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PAPERS ON CURRENT FINANCE



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PAPERS ON CURRENT FINANCE

BY

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INTRODUCTION

THE constant requests I receive from university students and correspondents at home and abroad for copies of one or other of these papers have led me to think that their publication in this form might be convenient; the more so, as the journals in which some of them originally appeared are now out of print. Generally speaking, with only slight exceptions, the papers are reprinted without alteration, and with no attempt to bring the figures up to date. The progress of events is now so extraordinarily rapid, and the situation changes so much from day to day, that only the daily press can keep fully abreast of the movement.

The connection between the papers may not be obvious at first sight. But they all relate either to financial problems directly raised by the war, or to problems which have gained new interest and urgency in view of the financial reconstructions which the war has made inevitable. A few words by way of introduction may serve to make this clear, and to summarise the main topics treated in the volume.

The first paper, mainly historical and critical, deals with the war crisis and the financial emergency measures, and may be found a useful compendium for reference as to the general financial policy followed in a period which must always figure in world-history. It also recommends the now-accepted method of continuous borrowing, and concludes with a general estimate of the economic and financial outlook.

In the second paper, the question of our financial resources is considered in more detail. After a brief sketch of our previous loan policy, the method of continuous borrowing is further advocated; and French experience is given in its support, as well as in favour of interesting the small investor, and the people generally, in the war finance. A protest is made against the discouragement of private thrift, and the waste in public expenditure: and the paper concludes with a few words on the necessity of heavy taxation.

The next two papers are concerned with the financing of industry, a problem which must assume immense importance after the war, when the demand for capital will be unprecedented. In the first of these, an attempt is made to indicate some of the most striking developments of modern business competition, and to show that they involve an irresistible trend towards larger industrial organisations, not only for greater efficiency, but for effective defence against forms of trade activity closely analogous to

those of war. We are thus able to judge better of the kind of financial assistance English industry will require; and in the next paper the question is considered in what way this assistance can be best provided. It is shown that what we regard as "banking" in England is of a quite peculiar type, and is prevented, by the very defects of its qualities, from discharging all the services rendered to industry by "banking" in some other countries; but it is contended that, outside what we here call banks, the English market has unrivalled financial resources, which only require suitable organisation to make them able to meet all reasonable demands. The question is not definitely raised in this fourth paper, but it will be gathered that the writer is of opinion that, even for England, the effective financing of her industries is of more importance than her international clearing business, and indeed is a primary condition of her mastery of exchange and her continued hold of the international position. Precise estimates of the profits on our international business are not possible; but it is safe to say that a loss of one half of it would be balanced by an increase of one per cent. in the national income. It can hardly be doubted that if half the skill and attention now bestowed on international finance were devoted to domestic finance, the increase in the national income might easily be five times that percentage.

The fifth and sixth papers, on Banking Reserve,

and the Crisis of 1907, may not seem to be so directly concerned with war problems as the rest. Both were designed to illustrate the question of the national reserve, and of the functions of the Central Bank. The immense financial liabilities created by the war have forced these matters to the front. They are now under consideration by a Committee, and it can hardly be doubted that when the Committee report, they will recommend some radical changes in existing arrangements. The old Act of 1844, on which our present system is based, was never defensible, and has been condemned by experts of all countries, so that its disappearance may be welcomed; but so many wild proposals are in the air as to the changes which should be made in the constitution and functions of our great national bank, that a few considerations on the essential principles of a banking reserve, always fundamental in finance, seem to be in place here. The question had been constantly under discussion in the ten or fifteen years preceding the war; and we are given to understand that just before the war broke out the leading clearing bankers had agreed upon a scheme of reform, and submitted it for consideration to the Bank. It was, unfortunately, just too late; and we had to face the war strain unprepared. Experts were agreed that our reserve position was deplorably inadequate for such an emergency, but the most pessimistic hardly expected to see a general moratorium. It is now admitted

that this was unnecessary, except as a concession to panic; which panic, again, was really due to the general sense that we were caught unprepared. However, the events of the crisis of 1907 led to a complete reconstruction of the American banking system, under the Federal Reserve Act, to which the brilliant financial achievements of the United States during the war are mainly due; and it may be hoped that reflection on the history of the war crisis will have equally salutary effects here. There is certainly a revived interest in the subject, particularly evident on the part of the Chambers of Commerce, but by no means confined to these bodies; and this has led me to think that the inclusion of these two papers may not be found altogether untimely.

The seventh paper deals with the question of the alleged inflation of our currency. Perhaps there is nothing in our war finance which has provoked more discussion, or given rise to so much anxiety. The view taken in the paper is on the whole optimistic. The rise in prices is held to be caused, in the main, not by operations originating in the currency, but by the enormous increase of Government expenditure; which, in so far as it is really required for the effective prosecution of the war, no one would dream of restricting. The effect has been to more than double the total national expenditure; and it stands to reason that the currency by which the payments are handled must increase to something like the same

extent. That this necessary or minimum expansion of currency has been gratuitously exceeded, in consequence of wasteful expenditure, and particularly of extraordinary advances in wages conceded to pressure, I entirely agree. But here we are brought up against questions of politics, which lie outside the limits of a financial study. Great stress has been laid in very well informed quarters upon the difficulties we shall have to meet in returning to an effective gold standard, and in rectifying and maintaining the foreign exchanges. The difficulties will be serious; but here, again, I must remain an optimist. The resources of civilisation in this regard have by no means been exhausted; they have indeed been enlarged in some respects by certain developments of the war finance: and with the co-operation of the United States these monetary difficulties will soon yield to treatment. But this is not to say, and I hope nothing in these papers will be construed as saying, that the strictest economy is not essential. On the contrary, the whole argument assumes that every possible check is imposed upon some quite indefensible waste and recklessness in expenditure. The War Bonus policy, for instance, with its endless reaction on prices, might easily be carried to a point which would make financial recovery nearly impossible, to say nothing of the grave problems it is leaving us to face on the return to peace conditions.

As is stated in the paper itself, the Address on Inflation was designedly prepared to start a discussion on the subject, in which, as was expected, the conclusions of the author were acutely criticised. It is thought, therefore, that the reader will welcome a reprint of these interesting criticisms, all the more as they may serve to correct any undue emphasis or bias in the opening statement.

In an Appendix will be found a short paper on Monopolies, written thirