have discussed machinery provided by that highly organised international money market, the City of London. As a summary, we may say that the City of London, with its organisation of acceptance houses and discount market, provides exceptional facilities for the financing of internal and international trade and for the financing of foreign bonds. That organisation is concerned mainly with the supply of short-term money; and British merchants have also taken advantage of the facilities for credit afforded by the joint-stock banks.

We must now consider the organisation involved in the supply of long-term money; for, in order that industry should be set up and organised in the modern world, resources are needed in great amounts: there is therefore a capital market, or long-term money market, as distinct from a market for short-term loans.

The Relationship between the Banks and Industry.

England was a great trading and commercial nation before she became an industrial nation, and her commerce centred in London, which became the great financial city of the world as well as the entrepôt for trade. When British industry began its development in the nineteenth century, however, this development went on independent of a centralised financial control, although the facilities offered by the joint-stock banks were utilised, because the units of industry were founded on a basis of the family business, and on a small scale, and capital was privately provided and extended out of profits. Banking facilities were provided by the independent banks, often family banks, with headquarters in the provinces, particularly in the Midlands and the North, where the new industries were growing up. Again, a large class of investors existed who did not rely entirely on their bankers but exercised their private judgment in making investments.

In Europe, and particularly in Germany, the banking and

financial system became more closely associated with industry. The Industrial Revolution began later on the Continent than in Britain ; capital and independent investors were scarce. Therefore, in order that Continental industry could compete with British industry, the banks were obliged to assist industry in obtaining permanent as well as short-term capital. Germany, to a great degree, owes the great development of the 'sixties, the 'nineties, and the first decade of this century to the activities of her banks, which entered into intimate relationship with the industrial and trading companies, collaborating with them from their foundation in drawing up the financial arrangements and in some cases taking up a part of the shares.

In France the individual investor was generally a small capitalist, relying on suggestions from the banks, which made nearly all the issues of shares in industrial undertakings ; and certain powerful banks developed into " *banques d'affaires* ", closely connected with industry at home and abroad.

In the United States, finance was intimately connected with the development of American industry. Railways and the great industries were affiliated to particular banking houses. The industrial issues were made through responsible issuing institutions, the large banks in the important centres making their issues through subsidiary Securities Companies. The banks have made loans to investors and speculators against industrial securities either directly or through brokers. Thus, although the connection between banks and industry has not been so intimate as in Germany, the American banks have performed substantially the same function for industry as the German ones in providing financial assistance and advice, in issuing credit for the soundness of the enterprises they have supported, and in assuming a definite responsibility in the control of industry.

In Britain, with the exception of one or two houses, there does not exist any such organisation for the guidance of the ordinary investor in the issue of home industrial shares. The great joint-stock banks receive subscriptions, and their names appear on the prospectuses of undertakings, but beyond seeing that the latter comply with the requirements of the law and that the issue is financially respectable, they do not vouch for the issues and are in no way responsible for them. Without sympathising with the idea that the banks should manage industry, the Macmillan Report sets out the view that there should exist a

closer connection between the City of London and industry, and that the banks should not give the appearance of sponsoring issues when their function is limited to receiving subscriptions. Whilst the industrialists themselves should be responsible for the business and general management of a company, the banker should be the adviser in matters of finance ¹

The market for investment in foreign loans has been more highly organised than that for the financing of home issues. It is now our task to examine the organisation involved in the long-term financing of industry, always keeping in mind the fact that there is no clear-cut distinction between the Short-term Money Market and the Long-term Capital Market, and that financial institutions operate in both markets. For example, the banks have extended long-term credits to industry ; again, although the main function of the Stock Exchange is to transfer long-term securities, a large part of its business is financed with short-term loans.

The Institutions of the Capital Market.

The institutions of the Capital Market fall into two divisions : those which are concerned with the issue of new capital for industrial enterprises, and the Stock Exchange, which deals in the transfer of rights in already existing securities, mainly (a) loans issued by public bodies ; and (b) the capital issued by public companies. In this section the first division is considered.

The Capital Market is an organisation for bringing together the investor who wishes to invest his money in the form of permanent capital, such as factories and machinery and railways, and the company or municipal authority wishing to obtain such loans. The joint-stock banks, the merchant bankers and insurance companies, stockbrokers and jobbers, and the issuing houses, co-operate in forming the mechanism known as the " New Issue Market ". The preliminary details are settled by the company promoter in the case of the joint-stock undertakings ; usually the company promoter is a financier specialising in the flotation of new companies ; or the promotion may be made by a parent company which is forming a subsidiary or allied undertaking, or by the vendor (or seller) of the business assets which are to be taken over by the new company. The system of company promotion is still subject to considerable abuse, and the word

¹ Macmillan Report, Paras. 388-390.

"financier" still conveys to many people the suspicion of unscrupulousness and deception.

Promoters work with *Issuing Houses*, the most important of the institutions concerned with the issue of new capital. Some of these are old-established merchant bankers, like Rothschilds or Schroeders or Lazards; others are such houses as the Charterhouse Investment Trust, the London and Yorkshire Trust and the British Shareholders Trust, which were formed in order to cater for the smaller industrial issues.

The issuing houses arrange for the public issue of stocks and shares on behalf of industrial undertakings and corporations

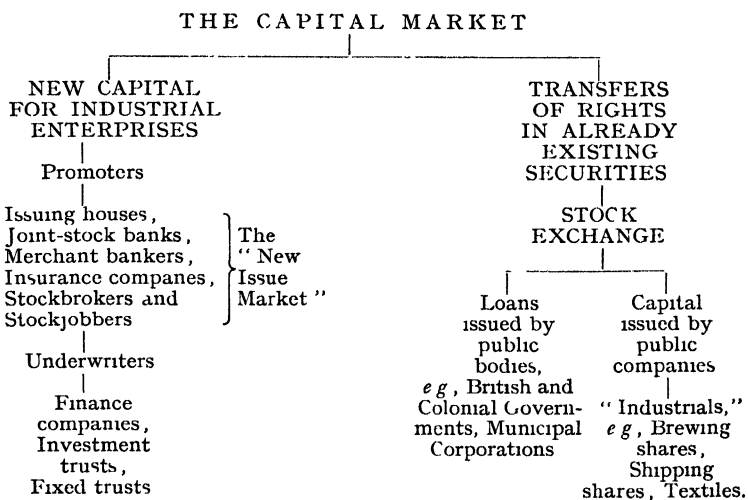


FIG 26 —THE CAPITAL MARKET

and governments, dealing only in securities having a fixed rate of dividend, such as preference shares. The jealousy of the issuing house for its reputation is a safeguard to the public, for its connections in the "City" depend on its reputation for thorough investigation of the financial position and prospects of the company whose capital it issues, and an investor who consults his stockbroker or other responsible financial adviser may be assured that where business is done with a good issuing house, he will not be led astray.

The preparation of statements and facts about the new issues and the work of receiving and accounting for subscriptions will be done by the issuing house. The latter work may also be done by

a bank ; but, as we have noted, the British joint-stock banks take no responsibility in regard to the character of the issue. The Macmillan Committee recommended that the issuing houses which specialise in foreign loans should extend their activities to domestic issues ; and the Committee believed that " there is substance in the view that the British financial organisation concentrated in the City of London might with advantage be more closely co-ordinated with British industry, particularly large-scale industry, than is now the case ".¹

The issue may be made on behalf of a business enterprise, or it may have been taken over by the issuing house, which then offers it for sale to the public at a higher price : this is called an " offer of sale ". The business enterprise is then assured of its capital, whilst the issuing house runs the risk of having the issue left on its hands.

When the company desiring to raise new capital has agreed on its terms with the issuing house, the latter arranges for the underwriting of the issue. Under the Companies Act, 1929, in the case of a first allotment of shares, a minimum amount of share capital, called the " minimum subscription ", must be subscribed before the company can allot any of its shares offered to the public. Underwriters are persons or undertakings who guarantee to take up shares and debentures which are not taken up by the public. The underwriters are banks, insurance companies, and other large investors. Underwriters may underwrite the whole issue, and arrange contracts with sub-underwriters, the principal underwriters receiving an *overriding commission*.

The underwriting commission will be, generally, higher the greater the degree of risk ; the Companies Act, 1929, lays down that the underwriting commission must not in any case exceed 10 per cent.

One method of issuing fresh capital which may be employed by an already existing company is to offer new shares to the existing shareholders only ; usually the right is given to shareholders to take up new shares proportionate to the number of old shares held and at a price lower than that of the old shares. Thus the expense of a public issue, incurring heavy underwriting charges and advertisement expenditure, is avoided. Another method is to make arrangements with a Stock Exchange firm or group of firms to sell the shares on the Stock Exchange as they

¹ Macmillan Report, para. 397.

would already existing securities; the permission of the Stock Exchange Committee must be obtained.

Finance companies may also act as issuing houses or underwriters; the main activities of these undertakings comprise the buying and selling of securities in a limited class of industry, *e.g.*, mining, and are of a somewhat speculative nature. They are

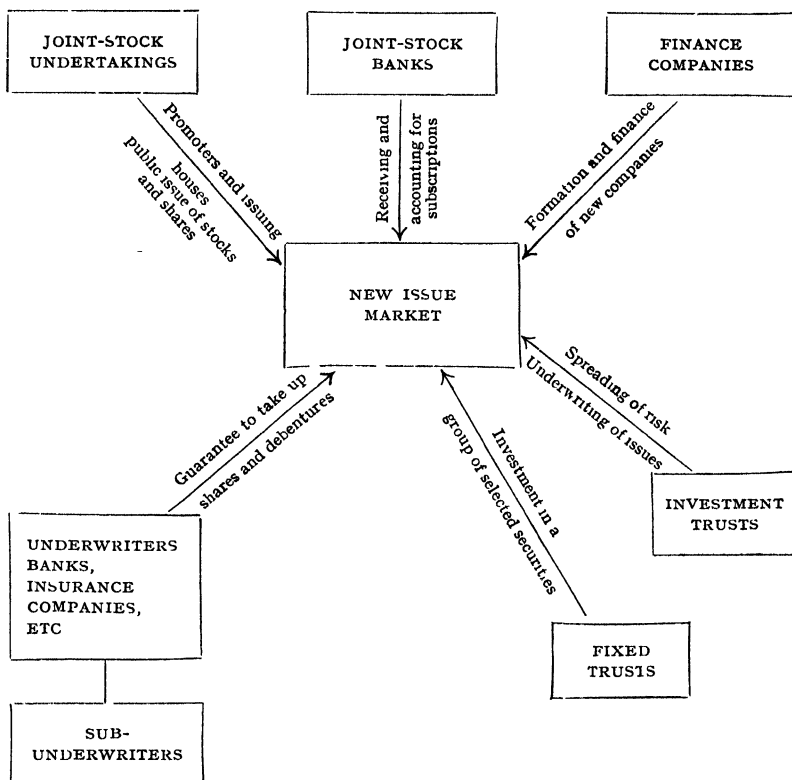


FIG 27 —THE ORGANISATION OF THE NEW ISSUE MARKET

not only interested in the investment of funds in established undertakings, but also conduct the formation and finance of new enterprises. We have already noted that the circumstances of the development of industry on the Continent and in the United States have resulted in such financial arrangements as this, in which the control of the business affairs is in the hands of those who provide the capital.

The problem of finding investments which will give the maximum return with the minimum of risk has been made the special province of the *Investment Trust*. The Investment Trust companies invest capital in a large number of different securities, thus spreading the risk over a number of types of investment of varying character. The investments are varied in order to secure the maximum return; the trust companies underwrite issues they intend to hold as permanent investments.

An American development of the Investment Trust is the *Fixed Trust*; investment is made in a group of selected securities only. A unit holding of shares is divided into sub-units, the price of the sub-units being fixed by the managers. The Fixed Trust was introduced into Britain in 1931, at the time of the depression, and became very popular. The desirability of regulating such organisations was recognised by a Departmental Committee appointed by the Board of Trade in 1936 to enquire into them, it was recommended that such Trusts should be registered, that the trustees should have an issued capital and paid-up capital of not less than £500,000 and £250,000 respectively, that a deposit of £20,000 should be made with the Postmaster-General in respect of each trust managed, and that full details of the securities should be published in the annual accounts.

The Balfour Committee pointed out in 1929 that financial weakness in industry, resulting in inability to build up reserves and make good depreciation, tends to operate in a vicious circle. The depression in the basic industries of the country stressed the need for co-operation between the bankers and the industrialists of the country so that industrial reorganisation and reconstruction might be facilitated. An organisation to advise industry and examine schemes of reorganisation, and in some cases to provide financial assistance, was created in the form of the *Securities Management Trust*, the Bank of England holding its capital. In April, 1930, was formed the *Bankers' Industrial Development Council*, with a capital subscribed by the Bank of England, the joint-stock banks, and the merchant bankers and finance companies, for a similar purpose. In 1934, *Credit for Industry, Ltd.*, was created with the special object of assisting small and medium-sized enterprises to raise capital; and in 1936 *Special Areas Reconstruction Association, Ltd.*, was set up in order to assist the establishment or development of industry in the Special Areas.

The breaking out of the Second World War interrupted the development of such schemes ; the urgent need for reconstruction after the War cannot but result in the creation of institutions designed to tackle the financial problems of the community more seriously and with firmer purpose. There may, indeed, be something like a revolutionary overhaul of our financial machinery ; it would be useless to attempt to forecast the nature of the coming developments : these will have to be worked out carefully with the assistance of financial experts and advisers and with the co-operation of business people and industrialists. One can only urge the reader to follow the course of such developments by the study of reports in the Press and of published expositions as they occur.

The Stock Exchange.

The Stock Exchange is one of the few financial markets in which business is carried on in a special building ; it is the market dealing with the transfer of rights in securities which already exist : that is, in stocks and shares and bonds. Stock can be subdivided ; it consists of the capital of a company or a Government or municipal loan in units of, usually, £100, although any amount may be bought. Shares cannot be divided ; they are issued as fixed portions of the capital of a company, such as £10 or £50. Bonds are agreements on the part of a corporation or Government to repay a sum of money ; the term " bond " is used in the U.S.A. as being practically equivalent to the British " debenture ".

The most famous of the Stock Exchanges of the world is the London Stock Exchange, usually referred to by people in this country as THE Stock Exchange ; though there are also provincial Stock Exchanges.

The securities dealt in are classifiable into two broad categories : (a) Securities are issued representing loans issued by public bodies, such as British, Colonial and Foreign Governments, and municipal corporations ; (b) Securities representing the various kinds of capital issued by public companies incorporated at home or abroad are the " industrial securities ", further classified into different groups, such as Shipping, Textiles and Mining ; they form the commodities of what are in effect different markets, bought and sold in different parts of the " House ", and by dealers in particular classes of shares—*e.g.*, mining shares may

be Rhodesian, Australian, West African, or " Kaffirs ", the well-known name for Transvaal mining shares.

Bearer Securities are securities of which the property passes by mere delivery, such as bearer bonds and share warrants to bearer ; *Registered Securities* are the property of persons whose names are entered as owners in the register of the body issuing the securities, the owner receiving a certificate stating the fact of his ownership and stating the nominal value and numbers of the shares. A *Transfer Deed* is made out when the securities are sold, and with the Share Certificate this is sent to the registered office of the body concerned for the necessary alterations to be made in its Register.

In the case of *Inscribed Securities*, the names of the owners are inscribed in registers usually kept at a bank, and no Certificate of ownership is issued. The Stock of the British Government and many Colonial Governments are inscribed stock ; the Consol Market is the market for dealing in British Government Stock : " Consols " is an abbreviation used for " consolidated annuities ", the part of the National Debt secured on the Consolidated Fund of the kingdom, the fund into which are paid such revenues as those derived from taxes, the income from Crown lands, and Post Office receipts.

First-class securities, such as Government and Public Stocks, Home Rail Stocks, and Treasury Bonds, are called " gilt-edged " securities ; their price reflects changes in various factors, such as the political situation. The prices of stocks and shares are affected by all sorts of influences : rumours of war or peace, the possibilities or developments in various industries—all those influences, indeed, which seem likely to affect the profits of those holding shares : hence the disfavour with which extremists of Socialistic views regard the whole institution of the Stock Exchange. In recent years the Stock Exchange has gone some way towards becoming an institution functioning with regard to public service ; and further reforms have been urged,¹ suggesting that greater efficiency of routine operations might be obtained, with a consequent cheapening of services concerning share transfers, and that a standard of professional qualification should be set up for members, with possibly the grant of a Charter to the

. ¹ See Oscar R. Hobson : " Stock Exchange Reform ", *News Chronicle*, Aug. 1, 1942, and " Public Stock Exchange ", *ibid.*, April 13, 1945. An official publication of the Stock Exchange, *Since 1939* (Couchman, 1s. 6d.), gives the main changes in Stock Exchange rules and practice since the War began.

Stock Exchange placing obligations on members in the conduct of their business. The necessity for the reform of this important investment market has found expression in the setting up of a "Joint Advisory Committee of Stock Exchanges", for discussion of matters of mutual interest between the various Stock Exchanges of this country.

Under the "dual control" system, the Stock Exchange building and finances were administered by nine elected members, known as the Trustees and Managers, whilst a Committee for General Purposes, consisting of thirty members elected annually, controlled the conduct of business, admitting members and authorised clerks, suspending or censuring members, and re-admitting members. The Trustees and Managers were the Board of Directors of a company owning the building, and every member of the Stock Exchange had to own at least one share in this company. The Committee for General Purposes had, therefore, to carry out its functions of regulating the conduct of members without being responsible for the finances of the Stock Exchange undertaking.

In April, 1944, it was announced that a scheme was being put forward to unify the control and management of the London Stock Exchange. It was decided that the dual authorities should be amalgamated, and that a single Board, composed of the Trustees and Managers and members of the Committee for General Purposes, should be formed. On April 1, 1945, the two bodies were merged into a Council of the Stock Exchange, composed of nine "foundation members" (the Trustees and Managers) and 30 "ordinary members", one-third of the latter will come up for election each year.

The Provincial Brokers' Stock Exchange represents about 400 stockbroking and stockjobbing firms. Machinery is provided for joint consultation with the London Stock Exchange and the Associated Stock Exchange.

Disputes between members of the London Stock Exchange must be referred to the Committee; members are personally liable to one another, whether acting for an outside client or not, and they are prohibited from taking legal action against one another without the consent of the Committee.

The members of the London Stock Exchange are obliged to seek re-admission annually; they are of two classes: (a) jobbers, acting as principals in the buying and selling of shares which they

may possess at the moment or which they believe they will be able to buy before the date fixed for delivery ; and (b) brokers, acting as intermediaries between the public and the jobbers. A member cannot be both a jobber and a broker, nor are jobbers and brokers allowed to form a partnership ; and jobbers are not now allowed to deal with provincial brokers. The jobber makes his profits from the difference between the price at which he buys and the price at which he sells ; the brokers obtain a commission, called *brokerage*, for their services.

There are also *Authorised Clerks*, having authority to act on behalf of their principals, the stockbroking firms ; and *Unauthorised Clerks*, who may enter the " House ", but are not allowed to deal.

This division of members into jobbers (or dealers) and brokers is exclusive to the London Stock Exchange ; it provides an advantage to the general public, for the broker and the jobber enter into mutual bargaining, since the broker is acting as the agent of a member of the public and tries to get as good a bargain as he can. A broker who is instructed to buy shares approaches a jobber and demands a price ; the jobber quotes him two prices, one at which he is willing to buy, and the other at which he is willing to sell : the jobber does not know whether the broker wishes to buy or sell shares. By quoting prices which are too " wide " the jobber will cause the broker to go elsewhere ; or the broker may persuade the jobber to quote prices within narrower limits, or may even bid a price himself, in which case, if the jobber has previously obtained those shares cheaply, the broker may be able to obtain a good bargain. If the client has given his broker a limit, the conditions of the market may be such that the order is not executed.

Competition between jobbers and the readiness of jobbers to quote a double price (the " jobber's turn ") tend to avoid wild fluctuations in prices ; if he obtains too much of a given stock, the jobber will lower his price to encourage purchases and discourage sales, whilst if he has sold too much, he will raise his price to induce brokers to sell to him, or he will be left " short ". In that case, he will have to get stock somewhere before *Settling Day*. Bargains between members are settled at intervals of about a fortnight. On *Contango Day* the bargains are completed or are held over until the next settlement, a charge called *contango* being paid for this postponement by a buyer not desiring delivery at

once, since he had hoped for a rise before Settling Day; a seller unable to deliver may postpone delivery until the next fortnight (or "account"); for this privilege of "carrying over" he pays an allowance called a *backwardation*. The second day of the settlement, when brokers' receipts are handed over, is called *Ticket Day*; on *Intermediate Day*, documents for the completion of the transactions are prepared; payments are finally made on the fourth day, *Settling Day*.

Before any shares are dealt in on the Stock Exchange, permission has to be obtained from the Committee; certain documents must be sent to the Secretary of the Share and Loan Department, including the company's Certificate of Incorporation, the Certificate enabling the company to commence business, the Memorandum and Articles of Association, a copy of the Prospectus, if any, or of newspaper advertisements; the company has also to enter into certain undertakings with the Stock Exchange, *e.g.*, to notify changes of directors and notify dividends. Permission to deal in shares is a safeguard to the public, since if permission is not granted, the company is deprived of an "official" market for its shares and will have to employ an outside broker, although some outside brokers are quite trustworthy and enjoy an excellent reputation, others are to be avoided.

The point has been mentioned that the jobber may sell shares which he does not possess at the moment, hoping to obtain them before Settling Day at a lower price than that which he has quoted; equally, he may buy shares which he does not intend to pay for, hoping that he will be able to sell them at a higher price before Settling Day. Although dealing in "Futures" is a legitimate method of doing business, as we find to be the case when dealing with the Produce Exchanges, speculation occurs in the case of "bulls" and "bears", the former being speculators who buy stock in the hope of a rise, the latter being speculators who sell stock hoping for a fall in price. Syndicates have been formed of "bulls" who have successfully "rigged the market", *i.e.*, forced up prices to a profitable level by cornering the market, and who have then sold to the public at this increased price.

On the outbreak of the War, carry-over facilities were prohibited, so that a good deal of speculative activity was eliminated—not altogether, since the time-lag between the issue of instructions by a client and his receipt of the Contract Note

from the broker recording the transaction enabled speculation to be carried on, though on a reduced scale.

The justification of the jobber on the ground that his activities prevent wide fluctuations in prices is not admitted by some writers; in times of crisis and depression, especially, wide prices have been quoted, ostensibly for the purpose of preventing panic sales; in any case, in common with the great majority of Mankind, the jobber, it may be presumed, will consult his own personal interests before those of the community.

A further type of speculation is that concerned with "options". A *call option* is the right to compel a seller to sell a definite amount of stock or number of shares at a definite price and within a certain period. Settlement is made by payment of the difference paid by the speculator if prices should fall, and to the speculator if prices should rise. The converse is the *put option*, the right to compel the seller of the put to buy a definite amount of stock or number of shares at an agreed price within a certain period. A *double option*, or *put and call option*, is a combination of the two: the right to buy or sell a fixed amount in the future at a fixed price agreed now; the amount paid for this privilege is twice that of a single option.

These options are, of course, insurances against the movements of prices. Naturally, there is considerable scope for gambling in these operations, and there would appear to be need for State control. The "stag" should also come in for careful study: he is the gentleman who applies for a large number of shares of a new issue in the hope that the issue will be over-subscribed, resulting in a rise of prices, and so enabling him to unload his shares at a profit.

The daily Official List of the different classes of securities dealt in and published by the Committee is some protection to the public, in view of the regulations which have to be complied with before permission is granted to deal in the shares on the Exchange, though inclusion in the List offers no guarantee that the particular item quoted is a suitable investment for the general public: it is merely a means of ensuring facility and honourable dealings in bargains; it shows the estimated prices ruling at the end of the day (the "closing" quotations), the prices at which business has actually occurred, when the interest on any given security is due, and whether the interest or dividend on any particular security is

included in the price or not (" ex. d." or " ex. in." mean " without dividend " or " without interest " respectively).

The function of the Stock Exchange in providing an international free market for investment has been invaded of recent years by the tendency towards outside dealings. Banks and discount houses have made use of the modern facilities for keeping in touch with the capital market institutions to transact investment business directly ; transactions in gilt-edged securities are particularly affected by the tendency to use outside intermediaries, and brokers may save the jobber's turn by " marrying " the buying and selling orders of their clients.

We have surveyed the field of the Money Market, and considered the financial aspect of the functioning of business undertakings. We may now proceed to a discussion of the matters connected with the organisation of the typical business undertakings themselves.

PART THREE

BUSINESS ECONOMICS

CHAPTER IX

THE ORGANISATION OF THE BUSINESS UNDERTAKING

THE relation between the study of Commerce in general and that of Business Economics was discussed in Chapter IV of Volume I. There it was pointed out that a business undertaking is one of the many types of associations which go to make up the structure of Society; it is an association engaged in the satisfaction of some material need. Though an association engaged in providing what may be regarded as a spiritual or psychic need of Mankind—for example, an orchestra—may be so organised as to provide a profit for those responsible, and, indeed, will be organised on business lines for the sake of efficient functioning, the term “business undertaking” is restricted to that type of organisation whose main object is the pursuit of a purely economic aim.

We have seen that such an economic aim is not peculiar to the strictly commercial undertaking: the public utility undertakings are pursuing economic aims, and to that extent they are business undertakings. The study of Business Economics will therefore embrace the study of the establishment, organisation and management of public utility undertakings. But in the study of Commerce a further restriction of the scope of the term is necessary: though the scope of the term “Commerce” itself is being widened, in accordance with the tendencies towards public control, or at least supervision, in this dawn of the Age of Planning, yet for present purposes, and to take account of present realities, it is necessary to consider the business undertaking as being one engaged in strictly commercial activities—that is to say, those activities which are pursued in furtherance of the aims of Trade and its auxiliaries: the business undertaking is generally regarded as one purely voluntary, entered into by individuals for their own profit.

In view of the unsatisfactory looseness of definitions at present

prevalent in the new study of Commerce, and especially as public control and planning extend into the field of Commerce, it is evident that definition must be somewhat arbitrary: Commerce as a branch of the science of Economics waits upon the development of events for its own development. In this chapter we are concerned with the study of the business unit as the association formed for the purpose of pursuing private ends with a view to profit; though it must be repeated that the principles upon which the successful business unit run for private profit is organised are followed equally in enterprises run for the public welfare.

The Entrepreneur and the Organiser.

In this volume it is sufficient to point to what has been said in Volume I about the differentiation of functions as between the entrepreneur and the organiser, the risk-taker and the planner, respectively.¹ In the case of a sole trading establishment, the functions of risk-taking and organising are combined completely in the one person—the proprietor not only invests his resources in the enterprise, but himself organises the distribution of those resources and plans the lay-out and conduct of the business unit, though he may employ a manager who shares the responsibility of the organising. In the case of an ordinary partnership, the risk-taking and organising are shared between the partners, who have invested their resources in the enterprise.

Separation of these two functions takes place in the limited partnership, in which the unlimited partner or partners take the main risk, also undertaking the function of organisation; the limited partner or partners take a risk limited to the amount of resources invested, whilst taking no share in the organisation or management of the enterprise.

A more complete separation takes place in the limited company, the shareholders taking no part in the organisation of the concern, their power being limited to voting. The Board of Directors are responsible for the control of the company owned by the shareholders, who, nominally, appoint the directors; in practice, they are nominated by the promoter of the undertaking, and their re-election is usually only formal.

The private limited company is similar to the sole trading concern in that the control of policy and administration is vested

¹ Vol I, pp 55-56.

not only in theory but also in practice in the hands of the proprietors.

At the other end of the scale stand the co-operative undertakings and the public utility concerns, where the shareholders and the ratepayers or taxpayers, respectively, are themselves the consumers as well as the entrepreneurs. Control of policy and administration is vested in paid managers.

The Organisation of the Typical Business Undertaking.

The great variety of business units precludes any attempt at dealing with business organisation in general, beyond the setting out of certain principles which are common to such economic associations. Each business unit is an individual entity, and the

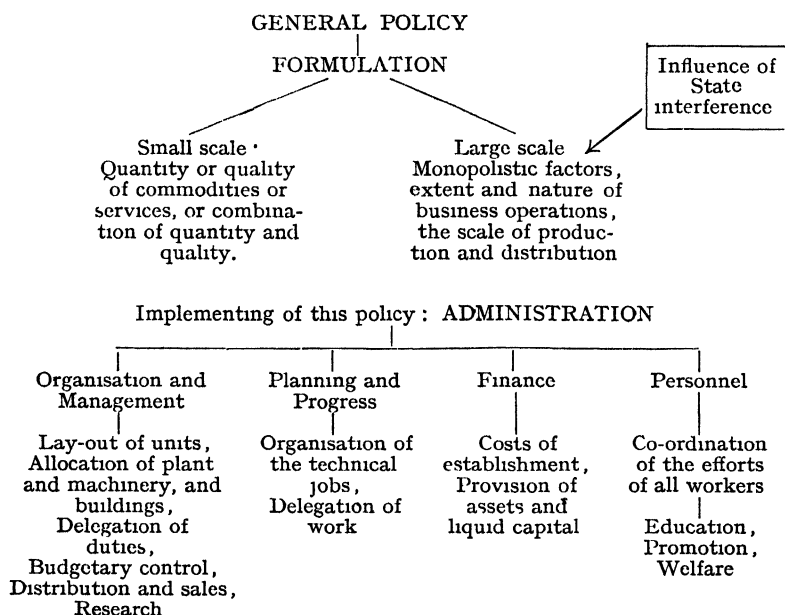


FIG 28 —FACTORS IN THE ORGANISATION OF A BUSINESS UNDERTAKING

details of its policy and administration will depend on the temperaments, abilities and business sense of the persons responsible for its running. The factors which are of greatest importance in the organisation of the typical business unit are shown in Fig. 28.

General Policy

The business unit is an enterprise directed towards the attainment of an economic aim. The general policy of the business is the clear formulation of that aim and the putting of it into practice. It may be the buying and selling of commodities on a large scale and at the cheapest price in order to attract a great number of customers, as in the case of the multiple shop. It may be mass-production and sale of articles for a wide market, or it may be the production or buying and selling of a small variety of articles produced in as perfect a state as is possible and with the highest class of materials and workmanship available, as in the case of electric motors. The organisation may be one concerned entirely with pure trading activities, or manufacturing and warehousing activities may be combined in its general functions, as in the cases we have considered in Chapter II.

The tendency of the age is towards a test of the ethical validity of the policy of a business undertaking on the ground of public service. In the case of a small undertaking, the general public have some kind of direct control over its policy in so far as they may refuse to deal with it if its aims are considered as merely predatory. In the case of a large undertaking, perhaps organised as a business combination with subsidiary concerns, and in control of great resources and channels of distribution, so that to a great extent it controls the purchasing power of the general public, control based on the criterion of service to the community can come only from the State. But the wealth and power of individuals directing the destinies of vast business undertakings are such that they find it comparatively easy to obtain high positions in the direction of the business of the State itself, and thus effectively to stand in the way of any reform of business policy. Such a situation can be met only by action on the part of an educated and enlightened electorate; and thus the problem moves into the more strictly political sphere.

It will be seen that the question of business policy raises serious social problems only when the undertaking is on a large scale and likely to impinge upon the question of the freedom and welfare of the community. There is little question of policy in the case of, say, a small grocer's or stationer's shop; the business is founded for the buying and selling of groceries or stationery, and the object of the proprietor is to please his circle of customers,

and so extend his operations that he will make a profit sufficient to provide him with the necessities and some of the refinements of life. The public is the final arbiter. Again, once a small or medium-sized manufacturing undertaking has decided whether it will concentrate on the mass-production of cheap articles, or on the production of finely turned-out articles, or whether it will try to reach a compromise between the two, the general question of policy is settled: the public will decide whether or not the policy is acceptable to it.

But those undertakings on a large scale possessing powers over the market of a monopolistic nature can to some extent dictate to the public the nature and prices of the commodities supplied to them; and we have already discussed the question whether it is a healthy state of affairs for the State itself to possess such powers. The solution of the problems involving the conflicting principles of individual freedom, both for the producer and the consumer, and of control and planning in the interests of the community, must inevitably be some kind of compromise, especially when it is remembered that the phrase "interests of the community" means nothing unless it means the best interests of the individuals forming the community. And who is to determine what are the best interests of the individuals of the community? Is it not true that some individuals prefer what is not best for them? Shoddy commodities may meet a large public demand, just as shoddy music and shoddy literature meet a large public demand. Once more we arrive at the conclusion that progress in the material sphere, as in the cultural and spiritual sphere, must come only by the self-education and personal effort of the great mass of individuals themselves. This statement would have sounded dangerously like cheap moralising a few years ago, but the events of the last few years, and especially the beastliness and degradation of Fascist and Nazi ideologies, have taught Mankind that policy, in social life generally as in business, must, to be effective, come from the people, and not be imposed on them from without: the relevance to the commercial world lies in the fact that business policy relating to the nature of the commodities produced, their quantity and quality, their methods of production, their means of distribution, depends in the last resort on the will of the consumers, the general public. It is the public who have the ultimate power to determine what goods shall be produced, and

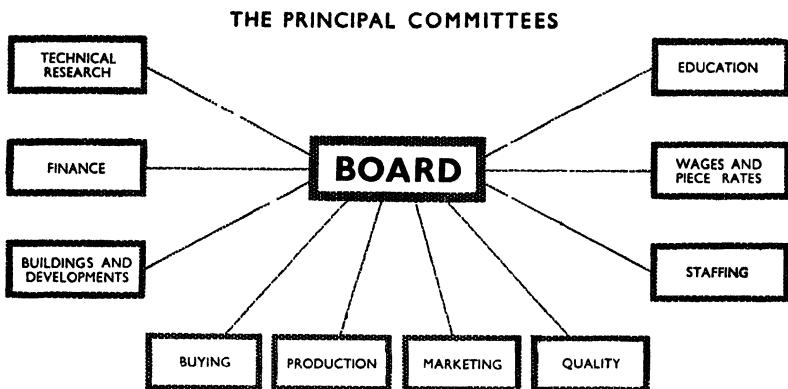
how ; apathy and indifference on their part leave the producers free to produce the goods and sell them as they can, while spending huge sums on advertising and calling upon the consumer to pay for it. It is a striking commentary on the fundamental soundness of democratic human nature that, on the whole, most business undertakings are conducted decently and with a fair dignity ; but the opportunity given to scoundrelism has been too wide for the word " commercial " to avoid a tinge of odium. Not only do the public not get what they want and should have ; they often get what they want and should not have—shoddy commodities like poor foodstuffs and some patent medicines, degrading commodities like cheap and nasty literature and cinema films. A discussion of business policy cannot avoid references to such matters if such a discussion refers not to the world of the past, whose culminating effort was a world war on a grand scale of misery and slaughter, but to a planned world of progress and enjoyment of the best things : in such a world Business Economics and Ethics cannot be separated.

That, in fact, they are not always separated to-day is shown by the pride taken in the value and workmanship of the products of some business undertakings—in dress design, in machinery, in confectionery, in clothing, in food production, in a hundred types of products and commercial activity. Even advertising has been done with dignity and restraint. From the smallest retailing establishment to the greatest manufacturing works, throughout transport and insurance enterprises, differences of policy strike at once the attention of the discerning customer. Differences of policy become evident on a comparison of the departmental stores, the chain stores, and the co-operative retail undertakings. By taking thought on such matters, one can begin to see how business policy can receive some measure of control from the consumer's side, and that it is not always a matter of dictation on the part of some all-powerful " executive ".

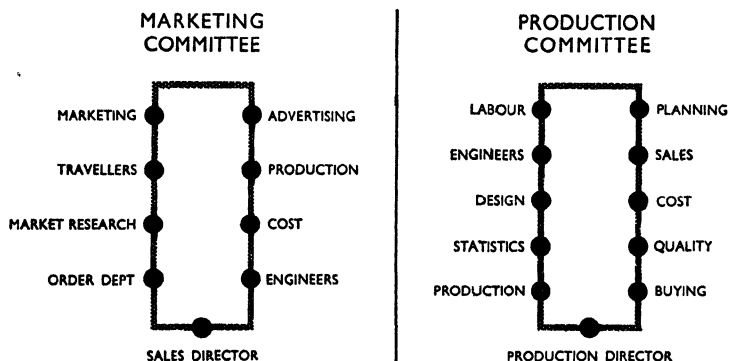
In a large undertaking, the formulation of policy must be to a great extent the result of the deliberations of several departmental heads. Marketing and sales problems are related to problems of production ; in fact, each section of the undertaking will have its own policy, and the integration of these separate policies is the concern of the Board of Directors.

Fig. 29 shows how this integration is secured, in the case of the great cocoa and chocolate undertaking of Cadbury Brothers

THE BOARD AND ITS COMMITTEES FORMULATE POLICY AND CO-ORDINATE THE DEPARTMENTS



VARIOUS DEPARTMENTS ARE REPRESENTED ON EACH COMMITTEE TO ENSURE CO-ORDINATION—e.g.



OTHER MEMBERS OF STAFF MAY BE REQUIRED TO ATTEND

Reproduced from *Industrial Record*, 1919-1939 (Cadbury Brothers Ltd.)

The establishment of interlocking Committees (e.g., as between Sales and Production), each under the Chairmanship of a Director, ensures close co-operation in the framing and carrying out of policy. Each Director is also in charge of several departments, so that the Board has effective control over the day-to-day running of the business.

FIG 29—FORMULATION AND CO-ORDINATION OF POLICY, CADBURY BROTHERS LTD.

Limited, by means of a system of interlocking Committees (*e.g.*, as between Sales and Production), each under the Chairmanship of a Director; each Director is also in charge of several departments. Thus, close co-operation in the framing and carrying out of policy is ensured, and the Board of Managing Directors, in whom the control of the Company is vested, has effective control over the day-to-day running of the business.

Each committee includes not only the principal executives in the activities dealt with by the committee, but other representatives of other departments likely to be closely affected by its decisions. For example, the Marketing Committee is responsible for sales policy, but few decisions can be taken by this Committee without calling for the co-operation of the production departments and of the Cost Office. Therefore, the Marketing Committee, besides including the Directors and Senior Staff dealing directly with Selling, Marketing, Advertising and Market Research, includes also the Director in charge of Factory Production and the Director in charge of Costs. Similarly, although the Production Committee consists mainly of members immediately concerned with the technical and factory departments, it includes also the Sales Director and officials representing the Cost Office, the Statistics Department, and the Buying Office.

A number of sub-committees or "groups" are normally appointed by each main committee partly out of its own membership and partly sometimes of more junior members of the staff, to settle details arising out of its decisions and to give preliminary consideration to questions which subsequently figure on the agenda. Further co-ordination is secured by the part-time attendance at committee meetings of officials or Directors specially interested in a particular subject of discussion, although not regular members.

Thus: the Committees report to the Board of Managing Directors, who meet formally once a week, or oftener if necessary; and since each Director is personally responsible for a particular section of the business and is in constant touch with his or her colleagues (since 1919 one of the Directors has been a woman), a close degree of co-ordination is achieved between the policies and programmes of the different departments.

It may be noted that while retaining many features of a family concern, Cadbury Brothers Limited have for many years

recognised the fact that Industrial Management is a highly skilled profession involving careful recruitment and training. Each Managing Director receives, before his appointment, a period of practical training in the daily routine of the various departments. For many years the Management Staff have been graded into definite groups, each with clearly defined privileges and status; in 1943 three members of the senior Management Staff joined the Board as Managing Directors.

The Extent of the Business Operations.

The general business policy dictates the nature of the commodity to be produced or sold or the nature of the service to be rendered, and the quantity of the commodities to be produced or turned over, or the extent of the services to be rendered. The factors of finance and general administration are, of course, also concerned, and, in fact, the inter-connection of all these factors is easily realised. The problem of the size of the undertaking is intimately bound up with that of the problem of finance and that of technical management. Such separation as is indicated in Fig. 28 occurs because in no other way than by the method of abstraction can we arrive at a composite picture of a typical business undertaking as a living, working machine. Analysis of the total organisation aims at an estimation of the relative influences of all these factors; but it must be realised that they are dynamic, not static factors: they act and react on one another in such a way that a change in one factor produces a change in the others, perhaps a great change in one factor, a smaller change in another. Greater control of resources, an increase of finances, may point to the possibility of an increase in the size of the business operations; but technical efficiency may not be maintained or improved proportionately to the increase in one or all of the factors of production.

The last century has revealed a tendency for the average size of the business unit to increase: the improvements in transport and communications, the increase in population and the growth of towns, the development of banking and financing and insurance and warehousing facilities, have made possible the conduct of business on a larger scale than before. The larger amounts of capital necessary for the carrying on of business on a larger scale have been readily obtained since the introduction of limited liability. These have been the root conditions favouring the

growth of such large-scale undertakings as the department store and the multiple shop, and the development of the Cartel and Trust organisations and all the forms of business concentration have followed inevitably.

Mere size, however, does not necessarily make for success in business operation. The market for, say, motor-cars or tennis-balls or spectacle-frames is not unlimited, and increasing the size of the business beyond the point where its whole output is absorbed by the market results in the expenditure of resources on overhead charges for which no return is made.

The possible size of a business is determined by the extent of the market and the capital and other resources which are available for the marketing of the product. Increase in size brings with it the advantages of large-scale organisation: specialisation of management and delegation of duties in pursuance of the principle of division of labour, the obtaining of stock at favourable terms of discount by dealing in large quantities and direct with the manufacturer, the proportionate decrease in overhead charges per unit as they are spread over larger sales. But these advantages may be secured only where possibilities of expansion occur in the first place: a small-scale suburban retailer, or a local tailor, cannot hope to expand on a large scale, since their undertakings are personal to the extent that they cater for the needs of a small circle of individual customers. If the tailor were to expand his business into a large concern catering for the thousand, he would be undertaking a different kind of business altogether: the personal touch would be entirely lost, and a quite different sort of customer contacted; the change would in effect be from one type of undertaking to another.

Where possibilities of expansion in the same type of business do exist, there is yet a best or *optimum* form in which there is no waste of resources. E. A. G. Robinson, in *The Structure of Competitive Industry* (Cambridge University Press, 1931), defines the optimum firm as "that firm which in existing conditions of technique and organising ability has the lowest average cost of production per unit, when all those costs which must be covered in the long run are included".¹

If, because of the conditions of competition, a firm has to accept a lower price for its products in order to increase its sales, profits may decrease rather than increase, and it will not be able

¹ *Op cit*, p. 15

to increase to its optimum size. The factors determining the size of the business unit will be technical, administrative, financial, and those referring to the market. Technical factors may tend towards an optimum of their own—for example, in bread-making small units make for greatest technical efficiency, whilst in steel-making and ship-building the optimum technical unit will be large. But the technical optimum gives no indication of the ultimate size of the unit—"the technical optimum, though it affords in a sense a minimum scale of efficient operation, contributes hardly, if at all, to the fixing of a maximum scale beyond which growth will lead to progressively increasing cost per unit".¹

A study of such a book as that of Robinson's will indicate to the student the nature and magnitude of the task which would have to be faced by a body of practical economists who were asked to deal with the problems of the planning of the extent of business operations on behalf of the community. Such a task would be a tremendous one; it becomes evident that no "clean sweep" of the structure of Industry and Commerce can be attempted on the basis of enthusiasm alone. We are more and more led to the conception of business operations as being, at least as far as small-scale and individualistic enterprises are concerned, the attempts of individuals and small groups of individuals to meet the changing forces of innumerable economic factors which are themselves changing in response to the changes of the human environment. In such large-scale enterprises as coal-mining, ship-building and banking, committees of experts endowed with adequate powers might conceivably enjoy a good degree of success in determining on behalf of the community the nature and extent of the business operations; but there remain a great number and variety of enterprises on a smaller scale where public control is attended not only with difficulties of an overwhelming scale, but with dangers to the very soul of democracy: we have already considered the case of the small retailer and his struggle with the big enterprises. Personal ability, the degree of risk involved, the extent of the market, are factors which will make for the survival of the "small man" with the requisite ability, the willingness to take the risk, the knowledge of the market, and the desire at all costs to be his own master. Even the amount of capital required will in some cases favour the small

¹ Robinson, *op. cit.*, p. 35.

business: it would not be worth the time and trouble of the large-scale industrial and financial corporations to set up an undertaking necessitating the outlay of only a few hundred pounds—a sum which might be quite sufficient for a person with exceptional ability, and in a favourable economic environment, to begin and maintain successfully an enterprise which would give him a fair living, assure him a happy independence, and be successful in procuring a circle of satisfied customers.

Administration and Management.

The lack of accepted terminology in Business Economics results in a certain arbitrariness of definition. In Part I of *Factory Administration in Practice*,¹ the late W. J. Hiscox uses the term *administration* to denote the functions of the Progress Department, the carrying out of the details of the work planned by the Planning Department. In Part II, Price defined it as “the work of determining the policy of the business and of co-ordinating the sales, distribution and finance aspects of the business with the production through the system of organisation which is set up,”² *management* comprising the actual work of seeing that the instructions dictated by the administration are carried out and of supervising the activities of personnel and machines in attaining the objects of the business. Thus, as James Stirling points out in the Introduction to that work, Hiscox used the term as a function of the management, whereas Price uses it as a function of the directorate.

While stating that Price's definition should be accepted as the accredited modern usage of the term, there being to-day “general agreement that the term covers the functions of the higher control of a business,”³ Stirling admits that there is still some diversity as to the scope of its operation, some authorities using the term to cover not only the determination of policy but also the entire range of management, whilst others restrict its scope to the functions controlled by the directors of the undertaking.

To the present writer it appears that there is a difference between the formulation of business policy and the implementing of that policy in the actual general conduct of the business operations, especially where, as in the case of the large joint-

¹ Hiscox and Price, Fifth Edition (Pitman).

² *Op. cit.*, p. 277.

M (II.)

³ *Ibid.*, p. vii.

stock undertakings, there is a Board of Directors who formulate the policy and lay down the general lines on which the business is to be run, including the matters of quality and quantity of product, while leaving the conduct of the business undertaking, its particular organisation, the co-ordination of management, planning and progress, accounting and financial records, and personnel management and welfare, to others as a practical problem in business economics. In the case of the larger, more purely commercial undertakings, such as a department store, the separation is more apparent than in the case of the smaller trading undertakings and manufacturing undertakings.

In Fig. 28, therefore, *administration* is regarded as the implementation of the policy formulated by those controlling the undertaking as a whole, and comprises the co-ordination of all those factors entering into the organisation of the undertaking, *management* comprising those functions which are involved in carrying into effect the business decisions of the administration—that is to say, those decisions which the administrators regard as being best calculated, having regard to the particular characteristics of the unit concerned, to serve the purposes of the policy formulated. The relationship of administration to management is, therefore, similar to the relationship of planning to progress.

The point, of course, is somewhat theoretical; in practice, policy and administration and even management may very well be in the hands of the same persons, especially in small undertakings, and those concerned would be hard put to it to explain where administration left off and management began. In the case of large undertakings, however, the division of function as apart from division of labour is more apparent: the Board of Directors would formulate the policy, leaving administration to a Managing Director or a General Manager, who would co-ordinate the work of the Departmental Managers, or of the Commercial Manager and Technical Manager if it is a manufacturing undertaking. On the other hand, we have already noted, in the particular example of Cadbury Brothers Limited how the formulation of policy emerges as the result of the deliberations of departmental heads, and how the integration of these policies is the concern of the Board of Directors. This does not invalidate the statement of the separation of functions as between formulation of policy and administration or imple-

mentation of that policy suggested in this work; it is merely an example of the fact that business operations in practice may be, and often are, far more complex and inter-related than might be suggested by neat definitions or diagrams; every undertaking has its own separate problems.

In practice, again, administration must be intimately related to management. The lay-out of plant and machinery and buildings, and the delegation of duties to subordinates, whether departmentally only or on the scale of the undertaking as a whole, are management functions which must be related to the wide functions of administration, of co-ordination of the factors involved in organisation as a whole.

It will have become apparent to the student—indeed it is a matter of plain common sense—that only where the volume of operations justifies their employment, can labour-saving devices such as office machinery, and the delegation of duties to subordinates, the whole elaborate hierarchy of officials and under-managers, add anything to the efficiency of administration of a business undertaking. In large-scale production, as in the case of a large engineering works, division of labour such as is illustrated in the diagrammatic examples of business organisation given in Volume I, becomes not only an advantage, but a necessity. It is obviously a necessity, because only by the delegation of functions to persons possessing responsibility for the conduct of one job or operation can the undertaking carry on at all. The advantages of division of labour arise from the specialisation of function which we have noted as being one of the methods of progress of Mankind in the material world: greater skill is developed by individuals; time is saved in travelling from machine to machine or from job to job, and machines themselves can be specialised, technical research can be carried on. Division of labour may take place within an industry as within a single business undertaking, *e.g.*, radiators and electrical equipment for motor-cars may be the products of a specialised group of undertakings. One has only to consider a common object such as a bicycle or a motor-car to realise how far this process of specialisation has proceeded in the modern world.

Such specialisation, however, may quite well make for smallness of size and consequently a system of administration far less complex than that obtaining in units of greater size and covering many more operations. Manufacturing units confining

themselves to one particular article of a simple nature, and trading undertakings dealing in only one branch of activity, have no need of the intricate administrative systems found in such organisations as large engineering undertakings in Industry or the great departmental stores in Commerce.

Where large-scale organisation is possible, advantages additional to those of specialisation of labour and machines are secured : the large amounts of raw materials or stock purchased are obtained at a less cost per unit because of the special discounts obtainable, and transport and insurance charges are spread over these large stocks and thus reduced ; standing expenses, such as rent, heating and lighting and office expenses, are spread over a large output and are less per unit of output ; experiment and research may be carried on ; more elaborate publicity campaigns can be undertaken.

But even where large-scale operation is desirable, or even necessary, there are serious disadvantages which must be contended against, either by the undertaking itself or by the community as a whole. The case for the watchfulness of the community arises when there is a tendency towards business combination which may obtain an unduly large a proportion of power or influence in the economy of Society. The need for care on the part of the undertaking itself arises from the tendency towards over-departmentalisation and bureaucracy which accompanies the system of checks and counter-checks imposed by a directorate unable to supervise the details of the working of the business machine. This is precisely the danger which results from over-Socialisation of the State : the tendency to increasing returns is eventually replaced by decreasing returns, and there arises a host of officials creating their own jobs, and thus appropriating unnecessarily a share of the national income. When that share surpasses what is warranted by the needs of the industrial and commercial machinery, when the existence of bureaucrats is not justifiable on the ground of efficiency, a position is created which is analogous to a war economy : a proportion of the resources of the community, or of a business undertaking, is expended in sheer waste.

Just as the solution of the evils of centralisation in a modern State may be avoided by devolution—that is, by the delegation of functions to local areas—so in the administration of a vast commercial undertaking, delegation of responsibility to units of the combination enables rapid decisions to be made and the

processes of production and administration to be carried on without loss of efficiency. Committees of local units may form an intermediate link between the local units and the central governing board. This system of decentralisation is practised in the case of the great chemical combine, Imperial Chemical Industries.

Planning and Progress.

In order that production shall take place smoothly without congestion and delays, that the commodities shall be ready at the time promised or scheduled for delivery, planning is essential ; and it is the primary function of the Planning Department or Planning Office so effectively to co-ordinate the technical and commercial aspects of the work involved that this end is achieved. Where goods are made to order, this fact provides the starting-point of the activities of the Planning Department ; otherwise, it takes the estimates of sales provided by the Sales Department.

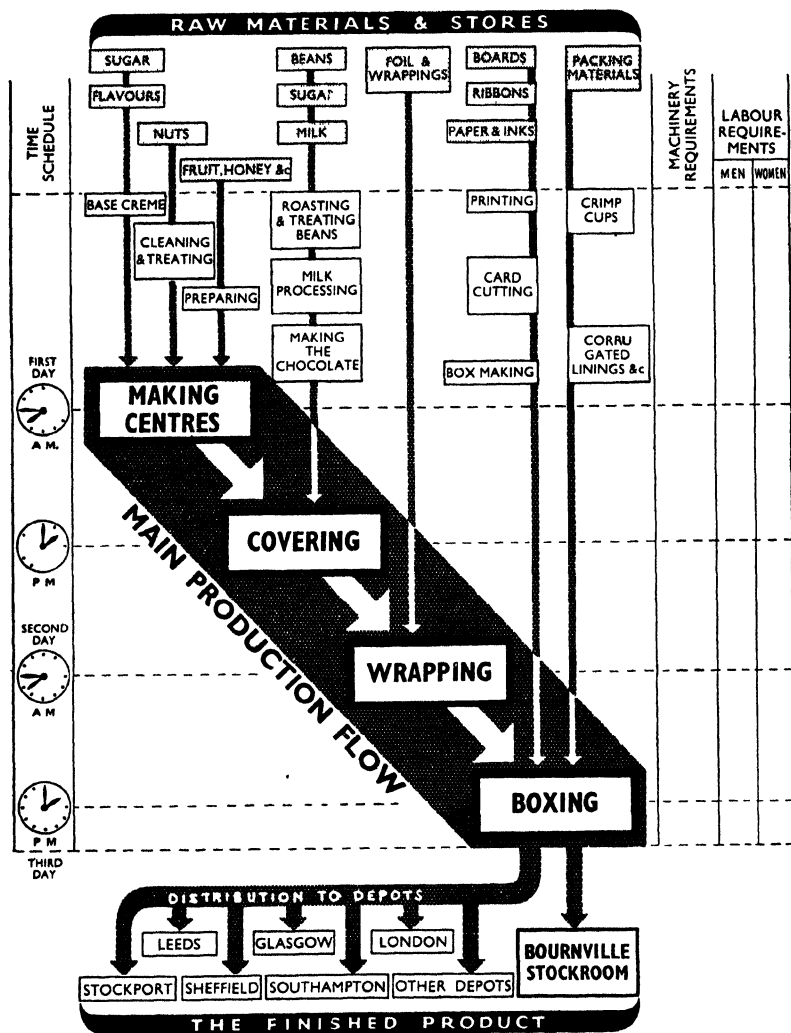
The actual carrying out of the details of the work planned by the Planning Department is the function of the Progress Department. Progress involves the day to day following-up of the work through the factory, the supervision of the processes involved, the control of the supply of raw materials and tools and the preparation of progress records and charts, so that the details of the work in hand can be ascertained at once, and pressure brought to bear where necessary to ensure that the plans laid down can be realised.

Such work cannot therefore adequately be described in general terms, it needs a high degree of specialised technical knowledge and commercial skill, and experience of the work of the undertaking concerned.

Fig. 30 illustrates the day-to-day planning involved in chocolate production at Bournville. Actual work orders are issued mainly on a daily basis, but in order to ensure maximum economy and smoothness of working and a minimum of oversight, production in each department is kept in a continuous flow throughout the year wherever conditions permit. From the forward estimates of sales provided by the Sales Department, the Planning Office plans factory production week by week and month by month, endeavouring to maintain this production at a steady total level irrespective of seasonal or chance fluctuations in sales or in turnover as a whole. Throughout the process of manufacture, production is checked against actual current sales

DAY-TO-DAY PLANNING

OF ASSORTED CHOCOLATE PRODUCTION



Reproduced from *Industrial Record*, 1919-1939 (Cadbury Brothers Ltd.)

The work of the Planning Department involves day-to-day progressing of work through the factory, the control of raw materials and of the distribution of finished goods. It also involves long-term planning, such as converting the forward sales estimates into a production programme to enable the Buying Department to purchase materials advantageously, and the Engineers' and Production Departments to make available the necessary plant and labour when and where needed.

FIG. 30 —DAY-TO-DAY PLANNING IN CHOCOLATE PRODUCTION

COST OF EACH LINE IS REGULARLY REVIEWED
FORM OF COST STATEMENT

NAME OF LINE <i>3^d "Hypothetical" Block.</i>		SALES		1941	Tons
Date <i>June 1944</i>				1942	Tons
				1943	Tons
PRICES OF MAIN INGREDIENTS		PRESENT COSTING		PREVIOUS COSTING	
		Raw Cocoa <i>56/8 cwt.</i>		Raw Cocoa <i>56/8 cwt.</i>	
		Cocoa Butter <i>1/5½ lb.</i>		Cocoa Butter <i>1/5½ lb.</i>	
		Sugar <i>50/10 cwt.</i>		Sugar <i>50/10 cwt.</i>	
PARTICULARS OF LINE					
Weight		<i>32 drums min.</i>		<i>32 drums min.</i>	
Packed		<i>4 doz.</i>		<i>4 doz.</i>	
Weight in Box		<i>6 lb.</i>		<i>6 lb.</i>	
Boxes to 100 lbs		<i>16 bb.</i>		<i>16. bb.</i>	
Price		<i>8/2½ per cwt.</i>		<i>8/2½ per cwt.</i>	
less 1½% Cash Discount per 100 lbs.		<i>135/1</i>		<i>135/1</i>	
To Retail at		<i>3^d each</i>		<i>3^d each</i>	
		Cost per 100 lbs		Cost per 100 lbs	
CHOCOLATE	Materials	<i>78</i>	<i>5</i>	<i>78</i>	<i>6</i>
	Process	<i>15</i>	<i>-</i>	<i>14</i>	<i>2</i>
MOULDING	Process		<i>3</i>		<i>2</i>
			<i>-</i>		<i>10</i>
WRAPPING & BOXING	Materials	<i>2</i>	<i>8½</i>	<i>2</i>	<i>7½</i>
	Process	<i>5</i>	<i>10½</i>	<i>5</i>	<i>6½</i>
FACTORY COST			<i>105</i>		<i>103</i>
DISTRIBUTION			<i>6</i>		<i>6</i>
SELLING EXPENSE		<i>10</i>	<i>13</i>	<i>10</i>	<i>13</i>
			<i>-</i>		<i>11</i>
MARGIN		<i>7½</i>	<i>10</i>	<i>8½</i>	<i>11</i>
			<i>135</i>		<i>135</i>

Reproduced from *Industrial Record*, 1919-1939 (Cadbury Brothers Ltd)

As a result of periodic reviews of the cost of each line, the Cost Office suggests to the Marketing Committee what variations, if any, in price or costs are necessary to give the required margin

FIG 31.—SPECIMEN COST STATEMENT.

and against the Sales Department's revised estimates of requirements, so that the Planning Department has to keep a strict control over the size of stocks, including both finished goods and work in progress.

Costing and Records. The issue of instructions based on these forecasts may be made through the Cost Office, whose main functions are to determine the price at which each unit of commodity can be sold, and to check the details of the processes of production and distribution, so as to expose waste and discover any increase or decrease in costs. The expected volume of sales, the detailed specification of the commodities concerned and of their manufacture are taken into account. By means of periodical costs statements the Cost Office indicates any variations caused by waste or unavoidable changes in costs, and suggests to those responsible for marketing what variations in price are necessary. Fig. 31 shows an example of a cost statement prepared by the Cost Office of Cadbury Brothers Limited.

The collection of statistical records is a source of valuable information in the machinery of correlation of departments or units comprising a large concern. The presentation by the various departments of statistics showing their running expenses, purchases, stocks sales, and any other such information over a given period enables the chiefs of the undertaking to view the activities of the undertaking as a whole, and thus to correct any tendency of a part to operate as a self-contained unit irrespective of the welfare of the undertaking as a whole. On the basis of past records and of reports and surveys of present working—of which, of course, there can be an endless variety—careful forecasts may be made of the sales quota allowed to different parts of the undertaking, production quotas, employment and financial quotas. The estimated volume of business may be related to the estimated costs allocated to each department, and a careful budgeting of expenses such as advertising, rent, rates, taxes for the period may be made, so that a measurable standard of commercial and industrial activity is applied. This system of scientific financial management, or budgetary control, can replace the speculative element in many business operations; but it necessitates, of course, the careful and accurate recording of costs and purchases and sales, the analysis not only of methods of distribution and local organisation, but also of such factors as the design and attractiveness of the products and their suitability in respect of the local areas in which they are distri-

buted. Thus, economic and psychological factors are involved which make the organisation of the business undertaking an extremely complex exercise in applied Economics.

It is evident that the administration of the business undertaking is not a self-contained problem, but one which relates to the whole problem of the undertaking, its purpose and policy; that is, administration is related, not to itself, as it were in a vacuum and carried on for the sheer purpose of providing jobs for subordinates, but to the needs of the undertaking; and those needs are special needs, resulting from the policy and organisation of the unit, and the interaction of these factors with their environment, the needs of the community, its preferences and dislikes. The administration of any particular unit is a specialised machine, but a machine flexible and capable of adjustment to the conditions of its working. Whether control is centralised or not, whether the principle of delegation of duties is carried to a small or large degree, will depend entirely on the conditions for efficiency of the undertaking as an individual unit in a greater social and economic whole.

Finance.

To use a phrase which has now become practically a cliché, finance is the very life-blood of a business undertaking, though it is from the side of accounting rather than from the aspect of an undertaking as a social unit that the subject has received most attention. Certainly accounting is a necessary technical process. The undertaking has to make the most economical use of its resources, and the careful keeping of records and a systematic process of checking are part of the tools of husbandry.

The nature and amount of capital required on the establishment of a business undertaking will depend on the nature and scope of its prospective operations. The nature and extent of the probable market for the product or service to be rendered will determine the type of premises and equipment and labour required, and the operating expenses for the estimated volume of turnover will have to be carefully considered. In the costs of establishment will be included the promotion expenses, including the costs of investigation—this will amount to a considerable sum in an enterprise such as mining—and organisation expenses; in the case of a joint-stock undertaking, organisation expenses will be heavy, having to cover legal charges, registration fees, stamp duties, and all the expenses incidental to floating a

company: printing expenses and postages and stationery will account for a heavy charge.

The cost of the fixed assets will depend on the value of the property and constructions required; contingencies such as a rise in the cost of materials or labour will have to be provided for. Where an existing business is taken over, payment must be paid for goodwill, but the undertaking will have the advantage of having already a group of suppliers and customers; whilst an undertaking newly formed will have to attract a circle of customers and build up a connection with suppliers willing to allow credit terms. At the outset, therefore, a considerable working capital—or excess of current assets over current liabilities—will be called for. As the turnover increases, and receipts of payments come in, the necessity for a large working capital diminishes; but shortage of working capital is always a great drawback: the undertaking should always have enough cash resources to meet its liabilities promptly and to provide for the extensions of its operations as the opportunity arises. Adequate *floating* or *circulating* capital, *i.e.*, easily realisable capital such as cash, stock, and trade debtors in a sound position, should therefore form part of the capital of an undertaking. Strictly speaking, these should be spoken of as floating or circulating assets rather than capital, capital being the excess of assets over liabilities.

Those assets of a permanent nature, and which normally it is not intended shall be disposed of, are *fixed assets*, they comprise such assets as land and buildings, machinery and plant and equipment, and good will. Fixed types of assets are subject to waste and wear and tear, or depreciation, and allowance has to be made so that at the end of a term or terms sufficient resources have been accumulated to replace the asset.

Such matters approach the field of Accounting, but in the wider field of Commerce we may note that the funds necessary for financing a business may be obtained from several sources. In the case of a small undertaking, the proprietors themselves will provide the initial capital, aided perhaps by bank loans or private loans. The increasing interest shown by the banks in the problems of the post-war trading community comes from their realisation that the welfare of the whole community, including that of the banking institutions themselves, is dependent on a flow of resources adequate to meet the needs of enterprise. The Midland Bank was the first to form a special department to deal with post-war loans to Trade and Industry.

The credits granted by trade suppliers are an indirect form of loan, the goods supplied on credit forming part of the circulating capital of the undertaking to which they are supplied.

In the case of the large joint-stock concerns, the initial capital is provided by the subscribers ; additional capital is obtained by way of bankers' loans and advances by industrial finance companies, and resources for the purchase and construction of premises may be borrowed from building societies. If the whole of the authorised capital has not been issued, the further issue of shares will provide new capital. A common method of borrowing is by the issue of debentures, offering security and a fixed rate of interest to investors.

The business undertaking has to steer between the opposite evils of under-capitalisation and over-capitalisation, the former preventing the expansion and even the normal extent of the business operations, the latter being in effect the withholding of resources which could otherwise be put to productive use. The "watering of capital" occurs when bonus shares are issued not wisely, but too well, or assets are acquired and shown in the balance sheet at values which are grossly over-estimated. In the case of a "boom", the prices of stock may rise out of all proportion to their true value, and stock so acquired and valued may help to bolster up the appearance of value of the assets, except to those who are aware of the "watering" process.

The provision of checks by proper accounting methods and by auditing is, of course, a *sine qua non* for the financial conduct of a business undertaking ; and, especially in the manufacturing undertaking, the systematic collection and classification of information will provide the basis for a costing system by which the total cost of the business operations or of sections of the business operations (as in the case of departmental stores and multiple shops), or of groups of units or of units of products, may be determined, helping to ascertain the existence and causes of waste.

Personnel.

It is on the human element that the success of a business undertaking ultimately depends ; a business house is not a machine which is set to run by itself, or tended from time to time by an overseer, or tinkered with by a mechanic. Such comparisons break down in view of the fact that it is the human spirit which not only directs the policy of the undertaking, but labours

constantly in its day-to-day working, planning, controlling, buying and selling ; and it is human beings who perform these operations, not a mechanical contrivance mysteriously endowed with a brain. A business undertaking is a social institution ; and as a social institution it is the product of human minds ; its sustaining force is human mind. If in the past it has been regarded as a kind of profit-making machine, it is certain that in the future the social aspect of business will be more stressed : more and more is the business undertaking coming to be regarded as a co-operative undertaking which owes its existence to the fact of social needs. No doubt the conception will take a long time to grow and to be translated into attitudes and methods of working ; but the increase in public utility undertakings, in their scope and power, is an indication of the shape of things to come. Perhaps the small-scale undertaking will always strive to preserve a high degree of individualistic independence ; and it is well that it should ; the years before the Second World War have shown the fatal effects of encouraging huge industrial monopolies to control their markets by eliminating competition and fixing prices.

If it is true that the aim of a business undertaking is not to provide staff jobs for a number of predatory members of the community, it is equally true that the undertaking has no inherent virtue ; it is of significance not in itself, but in the ends it serves. The staff are there, not to serve the " business " as an end in itself, but only indirectly as a means of serving the ends of the community, including themselves. That this fact is being realised is shown by the increasing respect shown to the personality of the members of business associations ; the master and slave mentality is not so evident as it used to be in, for example, the drapery trade ; and progressive undertakings provide recreative and rest facilities for those of their staff who choose to make use of them.

Works Councils. To establish and encourage and maintain good relations between the rank-and-file workers and the management, and to foster and maintain the spirit of co-operation between the members of the little community constituted by a business undertaking, Works Councils have been set up in many factory undertakings. These Councils must be distinguished from the Joint Standing Industrial Councils which, following the recommendations of the Whitley Committee of 1916, have been formed by voluntary agreement in various

industries to provide machinery for negotiation and collective bargaining and the settlement of disputes; the latter are discussed in Chapter XI.

Works Councils are joint councils of management and employees formed to provide machinery for discussion of matters not covered by specific Trade Union agreement, with a view to achieving co-operation between management and "labour" in the interests of the efficiency of the undertaking as a whole, and in the interests of the welfare and comfort of the employees of the undertaking. Thus, the Works Council will discuss such matters as administration as distinct from commercial policy, working conditions such as temperature, ventilation and lighting, works amenities such as cloak-room accommodation, matters arising from accident prevention, transport, holidays.¹

At Bournville, there are separate Works Councils for men and women, but much of the work is done through joint committees. Each employee has two votes, one for a Works Council representative of his "Group",² and one for his Shop Committee members. The Shop Committees consist of Workers' and Management Representatives in each department; they report to the Works Council on matters affecting working conditions and welfare, or may take action through the departmental management. There is thus a clear channel upward and downward between the individual employee and the Board, replacing as nearly as possible the personal contact which was a characteristic of the undertaking when it was a "family" concern.³

Works Councils may also deal with schemes of social security, such as provision against sickness and old age. To take Bournville again as an example, the Works Councils administer certain joint contributory schemes, including a Sick Benefit Scheme to provide for benefits to supplement the National Health Insurance, and a Dependants' Provident Fund. There are also a number of Schemes at Bournville operated directly by the Company on the management of which there is employee-representation other

¹ See G. S. Walpole, *Management and Men* (Jonathan Cape, 1944), for a description and discussion of an actual Works Council in operation, and for a copy of its Constitution and Rules (Appendix III)

² Departments are grouped according to occupation, e.g., Cocoa, Chocolate, Engineering, Office, etc.

³ The constitution and functions of the Works Councils of Cadbury Brothers Limited, and the operation of this undertaking's welfare and social security schemes, are described and illustrated in *Industrial Record*, 1919-1939.

than through the Works Councils; e.g., there are Trustees of the Pension Funds representing (and elected directly by) the operatives, management staffs and Board, respectively.

Thus, the scope of the functions of Works Councils may include such widely different matters as welfare and recreational activities (in some undertakings there is a Welfare Officer directly concerned with these matters, or his functions may be combined with those of a Personnel or Employment Officer or Department), and the administration of wage-payment systems such as Piece-Rate Schemes; though Works Councils are not concerned with basic hours and wages, these being subject to statutory regulation or to collective bargaining between the Trade Unions and the employers. Equally, in management policy, such as the delegation of duties within the undertaking, the Works Councils have no share.

The delegation of functions in a large undertaking brings its own difficulties. The specialised nature of the work of many members of the business association makes the task of co-ordination a difficult one. The Board of Directors is thus at a disadvantage as compared with the proprietor of a small-scale undertaking; the control of the hierarchy of executives and operatives, of departmental heads and subordinates, calls for a high degree of knowledge, not only technical, but also of human nature.

This hierarchy grades down from the Managing Director or General Manager, through the higher executives such as Departmental Managers and lower executives such as foremen and overseers, to the operatives such as workmen and labourers and clerks.¹

It is in the interests of the undertaking as well as in those of the workers that the problems of recruitment, education and training, and promotion of staff should receive very careful consideration. The elaborate and careful provisions made by Cadbury Brothers, Limited, in this connection are set out in *Industrial Record, 1919-1939*.

Industrial Psychology is more and more intensively investigating the problems connected with the personnel of business undertakings; the field studied in recent years has included vocational guidance and selection, fatigue, industrial accidents, noise, methods of wage payments, movement study, absenteeism,

¹ See Vol I, Figs. 13-17.

management factors. Recent research in vocational guidance has been carried out on behalf of the Birmingham Education Committee.¹

The co-ordination of the legal and impersonal aspects of the undertaking is, in the case of a large joint-stock undertaking, in the hands of the Secretary who, in addition to attending to the legal formalities necessary in the administration of a joint-stock undertaking such as those concerned with the capital, and, especially in recent years, in addition to supervising the accounting of the undertaking, sees to the preparation of the Reports on the progress of the undertaking submitted periodically to the Board of Directors. He prepares statements showing the activity of the concern in units of production ; the costs of obtaining this turnover ; the relation of the turnover to costs ; the nature of the current assets and liabilities ; and the progress of trading activity in general, including the volume of credit purchases and sales in different departments or in different areas, and the amount of bad debts.

The services of people not on the full-time staff of the undertaking are of considerable importance. Legal advisers, auditors, technical consultants and advertising specialists fall under this category ; though in the case of nation-wide undertakings, such as the railway undertakings, solicitors are employed as full-time officers of the corporation.

The tendency towards business concentration and combination has raised problems which reach out from the sphere of organisation as an internal system to questions of wider social significance ; and it is to these that it is now proposed to direct attention.

¹ *Scientific Vocational Guidance and its value to the choice of employment work of a Local Education Authority* (1944), Birmingham Education Committee. 2s. 6d.

CHAPTER X

BUSINESS COMBINATION

The Historical Background.

If there had been anything in the nature of a true social consciousness—which is quite a recent phenomenon—in the nineteenth century, it would have declared itself as following a policy of “*laissez-faire*”. Translated into the actual facts of the case, this means that free competition was regarded as the natural state of human life. Prices, it was thought, were the natural resultant of the forces of supply and demand acting on the basis of free and unrestricted competition—competition between buyers as well as competition between sellers, between old industries and methods and commodities and new ones. The result might be high prices to the consumer, but, to continue to use the French that covered a multitude of economic sins, “*cela ne faisait rien*”. It was the Law, albeit a Kiplingesque Law.

However, such competition was never quite perfect. Human inertia and habit on the part of customers; the psychological effect of a well-advertised trade mark; the advantage of geographical accident; the possession of patent rights; the compelling force of a natural monopoly such as the supply of gas or water, railways or local transport services, or telephones, and the gradual realisation of the fact that the control of resources in a few hands might itself help to raise profits while benefiting the consumer, tended to bring home the truth that co-operation rather than competition is the greater force in making for survival. The increasing awareness of the advantages of co-operation by the workers led to the formation of trade unions, which tried to lay down the principle that competition for jobs should not be allowed to result in a low wage standard; the next step was to insist that this standard should be raised. The possessors of capital similarly tried to restrain the fall of profits through competition, and then to find means by co-operation to increase those profits.

Thus the effects of the opening of new world markets in America and Asia, the abolition of the old gild privileges in Europe and of serfdom, and the improvements in transport, in

giving scope to the play of free competition and individualistic enterprise, were countered by the forces making for co-operation.

But the co-operation adopted was not co-operation in the fully social sense of the word ; it was not the co-operation of Man in his struggle against his environment—even to-day the world has not reached that stage of development. It was a system of defensive and offensive alliances for the sake of profit.

There were two main lines of development in the integration of business operations. Sellers of goods and services combined to restrain prices from falling disastrously as the result of competition, agreeing not to sell below a certain price or outside a certain area or to exceed a given output ; or a selling agency might be set up to market the products of the producing units. Amalgamation might also be used to eliminate competition. This was horizontal combination, of which the cartel is the prominent example ; the organisation of the sale of commodities by means of a central selling agency was a course followed in Germany to a great degree.

The other main line of development of business integration has been along vertical development, control being secured of the various stages of production, from the obtaining of the raw materials to the production and sale of the finished article, and comprising the subsidiary processes necessary for final production—for example, the control of coal- and iron-mining in the production of steel : it is in the iron and steel industries that vertical combination has been most common.

The dependence of the iron industry on coal led the British ironmasters to acquire coal mines even before the nineteenth century began. In Germany, towards the end of the century, the successor of Alfred Krupp, who had acquired German coal mines and Spanish iron mines and a fleet of ore boats, took over the shipyards at Kiel. During and after the 1914-1918 War, Hugo Stinnes built up a vast organisation which originally comprised coal mines, coke-ovens and blast-furnaces, and to which were added steel, steel goods, shipping, and then unrelated interests in such things as films, lumber, newspapers, banks, hotels, insurance companies and shoe factories—a vast Empire which did not survive the death of its lord in 1924.

In Britain, such engineering concerns as Dorman, Long & Co. Ltd., and Bolckow-Vaughan, Ltd., the latter controlling also coal, iron, and limestone supplies, and Bovril, Ltd., owning cattle

ranches in Argentina and Australia, and controlling a vast marketing organisation, became great vertical combines; Lever secured control of the sources of his raw materials abroad; Lipton acquired tea and cocoa plantations. The consumers' co-operative movement, beginning with the establishment of retail stores, took to manufacture and agriculture, and acquired tea and palm-oil plantations, and formed banking, insurance and shipping concerns.

In America an original development took place in the shape of the Trust, the control of several amalgamating concerns being vested in a Board of Trustees, who directed the policy of vast sections of industrial life. The Standard Oil Trust was formed in

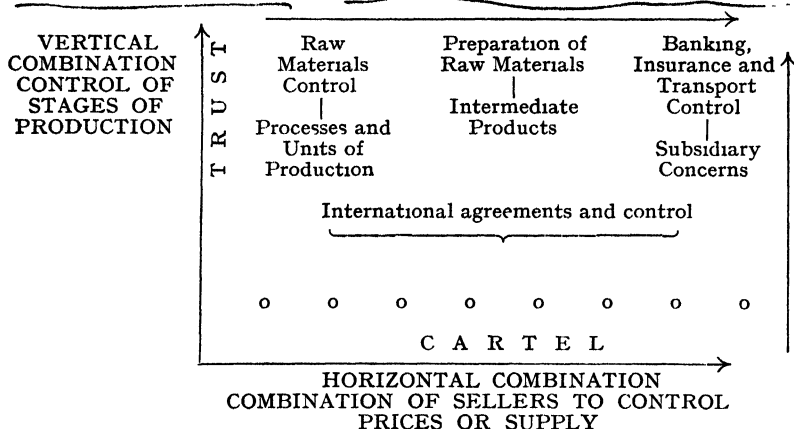


FIG. 32 — HORIZONTAL AND VERTICAL COMBINATION

1882, to be followed by others, including the Whisky and Sugar and Tobacco Trusts. The State stepped in, and in 1890 declared trusts illegal; this merely resulted in the combinations changing their names while continuing to operate as corporations or holding companies; nevertheless, the anti-Trust laws are evidence of the recognition of the danger in allowing "Big Business" to obtain too much economic power. The railway and bank amalgamations in Britain partake of the nature of the trust, though the railways adopted the pool system; they were compulsorily amalgamated in the public interest into four main groups in 1921. In point of fact, it is not true to describe these developments as though each was of a distinctive type quite separate in nature from the others. Amalgamations, interlocking directorates and holding companies shade off into

trusts ; and the pool and cartel become methods of organisation employed jointly with the Trust form, horizontal and vertical combination occurring together.

The Cartel (Kartell) began to flourish in Germany during the depression following the boom of 1871-73, and the tariff of 1879 encouraged the movement. The fixing of prices and output in the interests of the large concerns was a monopolistic tendency encouraged by the State. By 1906 there were nearly 400 cartels in Germany ; by 1932, 2400 cartels controlled the sale of 56,000 commodities.¹ Three well-known cartels were in coal, potash and steel. In 1893 the Rhenish-Westphalian Coal Syndicate was formed to sell the coal of 170 mines producing over half Germany's output. The central bureau at Essen charged competitive prices where there was cheap coal, especially British coal, available ; where prices were high, as in the Rhineland and Westphalia, high prices were charged. The profits were distributed among the members of this Pool in proportion to their agreed quotas.

Regulation of the industry during the 1914-1918 War was followed by Government control. The German Government formed eleven district syndicates to control the mines ; an Imperial Coal Union was appointed to fix quotas and prices, and to allocate markets ; and an Imperial Coal Council, consisting of representatives of producers, consumers, Labour and the State, for general planning and control. Subsequently rationalisation and modernisation resulted in the closing down of the less efficient pits.

A cartel to exploit the German monopoly of potash was formed in 1879, the attempts of a sales syndicate to charge high prices on sales abroad were defeated by firms outside the syndicate. The Government took over control in 1910, and regulated prices and production. The loss of Alsace, which broke the German monopoly, was followed by an agreement with the Alsatian producers to share the world market.

In steel, there were several cartels which united in 1904 to control the sale of steel, rails, railroad ties and girders ; this Steel Union (Stahlwerksverband), which had headquarters at Düsseldorf, included thirty steel works by 1914. It followed the practice of " dumping " goods abroad in order to maintain high

¹ Heaton *Economic History of Europe* (Harper and Brothers, 1936), p. 625.

EUROPE			AMERICA U S A
GREAT BRITAIN	FRANCE	GERMANY	
1890 . J & P Coats, Ltd., controlled one-third thread trade of U K Development of Lever Brothers United Kingdom Soap Manufacturers' Association, dominated by Lever Brothers, produced 70% British soap output.	1864 Comité des Forges (steel)	1870's Development of Cartels 1879 : Potash Cartel; Government control, 1910 1893 Rhenish-Westphalian Coal Syndicate (Ruhr)	1882 Standard Oil Trust, followed by Whisky, Sugar and Tobacco Trusts 1890 . Trusts declared illegal; combinations continued under other names. Iron and Steel combinations 1901 United States Steel Corporation formed 1900-1910 Enforcement of Sherman Anti-Trust Act (1890) Formation of associations to prevent excessive competition. Twentieth century . Great extension of Trust activity.
DYNAMITE TRUST : 1897 onwards			
RAIL - MAKING CARTEL : 1904 onwards			
SHIPPING RINGS AND CONFERENCES : Twentieth Century			
1929 : Formation of Unilever, Ltd 1929 . Formation of Imperial Chemicals, Ltd English Steel Corporation	1927 Chemical combine	1904 Steelworks Union Krupp Organisation Railways and armaments	
KRUGER MATCH COMBINE : 1913-1928			
STEEL 1930 20 undertakings produced 70% British iron and steel output		After 1914-1918 war . Electrical and agricultural machinery, etc 1914-1918 Government control and regulation of German industry	

POST-WAR DEVELOPMENT OF INTERNATIONAL CARTELS	
1934	British Iron and Steel Federation
	Hugo Stinnes and Thyssen
CONTINENTAL GROUP CONTROLLING 70% WORLD'S DYE PRODUCTION	
1914-1918	Government control
1925-1926	Government subsidy
	Quota schemes and subsidies on exports
1930	Coal Mines Act compulsory cartelisation
1938	Coal Commission
1945	<i>Coal Mining</i> —Report of the Technical Advisory Committee.
	Thyssen United Steelworks Company (1926)
	1925 Combination of 13 chemical and dye undertakings
FORMATION OF WORLD INTERNATIONAL COMBINES: VICKERS-ARMSTRONGS, I.C.I., ETC.;	
UNILEVER, LIPTON'S, ETC.	
COTTON	
After 1918	Formation of two great combines
1922-1928	Failure to secure agreement
1929	Lancashire Cotton Corporation
1944	Report of Cotton Textile Mission to U.S.A. (Platt Report)
DISTRIBUTIVE CO-OPERATION	
1844	Rochdale Pioneers
1864	English Co-operative Wholesale Society.
Twentieth century	Rapid increase of turnover to over £200 millions
	Commercial and industrial development

FIG 33 —SOME LANDMARKS IN THE HISTORY OF BUSINESS COMBINATION
(See also Figs 34 and 35)

prices at home. The 1914-1918 War had the natural effect of presenting huge profits to the steel industry. During the inflation period both vertical and horizontal combination took place ; and six great firms produced 90 per cent. of the country's steel. But the War had brought with it, too, the over-production that also characterised the coal industry : the total consumption, both home and abroad, was not more than half the capacity of the industry. International agreement was therefore sought ; in 1926 the Continental Steel Cartel was formed, including the steel-making undertakings of Germany, Luxembourg, Belgium and France ; Czechoslovakia, Austria and Hungary joined it in 1927, but Britain and Sweden stayed out. Agreement for five years regarding output, but not prices, was reached.

In France, a land of strong individualism, business association did not go much beyond the formation of a few *comptours* to handle sales and standardise the patterns and sizes of such steel products as girders. In Britain, railways, shipping firms and banks made agreements in their respective spheres to limit competition ; but the great staple industries, coal and textiles, were still in the hands of thousands of small firms who resisted efforts to persuade them to associate.

Organisation of the British Coal Industry.

The 1914-1918 War cut off the European coal trade from Britain ; the British Government took over the control of the industry, and, after the war, fixed domestic prices at a low level and allowed coal to be exported only under licence, so that the price of coal rose to great heights. The war had disturbed traditional markets : German coal was delivered by way of reparations to France, Belgium and Italy. The coming of the depression caused the removal of Government restriction. A coal strike in the U.S.A. in 1922 and the French occupation of the Ruhr in 1923, leading to a large drop in German output, stimulated the British coal trade for the time being, but in 1924 the world coal situation became more normal. In 1925 an embargo deprived Polish coal of its most important market in S.E. Germany, and Poland became a serious rival to Britain. From August 1925 to May 1926 the Government subsidised the mine-owners, and thus effectually prevented any real attempt to rationalise the industry ; and in May 1926 the seven-months' coal-stoppage began.

In 1924-1926 world consumption of coal was lower than in 1913. Technical improvements, the generation of electricity by water-power, the development of the internal-combustion engine and a reduction in the price of oil, influencing the development of road transport and oil-burning ships, all helped to depress the condition of the British coal industry. Domestic coal production took place by Britain's former customers; some European countries, *e.g.*, Germany, France, improved their coal-exporting trade, mainly on account of their lower costs. Her return to the Gold Standard in 1925 whilst other countries were devaluating their currencies did not help Britain's position, and the Government's attempts to deal with the situation were merely tinkering with it. The subsidy of 1925 had the effect of providing the foreigner with cheap coal at the expense of the British tax-payer.

But perhaps the most serious cause of the whole coal situation has been the excessive number of units, their diversity of organisation and the lack of co-operation between them—points stressed by the Coal Commission of 1925. In such circumstances, the more efficient undertakings did not feel encouraged to amalgamate with the less efficient ones. The variation in prices was, however, an inducement to form cartels for output and price regulation; and there were coal combines in the anthracite trade of South Wales, the only instances before the First World War of combines in the coal trade since the Newcastle Coal Vend, which broke down in 1844, controlled the sales of coal sent by sea from the north-eastern coal districts to London. After the war the "Five Counties Scheme", which came into operation in the Midlands in 1929, and similar schemes in Scotland and South Wales, were attempts, by means of quotas of output and subsidies on exports, to meet the competition in their respective markets.

Government control, under the provisions of the Coal Mines Act, 1930, took the form of limiting output and controlling minimum district prices, the latter proving a difficult task because of the variety of coal produced and the number and variety of markets. The compulsory cartelisation of the coal industry under State control was furthered by the establishment, under Part II of the Act, of a Coal Mines Reorganisation Commission empowered to promote colliery amalgamations. From 1926 to 1933 thirty-eight amalgamation schemes, covering

369 pits and 240,000 workers, were carried through. The 1930 Act was one due to the efforts of a Labour Government, and the administration of the Act was hindered by the opposition of an influential minority of coal-owners; the world depression, too, caused the allocations of output to be greatly in excess of consumption. But when the Act was due to expire in 1932, Part I, which required the industry to establish schemes for regulating the production, supply and sale of coal and to establish a central co-ordinating scheme, was renewed for five years.

But the insistent demand for nationalisation has not ceased. Under the Act of 1938, a Coal Commission was established to take over the ownership of all coal and certain associated minerals and rights as from July 1, 1942, and to promote amalgamations of colliery undertakings where the efficient working, treating or disposing of coal required it. The breaking out of the Second World War prevented the implementing of these intentions, but the great unrest among the rank and file of the coalfields must sooner or later enforce complete nationalisation ¹

The British Iron, Steel, and Textile Industries.

The troubles in the British iron and steel and textile industries were also due to a large extent to the British distaste for combination. Nevertheless, in iron and steel there has been a tendency to vertical integration from early days, certain firms combining all processes, from mining to the manufacture of the finished products; and there has also been a tendency towards horizontal combination. In 1929 the English Steel Corporation acquired interests in Vickers, Ltd, Vickers-Armstrongs, Ltd., and Cammell, Laird and Company, to form a dominating armaments combine, owning also steel furnaces, rolling mills and forges. In 1930 a combine known as the British (Guest, Keen and Baldwin) Iron and Steel Company was formed, and controlled the entire output of heavy steel products in South Wales and Monmouthshire. There was also some combination among other firms producing heavy steel in the North-East, Scotland, Lancashire, South Yorkshire and Lincolnshire.

¹ For the technical aspects of coal production, see *Coal Mining, Report of the Technical Advisory Committee*, March, 1945 (H.M.S.O., Cmd 6610, 1s. net). The Labour Government of 1945 is planning to nationalise the coal mines. See also *Report of the Coal Commission for the year ended 31st March, 1945* (2d net), and *Coal Industry Nationalisation* (Cmd. 6716, 1d. net), H.M.S.O.

But British unification of the iron and steel industry reached nothing like the stage attained in Germany, France, Belgium and the United States. For example, in 1930, while twenty undertakings produced 70 per cent. of the total iron and steel output of Great Britain, five firms produced 70 per cent. of the total German output. In Britain, iron and steel production suffered from the smallness of the individual plants: in 1929 the average output per blast-furnace in Great Britain was 48,000 tons, as compared with 138,000 tons in America and 97,000 tons in Germany. Fuel economies can be obtained with larger plants, the fuel costs amounting to about 30 per cent. of the total costs of steel production. In Britain, too, the industry has been overburdened with middlemen and depressed by price-cutting.

The British employers attempted to cut their losses by rationalisation and by forming combines; they also demanded a protective tariff, and in 1932 the "National" Government imposed a tariff of 33½ per cent. on a wide range of iron and steel imports on condition that the iron and steel manufacturers undertook the reorganisation of the industry. After an abortive attempt in 1933 to set up an Iron and Steel Corporation of Great Britain, a less comprehensive plan was adopted in 1934, a British Iron and Steel Federation being set up. But the lack of any real desire on the part of manufacturers thoroughly to overhaul the industry has given more weight to the demand for social ownership and control.

In the British cotton industry, the combine movement of the last decade of the nineteenth century was confined mainly to special branches, that is to say, to the fine-spinning, sewing-thread and the finishing trades. Before the First World War Lancashire supplied nearly three-quarters of the cotton goods entering into international trade; cotton products formed 31 per cent. of the manufactured goods exported by Great Britain; and four-fifths of the production of British mills was for the export trade. During the post-war boom two great combines were formed in the spinning branch of the industry, the Amalgamated Cotton Mills Trust and Crosses and Winkworth Consolidated Mills; by 1922 these combines together controlled 3½ million spindles. The sewing-cotton firm of J. and P. Coats, which had amalgamated with its four great rivals in this country in 1895-6, acquired controlling interests in small firms, gradually spread to the Continent and to America, and eventually obtained

a virtual monopoly of the world's cotton-thread industry. But the cotton-goods industry at home declined badly; by 1933 Britain had lost her place as the world's greatest supplier of cotton goods, mainly owing to the rapid increase of cotton production in other countries, particularly Japan, and to increased production of cotton goods in India and China. The strong organisation of the Japanese industry was a great factor in its success; four combines controlled 50 per cent. of the industry: the house of Mitsui owned mills and manufactured textile machinery, owned cotton plantations in America, controlled an importing and exporting undertaking, owned one of the largest national banks, and had interests in shipping, coal-mining and artificial silk.

An attempt in 1922 on the part of a number of British spinners to form a Provisional Emergency Cotton Committee failed to secure agreement for the effective control of the cotton trade. Another attempt in 1927—this time to form a cartel, the American Cotton Yarn Association, to grade yarns, fix minimum prices and regulate output—also failed because of the undercutting of the minimum prices by firms outside the Association. In 1928 a Joint Committee of Cotton Trade Organisations was formed to co-ordinate the various sections (*e.g.*, the American section, the Egyptian section), and to encourage amalgamations which would secure the advantages of specialisation and standardisation and large-scale buying and selling. A number of combines were formed, the most important, the Lancashire Cotton Corporation, in 1929: the latter, by 1931, had acquired over 100 mills, and was reorganising the production of standardised yarns and cloths.

But complete agreement has been lacking among the undertakings in Lancashire, and the use of machinery rapidly nearing obsolescence has not helped matters. By the beginning of 1935 the Lancashire Cotton Corporation, backed by the Bankers' Industrial Development Company, had acquired over 140 mills; only seventy-four were kept working, and over $4\frac{1}{2}$ million spindles had been discarded.

As in coal and iron and steel, it seems that a complete overhaul and reorganisation of the cotton industry, to conform with changed world and industrial conditions, and more complete centralised control, is the only solution of the difficulties of the British cotton industry.

The Cotton Textile Mission sent to the U.S.A. in 1944 to

survey the American cotton industry and to advise on changes of method which the mission considered might fruitfully be adopted in this country found that the superiority of the productive efficiency of the American operatives was due almost solely to greater mechanical efficiency in the United States. Greater mechanisation and modernisation was required in the British cotton industry; and the merchanting organisation also required drastic overhaul.¹

Circumstances may be said to have forced a measure of agreement on railways, shipping lines and banks; and as the world commercial system grew ever more complex, ever reaching across international boundaries in the search for spheres of exploitation, so combination in business proved a stronger force than political factors—or, perhaps, intermingled with political factors to produce associations which puzzle and disconcert the ordinary citizen and render him more than ever suspicious of the moral integrity of “big business”.

International Combination.

A few large units formed international transport cartels before the 1914–1918 war. We have already discussed in Volume I the shipping “rings” and “conferences” which made agreements on freights and fares, and parcelled out the shipping routes; in America and Australia legislative action was taken against them. We have noted, too, the method of attracting the loyalty of shippers to certain companies by offering them rebates. These “rings” and “conferences” operated on most of the world’s sea routes.

In armaments there were a few great concerns supplying a limited number of customers. The European cartel in rail-making formed in 1883 was strengthened in 1904; and before 1914 there were international agreements to control the sale of aluminium, electric bulbs, calcium carbide, plate glass, bottles and enamelware. “At least a hundred cartels crossed national frontiers.”² The War broke some of them temporarily, but after the war they were replaced and added to; steel, nickel and other metals, potash, nitrates, oil, dyes, paper, glue and wood pulp

¹ *Report of the Cotton Textile Mission to the United States of America, March–April, 1944* (H.M.S.O., 1s. 3d. net).

² Heaton, *Economic History of Europe*, p. 629.

SOME POWERFUL INTERNATIONAL CARTELS

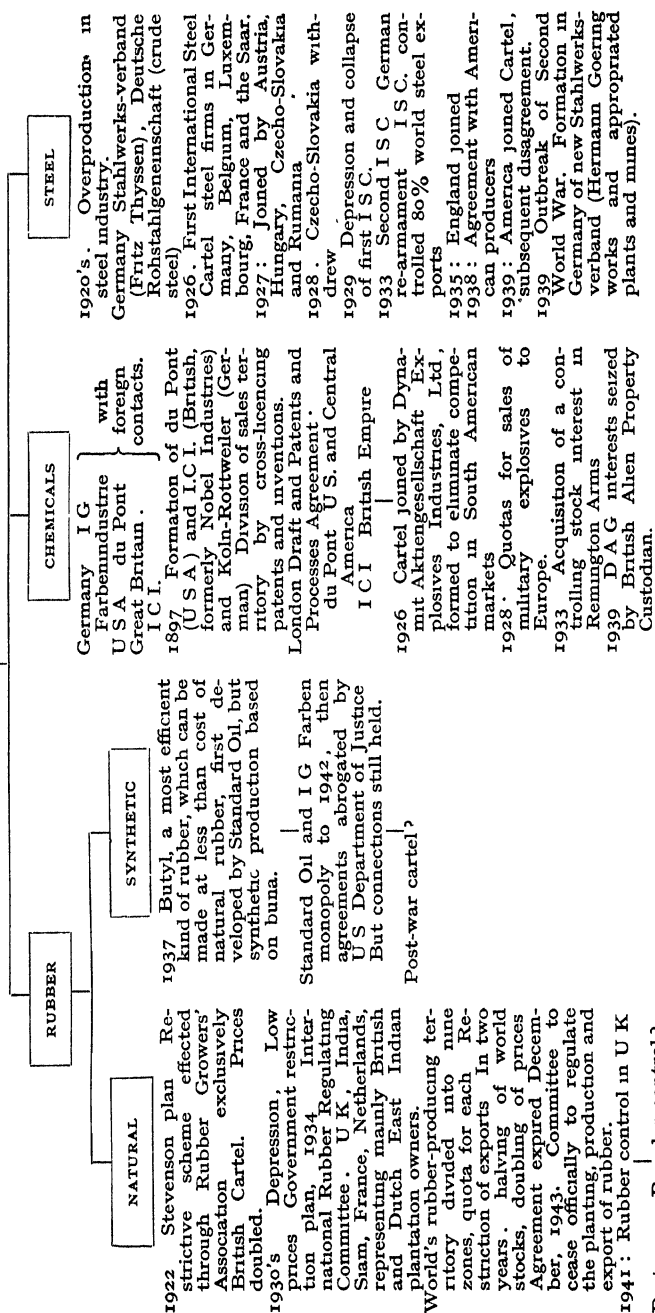


Fig. 34 — SOME POWERFUL INTERNATIONAL CARTELS

The information in this chart has been abstracted (by permission) from an abbreviated version (published by the Economic Reform Club and Institute of London) of *Cartels — the Menace of Worldwide Monopoly*, issued by "The New Republic" of New York, March 27, 1944

were among the products marketed through international organisations.

It must be remembered that the cartel type of organisation is one in which the individual undertaking does not lose its individuality. The agreements are for a limited number of years and are based on a quota system, each industry or firm affected trying to obtain profitable prices at least in the home market. Difficulties arise in the enforcing of price agreements—unless, following the German method, such price agreements are enforceable at law—for evasion is easy, especially where agents are employed in selling. A fixed selling price is a disadvantage to the undertaking wishing to expand production by offering the inducement of a lower price, though it may happen that such an undertaking may produce better goods at the same price than another and so capture the market, in any case, price restriction is no guarantee against overstocking the market.

Great difficulties are also found in maintaining an agreement to restrict output; and in the determination of quotas there is naturally considerable conflict between the members of the cartel. Cartels have been most effective in industries necessitating great capital expenditure and heavy overhead costs and where the number of undertakings has been small. Where a cartel has comprised too many units it has tended to perpetuate the existence of the least efficient by giving each a share in the market. Heaton considers that "it seems probable that cartel efforts in maintaining prices before 1929 did much to encourage excessive production, and that similar efforts after 1929 did something to prolong the depression".¹ Price maintenance has been more successful in the domestic field than in the international one, where "dumping" of goods at low prices is often too strong a temptation to be overcome.

Far greater control of an industry is obtained by means of such devices as amalgamation, interlocking directorates, holding companies and the various stages of Trust formation. Such developments were aggravated by the post-War boom and the inflation period in Germany. J. and P. Coats, as we have noted, obtained a virtual monopoly of the world's thread industry. In 1929, Lever Brothers, the soap magnates, already the possessors of factories and plantations and trading posts abroad, amalgamated with the Margarine Union, controlling the margarine

¹ Heaton, *op. cit.*, pp. 630-1.

and soap trade on the Continent, and itself the result of the amalgamation of two Dutch companies, to form Unilever, Ltd., a gigantic organisation whose activities included not only the production of vegetable oils and margarine and soap and perfumes and cattle foods, but also the operation of chains of grocery stores, fish shops and restaurants; 140 of these subsidiaries were formed, and their activities included fishing, whaling and sealing, and the production, transport and sale of soap, oil seeds, candles, jam and cocoa, in addition to products associated with soap and vegetable oils. They sprung up not only in Europe, but also in Nigeria, the Congo, the Dutch East Indies, North America and Australia.

In Germany strong combinations took place in the steel, electrical and chemical industries. In 1925 thirteen chemical and dye undertakings united to form the great financial unit, the *Interessengemeinschaft Farbenindustrie*; in 1926 four large undertakings, with interests in ore, coal and machine manufacture, combined into the United Steel Company. Three chemical works merged in France in 1927, and the two large German groups producing synthetic nitrogen, liquid fuel, rayon, explosives and camera films made agreements with the French firms and with firms in Switzerland, Belgium and Italy to form a Continental group controlling 70 per cent. of the world's dye production.

The first international trust was the Nobel Dynamite Trust, Ltd., established in 1886; it controlled the dynamite companies in Germany and Britain and made agreements with producers in other countries. In oil, there had been considerable rivalry between the three great combines, the Royal Dutch Shell, the Anglo-Persian and Burmah Oil, which was ended by co-operation.

We cannot trace here the intricate ramifications of the economic wars that followed the military war of 1914-1918. Combine fought combine; all the big batteries of finance were brought up to bear upon the field of the exploitation of the ordinary man. The chief industries concerned were electrical generation and appliances, wood pulp, rayon and non-ferrous metals: these were, Heaton tells us,¹ for the nineteen-twenties what railroads had been for the eighteen-forties and 'fifties. Little men tried to run huge undertakings whose nature and scope called for national, if not international, organisation, adding little or nothing to productive or financial efficiency, for the capital charges of their

¹ Heaton, *op. cit.*, p. 638.

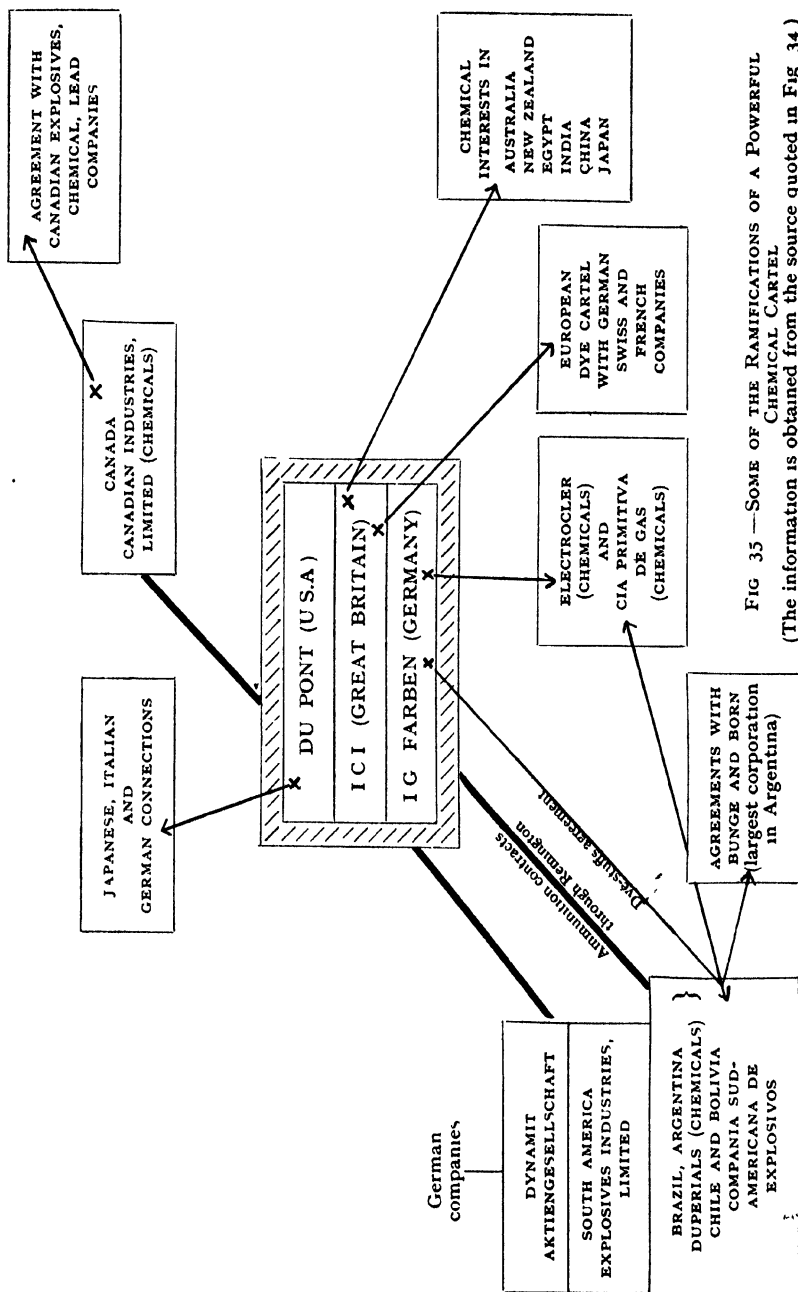


FIG 35—SOME OF THE RAMIFICATIONS OF A POWERFUL
CHEMICAL CARTEL
(The information is obtained from the source quoted in Fig 34)

undertakings were extremely heavy. Many were mere financial adventurers, strutting on the post-war stage, Napoleons of industry, catching up in their heady careers, like Napoleon, an army of humble and more worthy men to be broken and shattered.

Such was Ivar Kreuger, a Swedish engineer who grouped some Swedish match firms in 1913, combined them with their rivals in 1917; during the next ten years he built up an organisation controlling factories in forty-three countries, producing 80 per cent. of the world's matches, and securing control of the State match monopoly in thirteen countries. Vast amounts of capital were raised in London and New York; the financial juggernaut rolled on, catching the imagination of the get-rich-quick dreamers of the Old and the New Worlds, but scorned by a Russia which had sickened of the old ways of poverty and plenty of both the Old and the New Worlds. Drunk with the heady wine of High Finance, Kreuger imagined himself a financial deity, scorned orthodox methods, and forged and deceived. But the depression of 1929 swept over his pretentious schemes, found him out, and put him where he belonged: "in 1932 a tawdry suicide in a Paris hotel bedroom ended the career of this northern Napoleon".¹

The Future of Large-Scale Organisations.

The story of business combination under complete freedom of private enterprise is too often a sordid one. It is difficult to discuss fully the nature, scope and operations of business combinations as they exist to-day, because information about them is exceedingly difficult to obtain; it is secret and confidential, and one may well consider that this characteristic, like secret diplomacy in political life, is by no means an argument in favour of these types of organisation in economic life.

It is difficult, too, to forecast with any great degree of confidence the probable lines of development which will take place in the decades after the close of the Second World War. At present, enthusiasm runs high, hopes for a new and more equitable order of Society rise in everybody's breast; but men forget, and enthusiasm dies if but a modicum of reform is granted in the shining days of peace so that life becomes a little less arduous and there is a little more equity in the sharing-out of Man's resources.

¹ Heaton, *op. cit.*, p. 638.

Nevertheless, there are certain developments in process of evolution whose further progress will not be denied. Undoubtedly, there will be more emphasis on the principle of co-operation rather than mere combination for the purpose of defending self-interest in a kind of international economic warfare. The Co-operative system itself has already reached a high stage in communal ownership, though not in spirit: the prospect of dividends still looms larger in importance than the attractions of self-government and control. The fact, too, that it is only a rival to, and not the supplanter of, the great departmental stores and multiple shops, or even the small-scale undertakings, indicates not only that it is different in kind from these undertakings, but that co-operation of this particular nature has not a universal appeal. In point of fact, the co-operation in economic life that is required by the community seems to be something much wider than mere trading or productive co-operation; the community is quite content to leave the job of business organisation to the experts and to those with the flair for this particular work; what it does require is co-operation in the whole business of getting the best out of Man's economic environment. It does not want to destroy private enterprise, because it has a shrewd suspicion that private enterprise is in many respects more efficient, more alive, more polite and less cumbrous in its working than vast politically-minded bureaucratic organisations which are more concerned with the machinery of organisation itself than with the purpose for which the machinery is created.

But the community does now demand that waste and inefficiency in private enterprise shall cease; that it is not put to the expense of paying for the erection and maintenance of two factories where one would serve equally well—and it is the community who pays, eventually; that it shall not be required to waste its resources in vast advertising expenses; that it shall not be the victim of international economic wars which may so easily develop into the fiercer and civilisation-destroying armed conflicts that have shaken two generations in recent years; that it shall not be the goose laying the golden eggs for the cartels and trusts and combinations struggling to gain possession of it so as to extract the greatest return from it by monopolistic exploitation.

The satisfaction of the desire for exploitation of material resources in the interests of the community must necessitate

some kind of central co-ordination of the business policy of the country. If State control is to be avoided—and State control, never an unmixed blessing, is better avoided in some branches of economic life—the alternative is rationalisation in its best forms. Rationalisation comprises the reorganisation of industrial undertakings on up-to-date lines; the elimination of superfluous or inefficient units, processes or operations; the securing of the economies of large-scale working and buying and selling; the standardising of products and processes; and the employment of scientific management. Rationalisation does not necessarily involve amalgamation or cartelisation or trustification; though it may do so; its object is not the ruthless elimination of units for its own sake, but the co-ordination of units so as to produce the optimum result. We have noticed how much rationalisation has been imposed by circumstances upon our great staple industries.

There must, of course, be control of business combinations; and this will be not only a national, but an international task. The world cannot afford gentry of the Ivar Kreuger type; it has become tired of economic Napoleons and Hitlers. Nor can it afford States of the German type which will encourage cartelisation of its industries and trade in the furtherance, fully conscious or subconscious, of the policy of sacred nationalism.

Such international intricacies will have to be worked out by the intelligent labour of the democratic peoples of the world in the years to come; on them, on them alone, will depend the future and prosperity of Mankind. In Great Britain, a Labour Government pledged to control cartels and similar combinations came into power in 1945.

In the next two chapters we shall discuss the progress made in our own country in the sphere of economic activity carried on in the interests of the community.

CHAPTER XI

THE STATE AND BUSINESS AFFAIRS

The Development of State Influence.

There has never been a period when the State has kept absolutely aloof from business enterprise, for such a thing is impossible. We have seen that the economic system is a function of the social system, that the economic life of societies is part of the general social life, and that the economic activities of the members of a community are intimately and inseparably connected with other aspects of their social life as a whole. One cannot detach from social life as a whole the problems of the ways in which human beings make use of their economic environment; economic facts influence the formation of social strata, and so determine political classes; even religious attitudes and moral ideas are connected with economic facts in ways which we do not at present fully understand, for research in such matters has not gone very far. And in the same way, political facts and ethical facts and religious and moral facts influence the economic life of men and women: the social whole is exceedingly complex, and we cannot attempt to trace here the various strands that make up this whole.

This inter-relationship of all these aspects of Man's life has not been appreciated by our forefathers—indeed, it is hardly appreciated to-day. And certainly, if there is as yet little in the way of a true social consciousness even to-day, if it has taken two world wars of appalling material and psychological and spiritual damage to enforce the beginnings of such a social consciousness upon Mankind as a whole, there was even less of it in the years that have gone—the years that the locusts have eaten, when cruel and wasting military and economic wars have disturbed the development of human progress. Men thought that they could separate their lives into various compartments, all distinct and separate from one another, and that each compartment was entirely self-contained and had no influence on other compartments. This attitude reached its zenith of influence in the nineteenth century, in the days of "*laissez-faire*", when it was thought quite right and proper that a factory owner should carry his Bible to church on Sunday in humility and

	SOCIAL AND POLITICAL FEATURES	ECONOMIC FEATURES
800 A D — fifteenth century	Break-up of the Roman Empire. The Dark Ages: War, violence, ignorance. Invasions. The Feudal System under the Saxons. The Feudal System under the Normans (1066–sixteenth century). Decay of the Feudal System. Growth of towns; beginnings of municipal life and government.	Mainly agricultural; open-field system. Shipbuilding under Alfred, foundation of the Royal Navy. Merchant guilds (twelfth–fourteenth centuries) and craft guilds (fifteenth–sixteenth centuries). Fairs and markets. Fourteenth century Development of woollen industry. Fifteenth century. Enclosures for sheep-farming. Voyages of discovery.
Sixteenth– seventeenth centuries	The Elizabethan Age—growth of strong central government. The Renaissance. Rebirth of the spirit of the "ordinary man". Adventure in life, letters, and discovery. The foundation of the British Empire. The Reformation: freeing of England from the domination of the Roman Catholic Church. The Counter-Reformation (attempt of Roman Catholic Church to reform itself and stem the flood of Protestantism). The Civil War (King v. Parliament), 1642–1649.	Agriculture. Some handicrafts and shipbuilding. Voyages of discovery. The trading companies. The doctrine of Mercantilism. Navigation Acts: for the regulation of shipping and the fostering of British trade. Bank of England incorporated 1694.
Eighteenth century	<i>At home</i>. Beginning of rise of industrial class, and of class conflicts. Rise of Conservative and Liberal parties. <i>Abroad</i>. Wars with France. Expansion of overseas Empire. Quebec acquired, 1763. Settlement of Australia and Africa begun. Inland penetration of India. 1783. American Declaration of Independence.	Agriculture. Enclosure movement. Beginning of scientific agriculture. Britain a great commercial power. Industry: Beginning of Industrial Revolution. Inventions from 1733 (Kay's Flying Shuttle). 1776. Publication of Adam Smith's <i>Wealth of Nations</i>.

FIG. 36 —THE DEVELOPMENT OF
(To be studied in conjunction with

	SOCIAL AND POLITICAL FEATURES	ECONOMIC FEATURES
Nineteenth century	<i>At home</i> : Great increases in and re-distribution of population Reform Act 1832 The Chartist Movement · 1838-1848. Rise of the working class Rise of the Labour Party Trade Unions Anti-combination laws repealed, 1824 1868 First Trade Union Congress 1874 First election of Trade Unionists to Parliament Trade Unionism spreads to Agriculture <i>Abroad</i> . From 1870 Development of the British Empire as a World Power Development of the Tropical Empire Truck Acts 1831 onwards Factory Acts	Spread of the Industrial Revolution Rise of Co-operative Movement Development of private banking system crises 1844 · Bank Charter Act Limited liability 1858-1862. 1858 · Principle extended to banks joint-stock banking received a great impetus Mobilisation of capital at home and abroad Transport . Railways (after 1840); steam-ships (iron ships after 1860) Suez Canal : 1869 altered trade routes of world Refrigeration 1882 Free trade 1840-1914 Rise of combines .
Twentieth century	1914-1918 First World War Post-War boom, followed by the Great Depression of the Thirties (<i>see</i> Figs. 19 and 20) 1909-1918 Trade Boards Acts. 1911 . Beginning of social insurance legislation 1918 . Vote for men over 21, for women over 30. 1928 Votes for women at 21 1932 Statute of Westminster · British Commonwealth of Nations	War economy Entry of women into industry on a large scale <i>Trade</i> . Rapid development of marketing and distribution. <i>Transport</i> : Road v. Rail rivalry. Railway Act, 1921. <i>Industry</i> . Development of productive capacity Spread of combines. Industrial legislation : Workmen's Compensation Act, 1925 Factory Act, 1937.
	Increasing inter-connection of social, political, economic and commercial factors. Increasing international inter-dependence; but tariff and commercial wars 1939-1945 · SECOND WORLD WAR. 1945 · Labour Government in Great Britain. 1945 First Congress of World Federation of Trade Unions. 1946 · Jan 10. First meeting of General Assembly of United Nations Organisation	

grace, and work men, women and children to death in terrible physical and moral conditions on week-days.

In many ways the nineteenth century was an age of retrogression in the general social sphere, though tremendous material advances were made. The Middle Ages were years of material poverty and filth and violence ; Society was stratified into fixed orders, and the rule went to the strong and ruthless. But there was a spirit of paternalism mitigating the severities of government—Britain was still part of the great Christian Empire in Europe—and the guilds and economic associations of the Middle Ages did attempt to enforce some sort of economic integrity and honesty in the toil of men. And they preceded an age of intellectual ferment and discovery, of adventure in the psychic world as in the physical ; very soon after the crude barbarities of the Dark Ages the beginnings of the Renaissance were stirring in men's hearts.

In the political sphere the Battle of Bosworth Field saw the end of the private wars of the marauding ruffian-barons of the Middle Ages in Britain. Throughout the thirteenth and fourteenth centuries trade was growing, standards of comfort were rising as a result of the spreading of ideas by the Crusades ; trading cities, independent or nearly so, grew up : Venice, Florence, London, Paris, Hamburg, Novgorod—the Village Economy gave way to the Town Economy. Printing began, eventually to free men's minds from the intellectual domination of the Church ; the national State came into being, bringing the necessary control of a strong central government. The spirit of adventure and the improvements in shipbuilding sent men on voyages of discovery which were the beginnings of the developments by which the whole world was bound into one economic unit.

It is true that the Reformation, to a great extent the expression of the Renaissance in the religious sphere, occasioned material and psychical wars which destroyed lives and happiness ; that the coming of the modern State brought the evils of Nationalism ; that the opening up of new lands let loose the play of passions and greed. Many people were at heart savages in those days, as many people are at heart barbarians to-day. But the stresses and feuds, the struggles and conflicts, were the birth-pangs of the modern world as we know it to-day. On the scale of the earth's history, they were our yesterday ; they might have been but the prelude to a far happier and gracious age, had it not

been for the fact that the material inventions and discoveries of the nineteenth century gave tremendous material power into the hands of a Western World that was not ready for it, and came near to destroying itself in two great wars, which, however, may yet have shown the way to a better way of life to millions who have not thought very much about these things before, who may yet be living at the dawn of an even more glorious Renaissance.

The dissolution of the monasteries at the time of the Reformation had the effect of re-distributing the property and income of the Church, though mainly in favour of the nobility. Religious persecution re-distributed talent and ability: the Jews and Moors from Spain, the Huguenots from France, carried their knowledge and skill with them to be used in the lands in which they sought refuge; the industrial progress which England made in the sixteenth century, *e g*, in the manufacture of fine woollen cloths, owed much to the immigrants from Flanders.

The European trade routes which were established, the growth of towns and the greater combination of effort such as the confederation of north German towns into the Hanseatic League, the formation of national States and their regulation of currency and commerce, were all part of the great uprising of the human spirit and will, as even were the diligence, thrift and dour asceticism of reformers of the Calvin type; austere and gloomy as were the religious conceptions of some extreme and bigoted Protestants, and troubled much psychologically as Puritanism was with frustration and a sense of guilt, it did call out those qualities of husbandry and hard work which were necessary for the development of capitalistic enterprise in trade, industry and finance—such a development, it seems, being an inevitable step in the rehabilitation and economic progress of Europe.

Economic unity came slowly; internal customs, boundaries and local privileges lingered on to hamper the growth of trade; the evolution of national States was accompanied by wars caused sometimes by the ambitions of national leaders and rulers and sometimes by economic stresses; and these wars were fought on an increasingly expensive and destructive scale—not by those whose interests were directly concerned: the Italian and Hanseatic towns hired troops for the dangerous and dirty work of the actual fighting. The expenses of centralised government—expenses often more connected with the glorifying and self-indulgence of the clique of rulers than with the needs of the State, as in the

case of the court of Louis XIV of France—resulted in the piling up of indirect taxation and the farming out of titles, monopolies and patents, and the depreciation of currencies; the banking houses which were springing up entangled industry, commerce and trade with the personal affairs of monarchs and of the noble houses. The geographical discoveries occasioned further causes of wars of exploitation. The Renaissance and the Reformation had failed to direct the human spirit along the line of the greatest good; and it is only to-day, after centuries of painful learning by experience, that Mankind has reached a point where a new start can be made in bending the economic environment to human will and progress.

The brief sketch of the development of modern industry and commerce given in Chapter V of Volume I of this work cannot be elaborated here; to such works as Heaton's *Economic History of Europe* the student must go for a detailed account of the economic development of the Old World. We can, as it were, but note the headlines of economic history, as we do in Fig. 36. We note the rivalry of the new national States breaking out into Mercantilism, the system followed between the sixteenth and eighteenth centuries whereby international trade was regulated by means of import duties and prohibitions and export bounties so as to secure a "favourable balance of trade". The economic war fought with tariffs and bounties and prohibitions to encourage trade, manufacture and shipping, broke out into wars fought with material weapons.

The intellectual revolt against this state of affairs was led by Adam Smith, whose *Wealth of Nations* was published in 1776. The Napoleonic interlude prevented the implementing of the new vision until the second decade of the nineteenth century; and then from 1820, though the Protectionist policies of the Continent during the last quarter of the century brought about reaction in this country, England entered upon a Free Trade policy which lasted until the outbreak of the First World War. Her rapid progress in the Industrial Revolution lifted her into the position of leadership among the European nations.

In France the Protectionist policy employed by Napoleon lingered for a time, and it was not until 1860 that a free-trade system was introduced; but a protective policy was resumed in 1872, to make France one of the most highly protectionist of countries.

A united commercial policy for Germany was not possible until economic unity was achieved by the Zollverein in 1834, when internal customs between the various units were abolished, and obstacles were removed to inter-State transport and communications. The German Empire, formed in 1871, at first favoured free trade, but soon changed to protection and engaged in the customs wars. Thereafter the German story is one of consolidation and unification, of the development of a nationalism that tended to make the State the supreme fact of existence.

On the credit side of Napoleon's account, it must be said that he had already brought to France the advantages of commercial unification, abolishing the internal customs dues, improving transport and unifying the system of weights and measures. Both the Revolutionary and Napoleonic Governments did their utmost to encourage the growth of industry, holding industrial exhibitions, encouraging schools of civil engineering and mining—long before these were set up in England—and aiding technical research, as in the case of the sugar-beet industry, bleaching and steel manufacture.

The rise of the great nations of America and Russia, and the coming into being of the British Commonwealth of Nations, are political factors of tremendous significance in the story of European development. One can trace the connection between the opening up of the food resources of the New World and the decline of British agriculture. The inter-relationships of the factors of colonial expansion, of investments abroad, of the joint-stock system of enterprise and the spreading of risks and the separation of the functions of the capitalist and organiser, of factory legislation, of labour combinations and the attempts of the State to interfere with and regulate them, of business combinations and State control and regulation, of a hundred other factors of greater or less importance—all these are too complex to be dealt with here; their implications are being worked out, and some day economic historians will be able to put them into their proper proportion and perspective. What we cannot help but note is the increasing part which the State has played, and is playing, not only on general business policy, as in the prohibition or restriction or encouragement of imports and exports, but also in the narrower field of business organisation itself, as when it takes up arms against the Combine, or lays down

regulations relating to the formation, conduct and winding-up of the public limited company.¹

The British Colonies and the State.

The story of State activity in the wide field of the economic development of the British Empire alone would fill many volumes, for the purposes of illustration, it would be interesting to glance here at the way in which the State has interested itself in the application of scientific agricultural methods to the problems of the British tropical Colonies.²

The "Plantation Colonies" were founded for the production of certain tropical staple products, such as sugar, tobacco and coffee, they comprise the West Indian group, with Ceylon, Malaya, Fiji, North Borneo and Mauritius, relying on imported labour, and Nyasaland, Kenya and Tanganyika, relying mainly on native labour. The two main types of agricultural exploitation found throughout the Tropics are the large capitalist plantation and the small peasant holding. The problem of the raising of the standard of the small cultivator has thus been common to both Europe and the Tropics, the chief task which the European administrator has had to meet has been the training of the peasant to grow enough food for the requirements of his family and to produce a surplus from the proceeds of which he can buy other commodities, and especially food to guard against the danger of famine. This problem has been bound up, as in India, with questions of water supply, transport facilities, taxation and land tenure.

The planter in the tropical colonies found himself centuries ahead in comparison with the primitive agriculturalist. In his colonisation of the Tropics, he grafted his plantation methods on to the old system, or, rather, transformed that system. In the Gold Coast, for example, the self-sufficiency and isolation of the peasant agriculturalists were broken up, in the West Indies, peasant agriculture was transformed by scientific agricultural methods into a prosperous economic exploitation of tropical products grown for a market, the food for domestic consumption being mainly imported.

¹ See *Report of the Committee on Company Law Amendment* (Cohen Report), June, 1945, Cmd 6659, H M S O, 2s net.

² See Knowles, *The Economic Development of the British Overseas Empire*. This work, a masterly exposition of the economic history of the British Empire, has been consulted for the information that follows.

The influence of Western culture has probably been greater in the West Indies than in any other tropical colony, though their population is predominantly coloured ; and their general development, from the period of the founding of the Empire, has been directed by Great Britain. It was the planter who built up their prosperity, directing the production and exchange of their staple products, using imported labour and relying on imports for foodstuffs. The first imported labourers were negro slaves from the West Coast of Africa. On the emancipation of the slaves in 1833, the planters imported indentured Indian and Chinese coolie labourers ; and the Government found it necessary to intervene and lay down conditions of work and generally supervise this new traffic.

The West Indian islands had once been the richest part of the Colonial system, though their wealth was due in a large measure to the fact that they were the great slave depôts for Virginia and Spanish America ; and they had also been important entrepôts for the smuggling trade with Spanish America. But the prohibition of the overseas slave trade in 1807, and the gaining of their freedom by the Spanish colonies in the early part of the nineteenth century—as a result of which trade was carried on direct between Britain, the United States and Spanish America—dealt a severe blow at the prosperity of the West Indies. The freeing of the slaves in 1833 meant that the labour supply to deal with sugar production became inadequate, for the freed negro did not turn out to be a reliable regular worker, and the natives were content with a self-sufficing economy at subsistence level.

In the eighteenth century the West Indies had been even more important than the East Indies from the point of view of trade. But among other causes of depression, in particular the removal of Imperial preference, the growing world demand for such commodities as tea and coffee, the development of transport, the methods of government possible in such a large area as India and the opportunities for investment, enabled the Indian outposts to develop into continental areas of ever-increasing importance, whilst the West Indies declined. The decline of the revenues caused annual grants in aid from the home Government to become necessary.

In 1897 the position of the West Indies seemed hopeless, but as a result of the recommendations of the Royal Commission of that year, a new departure took place in Imperial policy. An

Imperial Department of Agriculture was set up in the islands by Great Britain in order that scientific methods might be applied to agriculture. The large derelict sugar estates were broken up and a population of negro proprietors was settled in under the supervision of the officers of the Agricultural Department.

St. Vincent was changed from its desperate condition of unemployment and decreasing population, in 1910 the Government of St. Vincent settled over 2,000 acres in its dependency of Union Island and created a valuable class of smallholders. The condition of the native population was improved and the land better utilised, though it was found necessary to control the negroes until they acquired settled habits.

A Government ginnery for the marketing of the cotton crop was established on the basis of providing profits for the peasant after the expenses of marketing had been met. Land settlement schemes and the development of similar marketing schemes to that for cotton, *e.g.*, cane sugar, resulted in the advent of a great prosperity. In 1903 Britain prohibited the importation of sugar from bounty-giving countries, and the entering of Canada on a tariff war with Germany after 1897 gave West Indian sugar the opportunity to gain the Canadian market. Moreover, Great Britain agreed to contribute half towards an annual subsidy of £40,000 to a steamship line to develop the fruit industry of the islands, and the fruit trade with the U.S.A. was developed. The encouragement of co-operation, land settlement, marketing, agricultural education, plant breeding and entomological research—all helped to bring prosperity back to the West Indies.

The feature that is of interest to our present discussion is the way in which the State, through modern methods of scientific research and their application, influenced the course of commerce and industry in a particular area. As a result of this policy in the West Indies, the sugar cultivation was improved with new varieties of cane yielding 10–25 per cent. more sugar; cotton was successfully re-introduced in 1903; cocoa-growing was greatly extended; rice was produced in large quantities and even exported to British Guiana; by 1911 the West Indies no longer needed support from Britain, but in fact enjoyed surplus revenues.

It is true that this prosperity did not last long; after the First World War there was a great over-production of sugar, and protection was adopted by importers. The depression of the 'thirties hit the West Indies severely, in spite of the re-introduc-

tion of Imperial Preference. Social conditions became very bad, and there were riots and labour disturbances. Enquiries into the condition of the West Indies culminated in the appointment of the Moyne Commission of 1940, which resulted in a more constructive policy.¹

The effect of scientific methods in agriculture on the development of the tropical Empire has been of equal importance with transport and financial and commercial developments. Scientific agriculture has provided better types of plants, entomology has fought insect pests; mycology has battled with fungoid diseases; and tropical medicine has sought to combat the diseases due to the environment, achieving its greatest triumph in the discovery in 1897 of the mosquito as the carrying agent of malaria; scientific agriculture has been developed concurrently with modern methods of processing and marketing.

Already in the nineteenth century botanical gardens existed in order to acclimatise new plants. An attempt was made by the Indian Government to start a tea-planting industry in Assam with the Chinese tea-plant; the latter did not flourish, and the indigenous variety was developed instead. The rubber plantation industry was begun in Southern India, Ceylon, Malaya, and the East and West Indies with stocks from Brazil. In general, however, attempts to introduce exotic plants did not prove very successful, and attention was therefore concentrated on efforts to improve indigenous varieties.

It was towards the end of the nineteenth century that the work of introducing new cultures was superseded by research in scientific agriculture. The success of the Imperial Department of Agriculture in the West Indies induced the setting-up of similar Agricultural Departments in India, the Federated Malay States, Nigeria, the Gold Coast, British East Africa and Egypt. In India a Department of Agricultural Research was started in 1905 at Pusa; researches on many important crops were carried out here, among its triumphs being the evolution of a wheat which gave revolutionary yields. The object of the officers of the Agricultural Department has been, in India, to eliminate variations in the quality of crops and promote good strains. In

¹ The Second World War severely hit the West Indies. For further information of conditions in the West Indies, see *West India Royal Commission Report* (Cmd. 6607, H.M.S.O., 7s 6d), *Statement of Action taken on the Recommendations* (Cmd. 6656, H.M.S.O., 2s), *Development and Welfare in the West Indies, 1943-44* (Colonial No 189, H.M.S.O., 2s).

Bengal and Madras greatly increased rice crops have followed their experiments ; much success has been achieved with ground-nuts, new varieties being introduced. A Sugar Bureau was set up to improve the inferior yield of the sugar-cane, and similar improvements have been made in jute, in tobacco, in silk and in fodder crops. Dry-farming and pest control have also made progress, and the application of agricultural machinery has also been given attention. The irrigation works set up by the Imperial Government have been a tremendous achievement. In Ceylon, the mycologists were too late to deal with the coffee disease, but they were able to rescue cocoa and to increase the yield eightfold in 1907.

In 1923 a new college to train men for tropical agriculture throughout the Empire was started in Trinidad

Thus, the progress of scientific agriculture in the West Indies, and the tropical Colonies generally, in India, and in Ceylon, has been attended by great economic profit ; the whole standard of agriculture has been raised over an area nearly as large as that of the British Isles, comprising the British West Indies, Honduras, and Guiana.

The Influence of the State on Modern Business Enterprise.

The foregoing account can hardly have failed to impress the reader with the extent to which the activity of the State has penetrated into the whole structure of modern social and economic life.

The formation of the Finance Corporation for Industry, Ltd., with a capital of £25,000,000 and borrowing powers of £100,000,000, to help industry switch from war to peace production, is a recently-created example. The setting up of a Ministry of Production is a significant development.

This penetration has been an inevitable accompaniment to the unification and consolidation of nations, as they have become more closely knit into complex and inter-related units. At home, the widening of the scope and the penetration of the individual life more deeply by commercial and industrial operations have called for an increasing vigilance and interference by the central authority ; and, as we have seen, colonisation and the building up of an Empire, a Commonwealth of Nations, have been accompanied by a similar process. Trade may follow the

Flag, but to an increasing extent, and perhaps with greater truth, the Flag, in the form of the State, has followed Trade and taken over functions or imposed upon itself functions which Trade had not either the will or the power to perform: such has been the course of development, rather than its reverse, in the case of India, the Dominions, the Colonies.

In the domestic sphere the State has become so all-pervading that its long arm is taken often for granted—we do not realise how closely bound up with the enterprise of individuals and groups are the regulating and supervisory activities of the State. In Fig 7 of Volume I an attempt was made to illustrate the relationship between the State and the other associations of Society, that diagram—or any diagram—is necessarily an extreme simplification of the complex and intricate truth. The State, it is true, is merely an association among other associations in Society—a fact which is often forgotten by those who would have the State rule them, instead of fitting themselves to rule the State; and in Nazism the truth is deliberately perverted, and the State deified. But it is the Great Association, the central body of authority which has been created to control the activities of the individuals of the community in the best interests of the community, without neglecting the fact that it is the individuals who comprise the community, and that he who would be the master of all must be the servant of all.

In practice, the State ceases to be a beneficent abstraction and resolves itself into a Government responsible to an elected body—Parliament in Britain—and to the body of electors, the citizens of the community. In practice, too, government is apt to get into the hands of a ruling class—or has done so up to now—and whether that ruling class be the old aristocratic-military-landed caste (as in Germany), the controllers of “big business” (as in Britain or America), or the leaders of a Trade Union or Labour group of interests, the government is bound to be carried on with a strong bias in favour of the interests of that class, whether or not those interests correspond with the interests of the community as a whole. With this fact we have to reckon when estimating the influence of that abstract thing, “the State”, on Industry and Commerce. The State is not an abstraction when it resolves itself into the flesh-and-blood individuals who are heir to all the ills of their upbringing, environment and prejudices.

While awaiting the era when education and moral and spiritual

development will have evolved a race of statesmen of such integrity and intellectual calibre that we can use the term "the State" without these mental reservations and qualifications, we must not fail to keep at the back of our minds the practical conflicts of interest and struggles of self-seeking with which at present the activities of the "State" are complicated. We must remember that Malaya was exploited for its rubber, not entered with the sole purpose of raising the standard of living of the Malaysians, nor yet in order to provide people of middle incomes with cheap but good tyres for motor-cars. The exploitation of the rubber resources of Malaya was a "commercial proposition"; it was because people were prepared to pay for rubber motor-car tyres that companies were formed to satisfy this demand; that investors were found willing to invest their money in the rubber enterprises. Naturally, if and when individuals of wealth and power in the rubber or chemical or textile or other industries obtain political power, they become to all intents and purposes the "Government", and will direct the destinies of the State to some extent in their own interests, whatever may be the extent of their desire to be disinterested and fair, because it is only human to do so, and because men have not yet learnt to control their conscious desires, to say nothing of their subconscious ones, which have developed great expertness in justifying and "rationalising" the acts and motives of the conscious mind. It says a great deal for the soundness of the human constitution that considerable progress has indeed been made in the evolution of a State which, in the democratic countries at any rate, does consider the interests of the community as a whole—though the State has often had to be pushed towards democracy by the violent struggles of many of its subjects—as in the case of factory legislation and Trade Union legislation.

Trying to bear all this in mind, we may discuss the ways in which the Central Government has found it necessary to extend its activities into the economic operations of the individuals of the community.

We find ourselves at the beginning of this discussion faced with the fact that it is impossible to present an adequate picture of the economic activities of the State without reference to political facts. For the first duty of the State—the very basis of its existence, in fact—is the protection of the individuals of the community, of the subjects who have invested it with supreme

power. And in the modern world, where men pretend to have gone beyond the stage of barbarism and constant fighting for selfish advantage, and where the material achievements of men make war a frightful holocaust of slaughter and interrupt the smooth progress of Mankind in wealth, health and spiritual achievement, one may lay it down as an axiom that the first duty of the State is to keep itself out of war, so that men and women may pursue their avocations without the risk of having their work in life cut short by physical destruction or, at the least, interrupted and hindered by calls upon their time and energies for wasteful activities. In war, the democratic State moves quickly and almost completely to Fascism and subordination of the individual welfare to the machinery of the State ; yet these evils, when an attempt is made to impose them from outside, are the very enemies to combat which the modern State is prepared to resort to the final arbitrament of war.

It may be argued that the complete answer to these observations is that it is only because the democratic system is threatened by those who would destroy it that the modern democratic State has to proceed to the final arbitrament of war, in sheer self-defence. But this answer presupposes that there is no other method available of dealing with a menace against democracy, and though this may have been true in the years following the First World War, when the attempts to build a League of Nations and a system of defence against the breaking-out of war itself failed, there is no reason why this failure should be regarded as final. Indeed, the whole progress and development of the modern world depend on the setting-up of machinery by which the peace of the world may be preserved. Whatever the nature of the machinery, whether it involves the setting up of an International Police Force, the careful preparation of plans for severe economic sanctions, and even the compulsory military training of sections of the population, the modern State is invested with the duty of somehow preparing that machinery.

It would have been far more convenient if Mankind had grown so adult in mind and spirit before these opportunities for wealth in foreign lands had occurred that these international problems would not have arisen, or at least would have been settled in a spirit of sweet reasonableness and co-operation. But it is as useless to bewail the slow development of the human spirit as it would be to bemoan the conquest of England by William the

Norman and his band of hungry and immoral adventurers. The thing is done now, and the least we can do is to try to learn from the lessons of the past and to provide, first, that war shall not occur again; and secondly, that the economic exploitation of the world's resources takes place not with the object of benefiting individuals and groups of individuals, national or international, but in the interests of Mankind. This task will keep Mankind busy for many years to come, from the statesman with his problems of relating the functions of government to the needs of

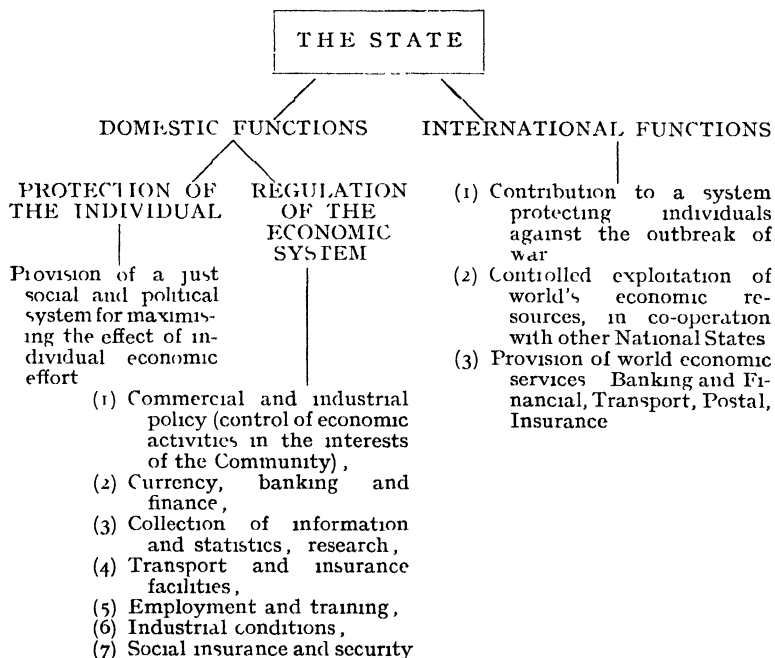


FIG 37—THE ECONOMIC FUNCTIONS OF THE STATE

the industrial and commercial system, to the private individual whose first task must be the securing of sufficient knowledge about the social and industrial and commercial system to see that the statesmen are doing their job properly.

If the reader will turn back to Fig. 6 in Volume I, he will recall that there it was suggested that the two main functions of the ideal State are, in the domestic sphere, the provision of internal order and justice; and, in the international sphere, co-operation with the other national States in the development of world economic resources, in the provision of world social

services such as a postal service and banking and currency facilities, and in the contribution to the maintenance of the machinery by which the world community is safeguarded against war. These suggestions are further elaborated in Fig. 37.

This is not the place for further elaboration of the political aspects of these problems. We must confine our attention to the relations of our own State with Commerce and Industry.

The State and Industry.

Fig. 38 indicates the ways in which the State concerns itself with the economic efforts of its subjects. Modern industrialisation has brought with it a host of problems, and legislation to deal with them is included under the wide scope of what is known as Industrial Law, though this subject covers also matters of a more strictly "commercial" nature, *e.g.*, the Shops Acts. We may deal briefly with each aspect of these provisions :

(a) Organisations of Employers and Workpeople—Trade Unions.

Employers may form their organisations, or "Unions," and indeed have formed themselves into Employers' Associations, but the term "Trade Union" refers usually to a combination of workpeople formed mainly to ensure strength of bargaining power in wage matters and conditions of work. Under the Common Law, combinations in restraint of trade were illegal, but the Trade Union Act of 1871 took away from membership of a Trade Union its former character of criminal conspiracy

By Section 2 of the Trade Union Act, 1913, a combination is a Trade Union if it is a combination, whether temporary or permanent, the principal objects of which are under its constitution statutory objects. These "statutory objects" are mentioned in the Act of 1876 and classified in Section 1 of the Act of 1913, they are the regulation of the relations between workmen and masters, or between workmen and workmen, or between masters and masters, or the imposing of restrictive conditions on the conduct of any trade or business, and also the provision of benefits to members so that Trade Unions can, and some do, discharge the functions of a Friendly Society.

Each Union is an autonomous body; its basis lies in the Local Branch or Lodge, which elects its own officers and committees and deals with local business, sending forward wider matters to the district or national organisation. Some Unions are formed by those in a single craft or group of crafts, others are organised

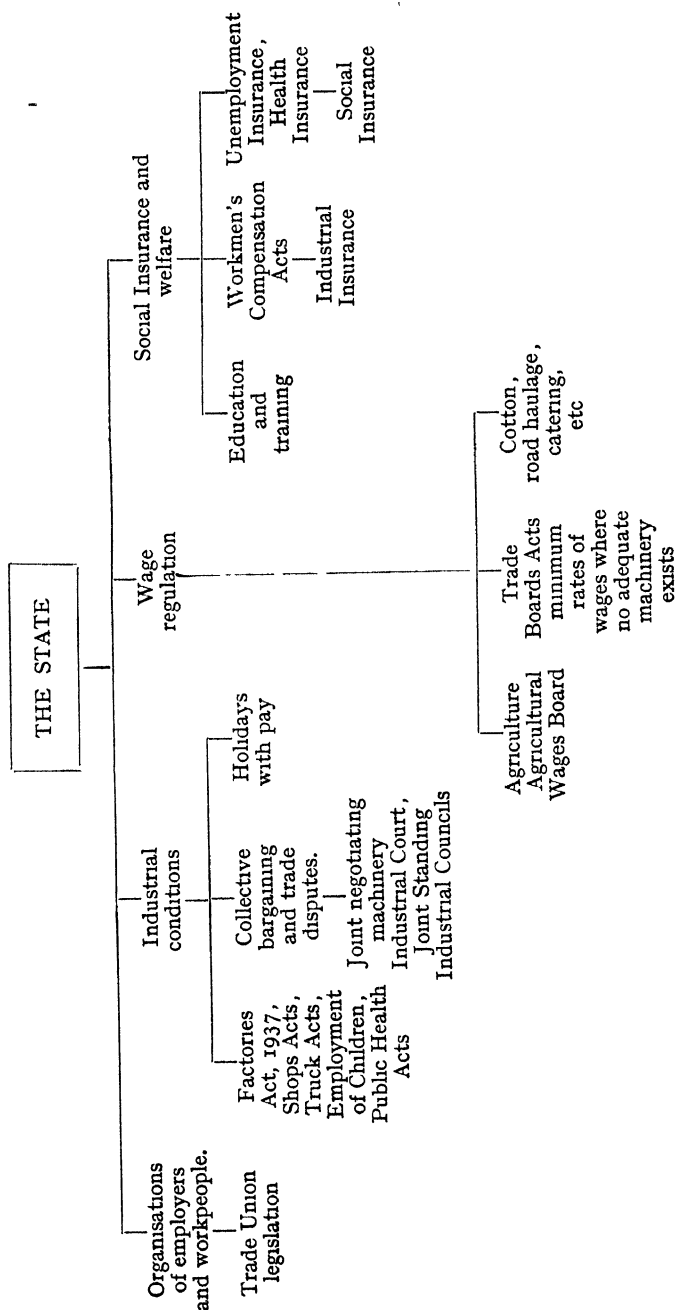


FIG 38—THE STATE AND INDUSTRY

on the basis of a whole industry, including within its ranks workers in a wide range of activities, *e.g.*, the National Union of Railwaymen.

The history of Trade Union legislation is more than a mere history of law-making; it is a fascinating story of social change and social struggle and achievement.

(b) *Industrial Conditions*. In order that the social unrest and damage occasioned by the carrying of trade disputes into the final stage of strike or lock-out may be avoided if possible, two important Acts have been passed to facilitate the peaceful settlement of disputes and the carrying out of collective bargaining between employers and employed. The recommendations of a Royal Commission set up in 1891 "to enquire into the relations between employers and workmen and to report whether legislation could be directed to remedy any faults disclosed" were followed in the Conciliation Act, 1896, which gave to a special section of the Board of Trade powers (subsequently transferred to the Ministry of Labour and National Service) :—

(1) to enquire into the causes and circumstances of a dispute;

(2) to take steps towards bringing the parties together;

(3) to appoint a conciliator or board of conciliation on the application of the employers or workers;

(4) to appoint an arbitrator on the application of both parties.

The Act is still in operation and much useful work has been done by Conciliation Officers in the sphere of industrial relations.

The industrial unrest during the 1914–1918 war led to a setting up of a Committee on the Relations between Employers and Employed (the Whitley Committee) to make and consider suggestions for securing a permanent improvement in the relations between employers and workmen; and to recommend means for securing the systematic review of industrial conditions affecting those relations, with a view to improving conditions in the future. The Committee made five recommendations, the implementing of which has had very important results in the development of machinery designed to prevent and settle industrial disputes :—

(1) the formation of Joint Industrial Councils;

(2) the appointment of Works Committees in individual

undertakings representative of management and workers (*see* Chapter IX, *ante*),

(3) statutory regulation of wages in badly-organised trades;

(4) the establishment of a permanent Court of Arbitration;

(5) the authorisation of the Minister of Labour to hold inquiries regarding disputes.

The last two recommendations were followed in the Industrial Courts Act, 1919. An Industrial Court was established as a permanent and independent tribunal consisting of persons appointed by the Minister of Labour and National Service, some of whom represent employers and some represent workmen, and in addition one or more women. Either of the parties involved in a trade dispute may refer the matter to the Minister, who must then take such steps as seem to him expedient. If he thinks fit, and if both parties consent, he may refer the matter for arbitration by (1) the Industrial Court or (2) one or more persons appointed by the Minister or (3) a Board of Arbitration with equal representation of employers and workmen. It is important to note that only with the consent of both sides to the dispute, and only where there has been a failure to obtain a settlement under the existing machinery in the industry concerned, may the Minister refer the matter to arbitration. There is no means of compelling an unwilling party to take advantage of these arrangements, nor are arbitration awards under the Conciliation Act or Industrial Courts Act legally binding on the parties concerned, but they are almost invariably accepted.

Even during the Second World War, the voluntary principle, as opposed to State compulsion, was maintained as far as possible (in the Conditions of Labour and National Arbitration Order, 1940, and the Restoration of Pre-War Trade Practices Act, 1942).

The first of the recommendations noted above referred to Joint Standing Industrial Councils, these have been formed in various industries by voluntary agreement for the purpose of providing machinery for negotiation, collective bargaining, and the settlement of disputes, other matters also come under their scope, such as the general principles governing the conditions of employment, technical education, training, research. Associations of Employers provide half the members, and Trade

Unions the other half. These Councils vary greatly in size, structure, nature and extent of activities, and degree of authority within the industry concerned, some do not negotiate wages. Where Trade Unionism has been most completely established, and the machinery for collective bargaining has been already well developed, as in the more important industries such as coal-mining and engineering, their establishment on the lines laid down by the Whitley Committee was not necessary. Local Authorities and the Government have adopted this machinery for their employees. In the case of many Joint Industrial Councils, an officer of the Ministry of Labour and National Service attends meetings and acts as a liaison officer.

This machinery for collective bargaining and dealing with trade disputes has been discussed in detail here because it has an intimate connection with the organisation of the business undertaking, we could not fail to distinguish the Joint Industrial Councils from the Works Councils dealt with in Chapter IX. But for details of the organisation of employers and work-people, of collective bargaining and joint negotiating machinery, of conciliation and arbitration, and of the statutory regulation of wages in certain industries, the student must consult the *Industrial Relations Handbook* issued by the Ministry of Labour and National Service (September, 1944, H M S O., 3s 6d. net).

As for the other aspects of industrial conditions shown in the diagram, all we can do here is to note that the Factories Act, 1937, consolidates and amends previous legislation and is designed to ensure safe and healthy conditions in manufacturing and certain other operations, the Shops Act, 1934, remedies injurious and unhealthy conditions in shops, the Young Persons (Employment) Act, 1938, applies to young persons under 18 not subject to the Factories or Shops Acts, the Children and Young Persons Act, 1933 (a similar Act was passed for Scotland in 1937), imposes important restrictions on the employment of children, the Truck Acts require that wages shall be paid in money only, and refer to such matters as fines and deductions for bad work, and charges for the use of tools or materials.

(c) *Wage Regulation*. As we have seen, in many industries rates of wages have been agreed upon as a result of collective bargaining between employers and employed. Trade Boards Acts, 1909 and 1918, gave the Minister of Labour power to establish Trade Boards where he was of the opinion that no

adequate machinery existed for the effective regulation of wages throughout the trade; their object was to fix minimum rates of wages.

Similar legislation for agriculture was passed: in 1924 for England and Wales and in 1937 for Scotland, the Holidays with Pay Act, 1938, enabled the wage-regulating authorities to make provision for holidays with pay for agricultural workers. Under the 1924 Act the Ministry of Agriculture and Fisheries was required to set up Agricultural Wages Committees to fix minimum rates of wages. Orders putting these rates into effect were made under the Act by the Agricultural Wages Board constituted by the Minister of Labour and National Service. The Agricultural Wages (Regulation) Act, 1940, provided for the fixing of a national minimum wage by the Agricultural Wages Board after consultation with the Committees. An Order in Council made in 1942 transferred to the Agricultural Wages Board for the period of the war emergency and so long as the present system of nationally fixed agricultural prices and an assured market for agricultural produce is in operation, the powers of the County Agricultural Wages Committees of fixing minimum wages and their powers under the Holidays with Pay Act, 1938.¹

Special legislation has been applied to cotton manufacturing,² road haulage³ and catering.⁴

(d) *Social Insurance and Welfare*. We may only note here, too, the training and education schemes for unemployed men and women and disabled persons conducted by the Ministry of Labour and National Service. With the projected schemes for County Colleges we touch on the wider field of education.

The existing schemes of Health and Unemployment Insurance are under revision. Government proposals for Social Insurance are contained in the recently-published White Paper,⁵ proposals for an Industrial Injury Insurance Scheme⁶ superseding the present system⁷ are also in process of discussion.⁸

¹ *Industrial Relations Handbook*, 1944, pp. 156-58.

² *Ibid.*, pp 159-60

³ *Ibid* , pp 147-56

⁴ *Ibid* , pp. 160-63.

⁵ *Social Insurance*, Part I (Cmd 6550, H M S O , 1944)

⁶ *Social Insurance*, Part II (Cmd 6551, H M S O , 1944).

⁷ *Memorandum on the Workmen's Compensation Acts, 1925-1943*. Home Office, June, 1944, H M S O

⁸ The Labour Government's National Insurance Bill was published on Jan. 24, 1946.

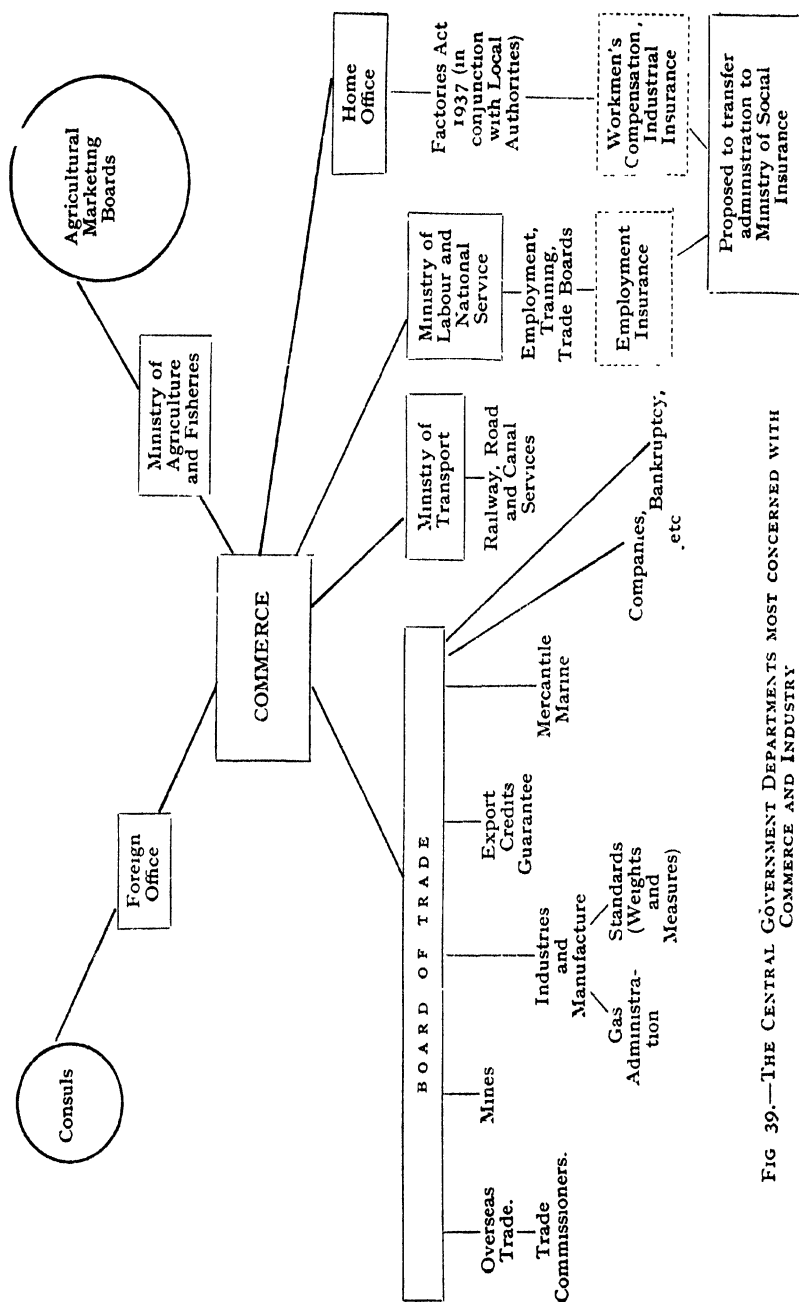


FIG 39.—THE CENTRAL GOVERNMENT DEPARTMENTS MOST CONCERNED WITH COMMERCE AND INDUSTRY

The State Departments and Commerce.

The details of the future relation of the functions of the State to Commerce remain to be worked out ; but we can survey the position as it has stood in our own country in the years preceeding the outbreak of the Second World War. The introduction of a Lend-Lease system, the proposals for an international currency system, the co-ordination of food supplies, the co-operation of institutions for investment and banking—these and similar developments will influence the pattern of world trade and industry after the immediate post-war problems have been met. But the main activities of the Government in the regulation of commercial activities will doubtless remain more or less in their present form.

The Board of Trade is the Government Department which most nearly approaches a Ministry of Commerce dealing with domestic and foreign commercial and industrial policy. The division concerned with Commerce and Industry comprises Departments which deal with the protection of British commercial and shipping interests, including treaties and tariffs and the licensing of imports and exports ; the collection and classification of information relating to matters connected with trade, home industries and manufactures ; mining matters, including the safety and welfare of those engaged in the mines, the administration of the Weights and Measures Acts, the administration of the Acts relating to patents, designs and trade marks, the dealing with matters concerned with the commercial aspects of transport and industrial power, the study of the economic effects of inventions and discoveries, the collection of statistics relating to Industry and Trade and Transport. The Departments concerned with the administration of public services administer the statutes relating to shipping through the Mercantile Marine Department, to joint-stock companies through the Companies' Department, and to Bankruptcy and Deeds of Arrangement through the Bankruptcy Department.

Consuls, who are persons whose task it is to watch over the commercial interests of the country abroad, are appointed by the Foreign Office, the consular and diplomatic services are distinct, and a consul cannot use diplomatic pressure to protect British interests abroad. But attached to each Embassy is at least one Commercial Secretary, whose powers are greater in this respect. There are also Empire Trade Commissioners, who keep in touch

with the High Commissioners of their area, and who report on conditions to the Department of Overseas Trade of the Board of Trade.

The Ministry of Transport is responsible for the safety of the travelling public and for the efficient control of the public railway, road and canal services. The Ministry has also additional powers relating to the control of harbours and docks and electric tramways and to electricity, it is probable that its functions in the future will be confined strictly to those concerned with transport.

The Ministry of Labour and National Service is concerned with employment and training, with unemployment insurance, with Trade Boards and industrial relations generally. The Home Office was responsible for the administration of the Factories Act, 1937, which simplifies, consolidates and amends previous legislation, but certain important powers are entrusted to the local authorities, after the outbreak of the Second World War, these functions of the Home Secretary were transferred to the Ministry of Labour and National Service

The new world will see changes in education facilities, in health and unemployment and other forms of social insurance and security whose details are in process of being worked out. In the past the State has undertaken the functions of laying down the rules by which the work of the community has been carried on, such as by establishing weights and measures and setting up a body of commercial and company law and legal machinery for the settlement of disputes, by making laws to protect the interests of the weaker members of the community and by seeing that these laws are carried out, as in the case of the Factory Acts and the Trade Board Acts relating to the "sweated industries", by devising machinery by which the economic system may work more smoothly, such as providing Employment Exchanges and social insurance generally, and by making provision for the needs of the community generally, as in the case of education and national defence. The War has seen a great extension of those functions, it has speeded up the process of the encroachment by the State on the liberty of the individuals comprising the community, commodities and business operations have been controlled, the whole fabric of economic life has been pervaded by the State.

This process must inevitably continue; but it is essential that

it should be continued along the right lines. We have already noted the attempts which were made to regulate the small trader practically out of business in the interests of the large-scale undertakings. Bearing in mind the fact that those in a position of economic wealth and power in the community are in a better position to control the destinies of the nation than the relatively poor and helpless, it may well happen that the "State" may itself become a business rival to the strictly economic undertakings. In the large economic sense, the State is itself a business undertaking ; and to close this present consideration of the commercial structure of the modern Western world it will be profitable to examine the conception of the State as a business organisation.

CHAPTER XII

THE STATE AS A BUSINESS ORGANISATION

THE reader who has followed the arguments of both Volume I and the present volume relating Commerce to the whole system of economic and social activity of the community will understand the insistence on the fact that the State is an association among other associations, though with wider functions and possessing the unique power of coercion over the members of the community. It is important to realise the full significance of this social and political fact, for its implications are of the utmost importance, as much in respect of the working of the industrial and commercial machinery as of the social system as a whole : in the last chapter an attempt was made to illustrate the extent of these economic implications.

Because the State is of such fundamental significance in the life of Society ; because it touches the interests of all the members of the community ; because it is a system of regulated social relationships, it is said to be an *institution*, just as the Family and the Church are institutions. This is a somewhat abstract way of looking at the State, for it comprises such a number of facts which are themselves to some extent abstractions ; but they are abstractions in the sense that each expresses one aspect of the multitude of social relationships rather than that they are essentially unreal.

When Mankind forms an institution, it is apt to invest it with a certain amount of sacredness ; primitive fears and ignorance combine to make all questioning of its essential *rightness* a social crime ; and reform or reconstitution of the institution is extremely difficult, not to say dangerous, to those who attempt it. The history of the Family and the Church is full of tales of the spilling of the blood of martyrs. The sanctifying and deification of the State have proceeded very far under Fascist and Nazi ideologies ; there was a parallel process in the early days of Russian Communism. Under Democracy, the conception of the State as being practically equivalent to the Deity, or as holding special authority by the express will of the Deity, has been fought, and will continue to be fought, with tenacity.

Fascinating as a discussion of this matter on sociological lines

would prove, we must concentrate in this volume on those aspects which are relevant to our discussion of the economic system and of Commerce in particular. And for our purposes we are justified in regarding the State as a business association like other business associations. Though we cannot separate the political aspects of the State from its economic aspects, we can say that as an economic institution its function is to reconcile and co-ordinate the operation of the two principles we have discussed in Chapter I of this volume · to achieve the greatest possible result with the available means, or a given result with the least possible means.

The political conflicts, of course, centre round the nature of the results to be aimed at. It is too easy to say that the ultimate aim of the State is to provide the greatest good for the greatest number ; for in the first place the nature of the greatest good itself has to be determined, and that in itself is more a matter of progress in experience and education than of philosophical argument , and in the second place, although in theory many people may agree with the statement of the thesis, yet in practice, and often driven by subconscious motives, they may prefer their own immediate interests to the good of the community, or may frankly adopt the view that life is a struggle in which the fittest survive and that they intend to struggle with the best. In any case, it is very difficult to persuade a person of wealth and power that his is not the best of all possible worlds.

If the reader will revise his study of the organisation of the business undertaking discussed in Chapter IX, he will realise the implications of the statement that the first function of the State as a business undertaking is the direction of the general policy of the concern—which is in this case the nation in its economic life. It has to decide what the general purpose of its conduct shall be, or to promote the best functioning of the economic activities which have been imposed on the community by historical and geographical circumstances. Under the Mercantilist system, for example, the State decided on the hoarding of gold, and tried to further this end by the encouragement of exportation of commodities and the discouragement of their importation. The circumstances of the Industrial Revolution were such that Britain became the leading industrial country of the world , it ceased to be a mainly agricultural country and became a manufacturing one. Already Britain had become a

great commercial nation ; London became the financial centre of the world. The national economy had changed fundamentally from the pre-Revolution days, and this change had not been directed or controlled by the State ; the function of the State was rather to promote the economic interests of the country in the best way and to the best extent according to the destinies which circumstances had dictated. The difficulties which the outbreak of the Second World War imposed upon transport induced the State to develop more efficiently and extensively the agricultural resources of the country.

The breaking out of wars causes the State to take greatly increased powers of government, but this activity is more in the nature of an interference with the economy of a country than a directive policy on the fundamental economic principles discussed in Chapter I of this volume. War-time economy is a special case, and not a normal case, Britain is now no longer an agricultural country, it depends for the greater proportion of its food supplies on importations from the great food-growing countries. No doubt the changes in population structure which are expected to occur may to some extent modify these factors, but until the time arrives when it becomes necessary to deal with the change in national economy, it would seem that the urgings of those who, like Mr A G Street, demand that great favours should be shown by the State to the farming community are founded on prejudices in favour of a particular occupation—to the cobbler there's nothing like leather. To base a national economic policy on the possibility of war may be a cautious one, but such a possibility would be founded on exceptional circumstances, and not on a normal line of development—unless all hopes of finally getting rid of the curse of war are to be given up, in which case there does not appear to be much hope of the intelligence or will of Mankind, and all hope of evolving a rational and economically efficient Society must be given up, to the ultimate end that our type of civilisation will be written off as another false start for humanity.

The developments and tendencies of modern business outlined in Chapter XV of Volume I—the changes in the nature and location of industry and in the relative importance of the industrial groups—and the great increases of the activities of the State in the social services and social insurance, remind us of the essential function of the State as the protector of the interests

of the members of the community. This function embraces activities far wider than that of the fundamental aim of keeping the community out of the waste, the futilities and the miseries of war not merely by the negative policy of refraining from aggression, but also by the positive and more exacting policy of keeping itself strong enough to discourage the gangster type of national leaders in other countries from attempting to despoil it, and also of co-operating with other States, politically, socially and economically, in keeping the peace of the world; the latter consideration brings in the question of tariffs and trade agreements and of the international economics which is coming to be one of the most important subjects of study of our times.

We cannot deal here in detail with the questions of the conflict of interests between the members of the community that have been touched on in the last chapter; we must pin down our discussion to the matter of the State as it actually exists—but without forgetting that there are political and social issues intimately concerned: we must abstract deliberately, though never completely. And we are concerned with the immediate fact that, practically, the State as a business organisation, as an association whose function it is to run the country in the interests of the community which has chosen that the State shall be the kind of State it is, resolves itself into the machinery of Central Government and Local Government.

Central and Local Government.

In its direction of the general policy of the country, the powers exercised by the Central Government are of a threefold nature:

(a) *Legislative.* The body which lays down the laws for the conduct of the citizens of the country and the business of the State is the Legislature, a body which in Britain is the High Court of Parliament, or, to give it its official title, the King in Parliament; it consists of the King, the House of Lords and the House of Commons. The latter, or Lower Chamber, is in practice the most powerful of the three organs of government.

(b) *Executive.* The Executive is the body which enforces and administers the law, consisting of the Ministers of State and their Government Departments, the personnel of which comprise the Civil Service.

(c) *Judicial.* The interpretation of the law and its application

to individuals and corporations who break the law or who appeal to the law for the settlement of their disputes is the function of the Judiciary, consisting of the Judges and the whole system of judicial machinery and personnel. Legal actions are of two kinds: Criminal, regulated by the Criminal Law, taken by the Crown against those who commit anti-social actions and lay themselves open to punishment; and Civil, regulated by the

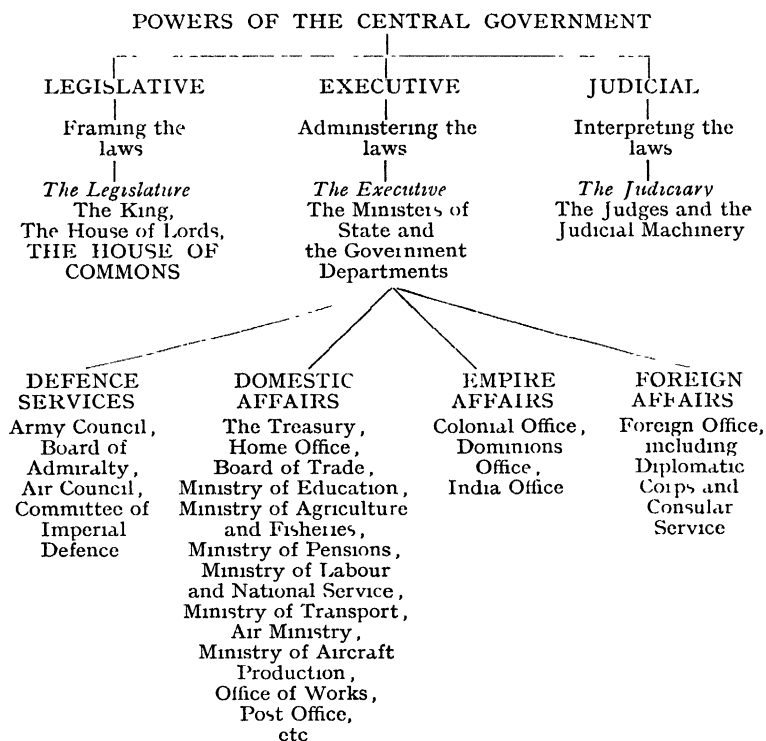


FIG 40 —THE POWERS OF THE CENTRAL GOVERNMENT OF THE U K

Civil Law, taken by one citizen against another in order to obtain damages or other compensation for acts committed by the latter detrimental to the interests of the former.

The legislative function of the Central Government resolves itself into the framing of the general policy of the national undertaking both in the domestic sphere, in regard to the relationships between the citizens of the community, and in the international sphere, in regard to the relationships between the citizens of this

country and those of other countries. Thus, of special interest to the student of Commerce are, in the home sphere, the body of commercial law relating to the carrying on of business transactions, and of company law relating to the formation, organisation and winding-up of companies; in the international sphere, import and export duties claim his special attention, fitting in with all he has learnt regarding the functions and administration of bonded warehouses, the Customs and the documents used in international trade.

The organisation and administration of the national business undertaking are carried on by the Executive. The Ministers, or Heads of the Departments of State, have as their functions the defence of the Realm through the armed forces of the Crown and the maintenance of order in the country itself by means of the police forces, the administration of home affairs and of foreign and Empire affairs, and the collection of revenue through taxation and the distribution of expenditure in such a way as to enable the business of the State to be carried on most efficiently.

The Departments of State most concerned with the home economy are the Treasury, the Home Office, the Board of Trade, the Ministry of Education, the Ministry of Health, the Ministry of Agriculture and Fisheries, the Ministry of Pensions, the Office of Works, the Ministry of Labour and National Service, the Ministry of Transport, the Air Ministry and the Post Office, a recent addition is the Ministry of Social Insurance. There are also Departments whose work is of a routine nature, and which usually have a permanent official rather than a Minister at their head. Such are the Board of Customs and Excise, the Board of Inland Revenue, and the Exchequer and Audit Department. The Departments most intimately concerned with commercial life have been briefly surveyed in the last chapter. We note the departmentalised structure of the machinery of Central Government, and we must now examine the method by which the State's finances are regulated.

The Finances of the State.

Before the Bill of Rights of 1689 declared that all forms of taxation based on the King's prerogative were illegal, taxes such as Benevolences and forced loans and additional Customs duties were levied without the consent of Parliament. By the passage of that Bill the control of the nation's finances was finally vested

in Parliament. The effect of the Parliament Act, 1911, was to make the House of Commons the supreme legislative body, and in particular to give control of the finances of the country to the House of Commons, the veto or delaying power of the Lords not extending to any Money Bill certified as such by the Speaker of the House of Commons.

This power of the Commons is all the more important to-day by the fact that, because of the increase of the work undertaken by the State, the costs of running the country have increased to a very great extent during the present century. At the end of the last century, the total annual expenditure by the Government amounted to £134 millions. In the year before the Second World War broke out the amount was £1,019 millions. During the War the Government was spending £15 millions a day.

Where has this great increase gone? At the end of the last century the amount spent on National Debt Services was £23 millions; on the Supply Services (Army, Navy and Air Force) £70 millions, on Education £11 millions; and nothing at all on Unemployment, Health, Old Age and Widows' Insurance. By 1938-9 the figure for the National Debt Services had risen to £232 millions, the increase being due mainly to the debt arising from the 1914-1918 war (it reached £350 millions by the end of the War, but was gradually reduced to £311 millions for 1942-3). The Supply Services took £254 millions in 1928-9, for 1942-3 the figure shot up to £5,000 millions. Education rose to £65 millions in 1938-9 and to £70 millions in 1942-3. The Social Services in Labour, Health and Insurance accounted for £165 millions in 1938-9, and the increase in expenditure on them continued during the War, reaching £190 millions in 1942-3. The new schemes for education and the social services will call for increasing expenditure in these fields.

Where does the money come from? Broadly speaking, it is true to say that a sharp distinction may be drawn between the finances of an individual and those of a public authority. whilst an individual adjusts his expenditure to his income, the expenditure of a public authority determines the amount of the income necessary to cover that expenditure. The Government determines the amount of money it wants, and then takes steps to raise the money.

The funds of the Government are raised mainly by taxation and by borrowing, the proportion raised by loans being not very

considerable in peace-time. There are also receipts from public property, such as lands or shares in enterprises like the Suez Canal, from enterprises like the Post Office, and from odd amounts like fines imposed at the Courts of Justice. The items of regular income come for the most part from taxation.

The main methods of taxation are two: (a) Direct taxes levied on income or capital, paid directly by the citizen to a collecting official—*e.g.*, income tax and death duties; (b) Indirect taxes levied on commodities and paid by the citizen in the consumption of certain goods and services—*e.g.*, taxes on tobacco and beer, and entertainment tax. In this case the tax is paid by the producer or seller, who in turn usually recovers it from the consumer.

We have had to suffer a considerable increase in indirect taxation in the Second World War; by the device of a Purchase Tax and increased indirect taxation generally, the Government was able to kill two birds with one stone. to deter people from spending, and so induce them to save the money in War Savings or the Post Office Savings Bank, thus helping the Government to counteract a tendency to inflation, or, if they persisted in spending (as many people suddenly endowed with vastly increased incomes as a result of obtaining jobs in munition factories and elsewhere actually did spend), to raise more revenue. Governments abroad have been able to derive a considerable income from State monopolies, such as tobacco and matches.

The determination of the proportionate amounts of revenue to be derived from direct taxation and from indirect taxation, and of the incidence of these taxes, necessitates very complex considerations. A direct tax, like Income Tax, can be adjusted to the size of an individual's income and to his circumstances, such as the size of his family and his commitments in the way of insurances. Indirect taxation takes no account of these factors, and on the whole the family man is hit very heavily by taxes on such commodities as tea and sugar. But the greater proportion of revenue from indirect taxation comes from liquor, tobacco and entertainments. In 1942-3 the proportion was three-quarters. In 1943 the amount spent by the nation on alcoholic drink and tobacco reached the £1,000 million mark for the first time: £1,053 millions out of a total expenditure of £4,981 millions, the increase of nearly £150 millions between 1942 and 1943 no doubt reflecting the increase in the amount of duty. On the other hand,

the amount spent on food fell by £56 millions to £1,264 millions.¹ It is certainly an astounding thing on which to reflect, that for every £1 the householder spent on food, he spent 16s. 3d. on alcohol and tobacco.

The difficulty of estimating the consumption of all goods and services which are subject to indirect taxation precludes the giving of official estimates on the total taxation borne by different incomes. The *Economist* of 24th October, 1942, estimated that in 1930-1 the total percentage of an income of £200 taken in taxation was 9·6%, and in 1941-2, 14·8%, the corresponding figures for other incomes were: £100, 11% and 19·1%, £500, 4·5% and 18·4%; £2,000, 15·7% and 40·5%. As the higher incomes were reached, so the proportion jumped for £10,000, 35·8% and 68·3%; and for £50,000, 51·4% and 90·7%. Up to £250, the whole of the direct taxation was represented by employees' social insurance contributions.

From the point of view of the State as a business unit, the considerations affecting a decision on the kind and extent of taxation to be adopted are many and varied. The economy of the tax is an important point: a tax may cost an unwarrantable amount in collecting it. Another important consideration is the effect of the tax on the source of revenue. Will the imposition of the tax tend to reduce the revenue-giving power? Will people work less time in order to avoid paying increased income-tax, or will they reduce their consumption of a commodity on which additional indirect taxation is imposed? How would a tax on turnover affect business undertakings? would it lead to the closing down of small businesses and the encouragement of combinations?

Income chargeable for tax is classified by the central authorities into five categories, the profits from businesses are dealt with under Schedule D. The State allows special treatment for a business in its early years, and allowances are made for replacements of assets, for wear and tear on machinery and plant, and for obsolescence. The intricacies of taxation have been made the special study of experts, and the accountant of a business undertaking is required to master a great deal of ground on the subject of taxation alone.

To return to our discussion of the organisation of the State

¹ *An Analysis of the Sources of War Finance and Estimates of the National Income and Expenditure in the Years 1938 to 1943*, H M S O (Cmd 6520) See also Oscar R. Hobson, *News Chronicle*, 2/5/44 and 8/5/44.

as a business undertaking : the centre of financial administration is the Treasury, the supreme Department of State, consisting of the First Lord of the Treasury, who is also the Prime Minister, the Chancellor of the Exchequer, and five Junior Lords, with secretaries and officials. Responsibility really rests with the Chancellor of the Exchequer, who makes proposals, in his Budget, for meeting the expenditure required, and arranges for the collection of the revenues. He is assisted by the Financial and Permanent Secretaries. The functions of the Treasury are to check the amounts spent by the spending Departments and to see that the amounts they spend do not exceed the amounts granted by Parliament ; and to curb the appetite of the various Departments for the national cake. It controls the four bodies responsible for the collection of the revenue—viz , the Board of Inland Revenue, which collects the Income Tax , the Board of Customs and Excise, which collects the indirect taxes , the Post Office , and the Commissioners of Crown Lands.

The control of national expenditure is, of course, in the hands of the House of Commons. During the autumn preceding a financial year, which ends on March 31st, each Department prepares an Estimate of its requirements for the coming year, the Estimates (with the exception of the Defence Services' Estimates) being presented for approval to the Treasury, to the Financial Secretary and to the Cabinet. They are then presented to the House of Commons, sitting as a Committee of Supply. Supplementary Estimates are prepared when it is desired to meet items of unforeseen expenditure.

We have noted that the State adjusts its income to its expenditure ; when the grants for expenditure have been approved, the House of Commons has to sit again as a Committee of the whole House, the Committee of Ways and Means, to consider the question of the raising of the funds.

The total income from taxation is collected during the course of the financial year, and sometimes it occurs that the money paid out from the Consolidated Fund, the Government's banking account, is greater than that paid in, so that the Government has to borrow money from the Bank of England. These advances by the Bank of England are called Ways and Means Advances ; we have already met with this term in dealing with the Bank of England Return.¹

¹ *Ante*, p. 128

Just as the Departments of State prepare their estimates of requirements, so the staff of the Treasury prepares an estimate of the probable revenues. These estimates of expenditure and revenues, together with figures showing the revenue and expenditure of the previous year, and the loss or surplus on the accounts for the previous year, form the basis of the Budget statement, and the Chancellor makes his proposals for an increase or reduction of taxation accordingly. These proposals are discussed by the Cabinet, and are kept strictly secret until the Budget speech is made. Premature disclosure would give rise to speculative activity and is regarded with great seriousness the reader will remember the alleged leakage of 1937, as a result of which a Cabinet Minister resigned.

The Budget proposals are discussed and if necessary modified by the House of Commons; the approved details are passed by the House as the Finance Act of that year.

The taxes, when paid, go through the Treasury on their way to the Consolidated Fund at the Bank of England, but the Treasury cannot intercept them, nor can it get money from this Fund without first obtaining the authorisation of the Comptroller and Auditor-General, a permanent official appointed by letters patent, independent of the Treasury, and answerable to Parliament alone; he can be removed from office only by an address by both Houses to the Crown. The function of this official is to ensure that public money is spent as Parliament directs, he sees that all issues from the Consolidated Fund are within the amounts and for the purposes authorised by Parliament. When he is satisfied on these counts, he signs the necessary issues from the Exchequer to the Paymaster-General, who pays out the sums required by the various Departments. For each Department there is an Accounting Officer who is responsible for the Appropriation Accounts—*i.e.*, accounts showing the ways in which payments by Parliament have been expended. The Comptroller and Auditor-General audits the accounts of the Departments, and sends these audited accounts and his Report to the Treasury, he attends the meetings of the Committee on Public Accounts, whose Report completes the financing procedure of the year concerned.

We have already noted the fact that the control of the money and credit of the country lies with the Treasury and ultimately with the Government; and we have met the form of short-term loans to the Government called Treasury Bills. A word or

two may be said about public loans in general. Public loans may be either internal or external, the former are subscribed by persons or groups within the area controlled by the authority raising the loan, the latter by persons or groups outside that area. Again, a loan may be either long term or short term—*e.g.*, Consols and Treasury Bills, respectively. Long-term and short-term debts are roughly equivalent to “funded” and “floating” debts, respectively, though there is no settled terminology here. Thus, the Funded Debt is the permanent portion of the National Debt, and consists of Consols; the Unfunded Debt consists of War Bonds, Savings Certificates, and similar forms of Government borrowing, and of the Floating Debt, that part of the National Debt borrowed for short terms, consisting of Ways and Means Advances and Treasury Bills.

In fairly long-term borrowing, a public authority often fixes two dates: after the earlier one, it *may* repay the principal; after the later, it *must* do so. When the date of the obligation to repay large sums approaches, borrowing for a term of years may be resorted to in order to repay part of the floating debt maturing in the immediate future: this process is called “funding the floating debt”. The paying-off of a debt is called *redemption*.

Since the 1914–1918 War, the total of the Unfunded Debt has been reduced by “conversion” into Funded Debt at a lower average rate of interest. Thus, in 1932, Mr. Neville Chamberlain converted nearly the whole of the £2,000 million 5% War Loan to 3½% Conversion Loan, making an annual saving in the interest charge of £30 million, the greatest feat of its kind in financial history, it inaugurated a “cheap-money period” which was taken advantage of by many municipalities and industrial companies similarly to convert their debts. If a public authority has not bound itself by making its loans “not repayable”—*i.e.*, compulsorily repayable at the price fixed for repayment when the debt was contracted—it can take advantage of a fall in interest rates to borrow at the lower rate and with the proceeds of the loan compulsorily repay the old one, thus saving interest charges. But Dalton says: “It is a common error to suppose that conversion operations have been an important factor in reducing the burden of public debts in the past”¹

¹ Hugh Dalton *Principles of Public Finance* (Routledge, 12th Edition, 1943), p. 283. See his chapter on *The Conversion of Public Debts*, Ch XXIV.

The burden of indebtedness may be reduced not only by redemption or conversion, but also by the provision of a *sinking-fund* system. A sinking fund is a debt-redemption fund ; a true sinking fund is met not from new borrowings, but from revenue . a fixed sum is invested annually, and principal and interest applied to the extinction of the debt when the sum required is realised. This method is often used by municipalities to repay loans borrowed for fixed periods.

Local Government.

The mention of municipalities reminds us that besides the central authority there is a complex structure of local authorities with whose activities the ordinary citizen comes more into contact than with those of Whitehall, the traditional, but not the only home of Britain's government offices. This is no place to discuss the complex but fascinating story of local government ; but we must note that besides the Administrative County of London, which has problems peculiar to itself, England and Wales are divided for the purposes of local government into districts the affairs of which are administered by two types of authorities

(1) *County Areas*, consisting of (a) Administrative Counties, each with its own County Council, with complete independent control—within the limits laid down by law—of the area it administers, (b) Urban and Rural Districts, into which the administrative counties are divided. The Urban and Rural District Councils share the work of administration of their districts with the County Council, the Urban District Council has rather wider powers than the Rural District Council, but both are subordinate to the County Council, (c) Rural Parishes, into which the Rural Districts are divided, if they have more than 300 inhabitants, they have Parish Councils, if less, local affairs are managed by a Parish Meeting, which all local electors may attend.

(2) *Boroughs*, or corporate towns, comprising (a) County Boroughs, set up by the Local Government Act of 1888, generally with populations of not less than 50,000 (the Act laid it down that in future country boroughs must have a population of not less than 75,000) ; the County Boroughs were given powers practically equivalent to those of a County Council, (b) Non-County Boroughs, towns which have received each its Charter of Incorporation from the Crown enabling it to manage its own affairs,

with powers less than those of the County Borough, some of its services being controlled by the County Council

Thus there is variation in powers, overlapping of areas, and altogether a fine confusion which may be typical of the English spirit of independence and capacity for muddling through somehow instead of drawing up and acting upon blue prints for the logical administration of the country, and which is all the result of the English way of life and the English conception of democracy, but which is very confusing to the student trying to make out the main moving parts of the machinery. All we can do here is to quote the Finance Act of 1931, which defines a local

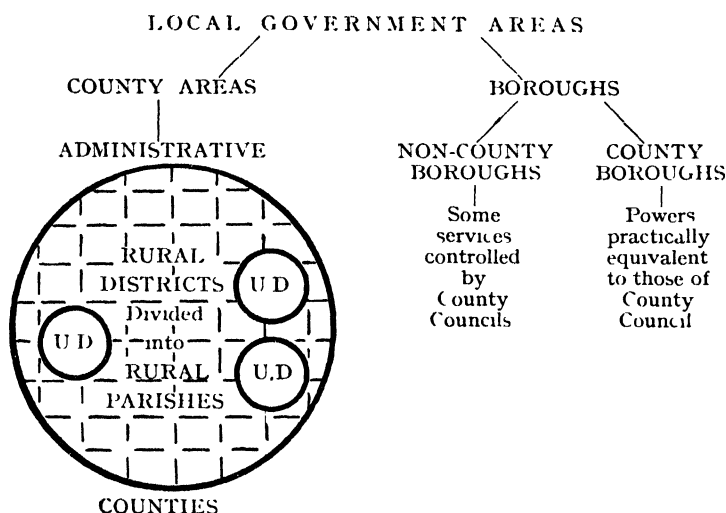


FIG 41 —THE AREAS OF LOCAL GOVERNMENT IN ENGLAND AND WALES

authority as “ any body having power to levy a rate or to issue a precept to a rating authority and includes the corporation for which any such body acts for executive purposes ”, and to note that in the County and Borough, rates are levied on property by an elected Council which has also the power to raise loans.

The main functions of local authorities are to provide roads and streets and works of public convenience and safety generally, to maintain health and sanitation, to provide centres of public welfare, such as Child Welfare Clinics, to care for certain classes of the community, such as the destitute and persons of unsound mind; to provide educational facilities; and to maintain a

police force The powers of the various Councils, as has been noted, vary considerably. Parliament imposes by statute certain duties on local authorities and, by means of Adoptive Acts, grants power to the local authorities to carry out duties which local authorities *may* undertake—*e g*, the provision of a public park. The obligatory duties are concerned with finance, public health, education, water supply, police, maternity and infant and child welfare, and, in time of war, civil defence. For some permissive duties special Private Acts are required

In order to meet the expenses of carrying out these functions, the local authority levies rates on all property rented or privately owned, except for agricultural land, which, under the Local Government Act of 1929, became exempt, the Act also relieved industrial buildings and freight transport hereditaments (such as railways, docks and canals), which the Act provided should be rated at one-quarter of their net annual value, on condition that the benefit should be passed on to industry in the form of reduced charges.

A rate is a proportion of the rateable or assessable value of a person's property. The rate is assessed by the local authority through its surveyors and valuers, who determine the fair annual rental value of the property. After an allowance for maintenance and repairs has been subtracted, the remainder is the assessment. For example, suppose the fair annual rental of a house is £50, and an allowance of £10 is made for maintenance, the £40 that remains is the assessment, or rateable value. The ratepayer pays so much in the £1, a rate differs from a tax in that whilst a tax cannot be more than £1 in the £1 of an income, rates may be and have been more than £1 in the £1, especially in the Special Areas derelict after the disturbances of the 1914-1918 war. A rate is therefore a tax on the local inhabitants of an area, not in proportion to their incomes, but in proportion to the annual letting value of their immovable property, and as such has been criticised.

The amount that must be raised from the rates is calculated by the local authority by dividing the estimated expenditure by the rateable value of the whole district. If, for example, a local authority needs £500,000 to balance its budget in a financial year, and the rateable value of the property in the district is £1,000,000, the rate levied is 10s in the £1. The person who owns the house referred to above, of which the assessment is £40,

would pay $40 \times 10s.$, that is £20, in rates in that year; the amount is usually collected in two half-yearly instalments.

Rates vary considerably throughout the country, but there are other factors governing the actual payments required besides the rate. In a town like Bournemouth, the rateable value of the property is likely to be higher than in an industrial town; a rate of 8s. in the £1 on an assessment of £100 provides the same net payment to the local authority as a rate of 16s. in the £1 on an assessment of £50. The social services required would be less in Bournemouth than in an industrial town. The economic activities of Bournemouth would be mainly trading, the population comprising a large proportion of retired and well-to-do people. At the same time, high rates in a poor industrial area (Merthyr Tydfil is the classic example, the rates reaching 27s. 6d. in 1938-9) are a great burden, of which public assistance constitutes a considerable share; and there is certainly a case for compelling the wealthy and more prosperous districts to share the heavy burdens of the poorer districts.

Central Government Control of Local Authorities.

The local counties or boroughs are by no means independent authorities. The revenue from local rates does not cover the expenditure of even the wealthiest boroughs; and the Central Government makes grants-in-aid to local authorities in respect of those services which involve heavy expenditure and which are of national importance—viz., education, police, roads and housing. These grants are made nowadays on the principle of need, such as the degree of wealth of the district, the percentage of unemployed and the number of school-children. Hence the Central Government exercises control over the local authorities in these ways.—

(1) Local authorities have not a general power to do anything they consider necessary; they have only those powers which are given to them by statute. These powers are specific powers conferred (a) by general Acts applying to all local authorities or to local authorities of a special class, such as education authorities, (b) by Local Acts conferring special powers obtained by the local authorities at their own expense through the Private Bill procedure; (c) by Adoptive Acts conferring powers on the local authorities coming within their scope; (d) by Provisional Order Confirmation Acts by which Government Departments, after

an enquiry has been held and subject to Parliamentary sanction, may confer certain powers on the local authority.

(2) The Central Government may enforce the performance of certain duties—*e.g.*, in connection with public health.

(3) Local enactments—*i.e.*, Bye-Laws, Orders, Schemes and Regulations—require, except a few of minor importance, confirmation by the Central Government.

(4) The Central Government approves loans and the disposal of municipal property, such as the sale, mortgage or leasing of land belonging to the corporation.

(5) The Central Government approves the appointment and dismissal of certain Local Government officers

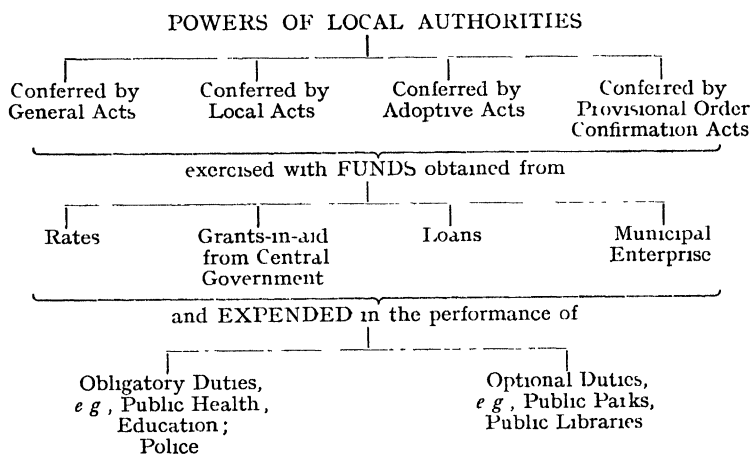


FIG 42 —THE POWERS OF LOCAL AUTHORITIES IN ENGLAND AND WALES

(6) The accounts of local authorities are audited by district auditors appointed by the Ministry of Health, with powers to disallow any item they consider excessive and to surcharge the authority with the amount concerned.

An interesting case relating to a dispute between a local authority and a district auditor is quite a recent one. Birmingham Corporation paid children's allowances to employees as part of a war bonus to meet the increased cost of living, following a request for an increased war bonus. Staff representatives had informed the Corporation that employees would accept a lower flat-rate increase if a children's allowance of 2s. 6d. per week were paid in respect of each child up to the age of fourteen.

The auditor disallowed the payments on the ground that they were not payable within the legal powers of the Corporation, and surcharged three councillors. A judgment by a King's Bench Divisional Court quashed his decision, and the auditor appealed against this judgment. On May 12, 1944, judgment was given in the Court of Appeal holding that Birmingham Corporation were justified, Lord Justice Goddard saying that the payment of children's allowances as part of the war bonuses was within the Corporation's powers; and, as the amounts were fair and reasonable, they could not be disallowed.

Borough Councils may appoint borough auditors to audit some of their accounts, though the borough auditors have no powers beyond those of checking, and some accounts, including those relating to education and public assistance, *must* be audited by the auditors appointed by the Central Government.

The Ministry of Health is the Ministry in general charge of the Local Government of the country, but the Ministry of Labour and National Service, the Ministry of Agriculture, the Home Office and the Ministry of Education are also involved in the complex web of Central Government and Local Government relationships.

In recent years there has been a conflict of two opposing tendencies: one by which more and more power is going to the Central Government, and the other by which more and more power is being delegated to local authorities and to Ministers and Government officials. The tremendous weight and complexity of national affairs has become so great that by means of Orders and Regulations, Ministers have been given powers which properly belong only to Parliament but which Parliament is too busy to exercise. A suggested solution to this conflict between centralisation and de-centralisation is *devolution*, the creation of several large areas in the country—e.g., Wales, South England, Central England, North-East England—with authorities possessing some of the wider powers of the Central Government, leaving the latter to look after only those affairs which are of national interest, with supervisory powers over the several areas.

The pre-war expenditure of local authorities in England and Wales was about £500 millions a year. Of this amount, £400 millions was for current expenses, of which about 40% was met out of rates, about 40% from payments for the use of municipal

services or property, and the remaining 20% from grants-in-aid by the Central Government, one-third of the cost of local services was met by the Central Government £100 millions was spent for capital equipment, and was met largely out of loans. The capital expenditure involved in such costly undertakings such as tramways, gas-works, lighting and baths are too large to be met out of rates at once, though interest on the loans and the annual instalments for the repayment of the principal are a charge on the rates.

These loans take the form of borrowing from banks or from private investors by the issue of stock. Nearly always, the approval of the loan by the Minister of Health must be obtained, and the issue of loans by Local Authorities is subject to various regulations laid down by the Central Government.

We have noted three ways in which Local Authorities obtain the funds necessary for the carrying out of their functions, viz, from Grants-in-Aid by the Central Government, by rates, and by loans. Mention of the latter source reminds us of the financial and banking system of the country, of the financial houses and Stock Exchange, and we are led to reflect on the essential unity of the economic life of the community as a whole. We are led to consider, too, not only the problem of Centralisation *v* Decentralisation, but also that of Private Enterprise *v* Public Control when we discuss the fourth way in which local authorities obtain funds, viz, by municipal enterprise.

Municipal Enterprise.

County Boroughs and County Councils have power—won against opposition both from Parliament and private enterprise—to undertake the supply of public utility services where private enterprise has failed to supply them, the profits being used to lighten the burden of rates. It is in the supply of services involving large capital expenditure and where centralisation of control is desirable or even necessary in the interests of consumers that the local authorities have usually undertaken their provision—*e g.*, gas, water, electricity, tramways and omnibuses; though private companies which undertake these public utilities still exist. Many of these public undertakings are run at a profit, but in some cases, *e g.*, the supply of working-class houses, the State has had to subsidise local authorities in the provision of this most essential utility.

In general, in undertaking municipal enterprise, the public authority has entered upon trading activities where it would be undesirable for the supply of a commodity or service to be a monopoly in private hands. Under the *laissez-faire* private capitalism of the nineteenth century, private water companies provided a service which was costly, inefficient, and even dangerous: cholera and typhus were the reward of the community in leaving water supply and sanitation to private enterprise in the early nineteenth century. The Waterworks and Gasworks Acts of 1847, by which a maximum dividend of 10% was permitted to these private companies, provided some measure of protection to the consumer, though the "watering" of capital enabled the law to be evaded.

Where there was competition between private undertakings, the result was anarchy. At one time there were the mains of five separate gas companies in Oxford Street, London. The waste and inefficiency of such private activity induced the municipal authorities to urge Parliament to give them power to carry on trading enterprises. In 1850 they owned one-eighth of the monopolies in the country; by 1930 four-fifths of the country's water supply, four-fifths of the tramway and omnibus services, two-thirds of the electricity supply and two-fifths of the gas supply, were in the control of local authorities.

But it is not only in the field of what may be described as public monopolies proper that local authorities have undertaken trading activities. Bradford City Council started a brick factory which brought the city a profit of several thousands of pounds a year; Glasgow went in for municipal farming, with equally happy results. Municipal authorities have undertaken with success all kinds of activities, from the provision of markets—one of the oldest forms of municipal enterprises—to race-courses (Doncaster), banking (Birmingham) telephones (Hull), to swimming-baths and golf-courses and tennis courts and bowling greens. The 1920 Air Navigation Act enabled local authorities to establish and maintain municipal aerodromes: the first was built in 1929. The slow development of civil aviation in this country was not encouraging to these projects, but there is no doubt that civil aviation will make rapid strides in the post-war world, with a corresponding development of the activities of municipal authorities.

Public Utility Bodies.

Provision for public utility services is not confined to the State and the Municipal Corporation. In Chapter VI of Volume I of this work the types of public utility concern were discussed: it was there pointed out that the distinguishing feature of the Public Utility undertaking is that it is conducted not with a view to profit, but essentially for the sake of providing a public service, though it may make a profit, which is then applied to the relief of the burden of taxation or rates, or, in the cases where the undertaking is semi-public, profit may accrue to the stockholders, *e g.*, the Manchester Ship Canal. In the case of the Port of London Authority and the Metropolitan Water Board, the capital consists of fixed interest-bearing stock, and the profits go to consumers in the form of reduced charges.

The varying types of organisation outlined in Chapter VI of Volume I are an indication of the British genius—or at least capacity—for compromise. They do not make for ease of classification, but they reflect the needs and aspirations of the time. It may be that the mixture of private, public, and semi-private public utility undertakings is a stage in the development of the State as a business organisation towards a more socialised structure. But the dangers of complete socialisation have been referred to several times in this book—perhaps the worst danger of all is bureaucracy, which may attain the dimensions of a social disease, and which at its very worst leaves the way clear for Fascism and Nazism.

The subject of Public Utilities is too wide for adequate discussion here. Such a constitution as that of the London Passenger Transport Board, controlling the greatest urban transport system in the world, is regarded by many as the ideal type for this sort of undertaking: the Board consists of members appointed for a fixed term of years by "Appointing Trustees" of wide experience in transport, industrial, financial or commercial matters, or in the conduct of public affairs; this method of appointment was quite different from that in the original provisions of the Bill introduced by Mr. Herbert Morrison, who wanted the responsibility for appointment to rest upon the Minister of Transport.

The coming into existence of the London Transport Board in 1933 may well have marked a milestone in the development of

the State as a business unit. The provision of stock of various classes, the method of appointment and control of Trustees—in fact, the whole organisation, neither completely joint-stock nor completely socialised in form, may be a pattern on which private enterprise and public enterprise may seek some form of reconciliation. That, indeed, will be the central problem of State economics in the years to come. The problem of the reconciliation of the interests of the private individual and those of the community has come full into public consciousness; it is the central problem of Society itself, and upon the nature of the solution or compromise arrived at will depend the material welfare and happiness of the Western World.

APPENDIX I

LIST OF BOOKS CONSULTED AND RECOMMENDED FOR FURTHER READING

I. ECONOMICS—PRINCIPLES AND GENERAL.

- Alfred Marshall : *Principles of Economics* (Macmillan, 1938).
L. Robbins : *An Essay on the Nature and Significance of Economic Science* (Macmillan, 1937).
K. Wicksell : *Lectures on Political Economy*, Vol. I (Routledge, 1934).
P. H. Wicksteed : *The Common Sense of Political Economy*, Vol. I (Routledge, 1935).

II. APPLIED ECONOMICS—INDUSTRY, TRADE, TRANSPORT AND PUBLIC FINANCE.

- Acworth and Stephenson : *The Elements of Railway Economics* (Oxford Clarendon Press, 1924).
C. T. Brunner : *The Problem of Motor Transport* (Ernest Benn, Ltd., 1928).
Cadbury Bros. Ltd. : *Industrial Record, 1929-39* (Pitman, 1945).
Hugh Dalton : *Principles of Public Finance* (Routledge, 1943).
H. Levy : *Retail Trade Associations* (Kegan Paul, 1942).
E. A. G. Robinson : *The Structure of Competitive Industry* (Cambridge University Press, 1931).
H. Smith : *Retail Distribution* (Oxford U.P., 1937).
W. F. Spalding : *The Finance of Foreign Trade* (Pitman, 1936).
L. H. Sutton : *The Nation Keeps House* (Hutchinson, 1938).
B. Whale : *International Trade* (Home University Library, 1932).
Committee on Finance and Industry (Macmillan Report) (H.M.S.O.).
Industrial Relations Handbook (H.M.S.O.).

Other official publications mentioned in the text should be consulted.

The Oxford Pamphlets on Home Affairs should also be read; and the articles in the Press by the City Editors of the various newspapers (*e.g.*, Mr. Oscar R. Hobson in the *News Chronicle*) will prove most useful.

III. MONEY, BANKING AND CURRENCY.

- Paul Einzig : *Currency after the War* (Nicholson and Watson, 1944).
Oscar R. Hobson : *How the City Works* (*News Chronicle*).
Walter Leaf : *Banking* (Home University Library, 1943).
W. F. Spalding : *A Key to Money and Banking* (Blackie and Son, Ltd., 1938).
R. J. Truhtil : *British Banks and the London Money Market* (Cape, 1936).
Hartley Withers : *The Meaning of Money* (Murray, 1937). *Money* (Nelson Classics, 1935).

IV. ECONOMIC HISTORY.

- A. Birnie : *Economic History of Europe* (Methuen, 1933).
E. L. Bogart : *Economic History of the United States* (Longmans, 1931).
J. H. Clapham : *Economic Development of France and Germany* (Cambridge U.P., 1921).
H. Heaton : *Economic History of Europe* (Harper and Bros., 1936).
L. C. A. Knowles : *Economic Development of the British Overseas Empire* (Routledge, 1934).

V. CENTRAL AND LOCAL GOVERNMENT OF GREAT BRITAIN.

An excellent recently-published introduction is

James Fox : *Civics* (Harrap, 1940).

APPENDIX II ¹

A SHORT ASSESSMENT OF CHANGES IN BRITAIN'S TRADE BROUGHT ABOUT BY THE WAR

Britain's Pre-War Export Trade.

Until the depression of the early thirties the United Kingdom exported annually upwards of £700,000,000 of domestic produce and manufactures, and £100,000,000 of imported merchandise. At the bottom of the depression (1932-33) these values had almost halved, and this reduction was not made good in the years that followed. The highest level was reached in 1937, when exports of domestic goods were £521,000,000 and re-exports were £75,000,000.

The purchasers of United Kingdom goods in 1937 (re-exports excluded) were : British Empire £252,000,000 ; Foreign Countries £269,000,000 ; the principal purchasers being :

	£m.		£m.
U. of S. Africa	41	U.S.A.	31
Australia	38	Germany	22
British India (excluding		France	21
Burma)	36	Argentina	20
Canada	28	Denmark (incl. Faroes) .	17
Eire	22	Holland	15
New Zealand	20	Sweden	13
Rest of Empire	67	Other Countries	130

The values of the principal types of domestic goods exported in 1937 were :

Product.	Value.	Principal Markets.
	£m.	
Cotton yarns and manufactures	69	British India, Australia, British West Africa, South Africa, Argentine, Germany.
Machinery	50	South Africa, British India, Australia.
Iron and steel and manufactures thereof	48	South Africa, Canada, Australia, Argentine, British India, New Zealand.
Vehicles	40	Australia, British India, South Africa, New Zealand.

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Product	Value	Principal Markets
Food, drink, and tobacco .	39	United States, Straits Settlements and Dependencies, British India, Eire, Germany, Canada
Coal	38	France, Denmark, Sweden, Germany, Eire.
Woollen manufactures and yarns	36	Canada, Germany, Argentine, South Africa
Chemicals, drugs, dyes and colours	25	British India, Australia, South Africa, Canada, United States
Non-ferrous metals and manufactures thereof	16	United States, British India, South Africa, France, U S S R, Germany
Electrical goods . . .	13	Australia, South Africa, British India, New Zealand
Clothing	10	South Africa, New Zealand, United States
Pottery, glass and abrasives .	10	Canada, Australia, South Africa, Eire.
Cutlery, hardware, implements and instruments	10	South Africa, Australia, British India

War-time Changes in Britain's Export Trade.

The value of the United Kingdom's exports of her own products fell from £471,000,000 in 1938 to £233,000,000 in 1943. When allowance is made for the rise in prices, the *volume* of exports was reduced to only 29 per cent. of the 1938 level. The following table shows which broad industrial groups have so far suffered the greatest reduction in their export markets in terms of quantity.

EXPORTS FROM THE UNITED KINGDOM

	Unit	1938	1943	1943 as % of 1938
Spirits	Million proof gals	9.1	5.7	63
Manufactured tobacco	Million lb	33.6	17.9	53
Woollen and worsted piece goods	Million sq yds	96	46	48
Pottery	Thousand tons	186	80	43
Machinery	Thousand tons	459	136	30
Cotton piece goods . .	Million sq yds	1,386	374	27
Books, etc	Thousand cwts	613	121	20
Pedal cycles	Thousands	576	112	19
Cotton yarn	Thousand cwts	1,098	172	16
Coal	Million tons	35.9	3.5	10
Iron and steel manufactures	Thousand tons	1,915	135	7
Motor cars and chassis .	Number	89,609	1,299	1.4

These declines in our exports have, of course, not been spread evenly over all countries. The following table shows, as a percentage, the value of our exports in 1943 as compared with those in 1938 to our major overseas customers, excluding Germany and the occupied countries.

1943 as % 1938		1943 as % 1938	
U of S Africa	55	Eire	57
Australia	70	New Zealand	67
British India	52	U S A	94
Canada	103	Argentina	49

The European Countries occupied by Germany, including Germany itself, Italy and the Channel Islands, purchased goods in 1938 to the value of £117.7 millions. In 1943 this figure had dropped to £0.3 million.

Changes in Post-War World Economy.

1. The main economic disturbances created by the war have been :

(a) General failure to maintain capital equipment in peace industries, failure to make good wear and tear of machinery, buildings, etc.

(b) Great shifts in ownership of foreign investments—*e.g.*, transfer of British investments in U.S. to American owners.

(c) Increase in certain national overseas debts—*e.g.*, British indebtedness to Dominions and India.

(d) Four to five years' damming of purchase of consumption goods (*e.g.*, clothes, domestic equipment)—often accompanied by enormous accumulations of small savings intended for their post-war purchase.

(e) Widespread destruction of capital goods, public utility installations, means of transport and communications, and housing.

(f) Growth of industry and engineering in formerly unindustrialized nations.

(g) Depletion of stocks of raw materials and foodstuffs.

(h) Creation of national controls on, *e.g.*, food and raw material imports, shipping, exchange, etc.

2. The main resultant pressures in the post-war world economy are likely to be, at least in the transition period :

(a) The demand for non-durable or semi-durable consumer goods, such as food, clothing and furnishings.

(b) The demand for raw materials to meet these requirements.

(c) The demand for the repair and reconstruction of storage and transportation facilities.

(d) The demand by industrial enterprises for new machinery and plant as replacements and repairs and to meet new or changed needs.

(e) The demand for durable consumer goods, such as dwellings, automobiles, refrigerators, radios.

(f) In the more prosperous countries consumers will demand a considerable improvement in the quality of many consumption goods (*e.g.*, clothes, domestic furnishings and equipment, etc.) and the expansion of many curtailed services (*e.g.*, hotels, holidays, entertainment, travel).

3. There have been considerable differences in the war-time experiences of various countries and from the point of view of the post-war export trade they may be grouped as follows :

THE NEUTRALS, *e.g.*, *Sweden, Switzerland, Spain, Portugal, Argentine*. The common features shared by almost all neutrals will be :

- (i) large credit balances against the belligerents,
- (ii) shortage of up-to-date heavy capital goods,
- (iii) the growth of local industries producing consumer goods.

ALLIED COUNTRIES WHICH HAVE NOT BEEN OCCUPIED . *e.g.*, *The Dominions and Colonies, U.S.A., India, Latin America, Turkey*. In all these we shall find :

- (i) a great accumulation of consumer purchasing power,
- (ii) shortages of many durable consumer goods and of luxury goods,
- (iii) considerable expansion of manufacturing capacity.

ALLIED COUNTRIES WHICH HAVE BEEN WHOLLY OR PARTLY OCCUPIED : *e.g.*, *France, Belgium, Holland, Denmark, Norway*,

Czechoslovakia, Balkans, Poland, Russia, China. In many of these countries we shall find :

- (i) very great poverty and destruction,
- (ii) close governmental control of economic affairs,
- (iii) concentration for some time on the simplest needs—bulk foods, utility clothing, housing,
- (iv) determination to restore prosperity by their own efforts,
- (v) some dependence on international credits or even international gifts.

MAIN ENEMY COUNTRIES : At least while the occupation lasts and probably for some years after, it is unlikely that either Germany or Japan will be in a position to unport and pay for large quantities of consumer goods and services.

THE POSITION OF BRITAIN : In terms of the home market there will be a tremendous accumulation of purchasing power, anxious to make good the postponement of five years' spending on clothes, houses, domestic equipment, motors, radios, holidays, etc.

In terms of export markets there will be

- (i) the long break of contact with almost all overseas markets,
- (ii) the growth of industry in many former importing countries, *e.g.*, the neutrals and the Empire,
- (iii) more intensive competition from American manufacturers, whether producing in the U S. or producing in the consuming countries,
- (iv) considerable Governmental encouragement for exports on grounds of long-term policy. *If the British manufacturer simply follows his short-term interests he is likely to devote all his immediate attentions to the highly profitable home market, this abnormal demand may not last, however, for more than three or four years—by which time the task of entering foreign markets will probably be much more difficult.* The Government may seek to prevent this by giving the exporter priorities in terms of man power, raw materials, credit facilities, etc.

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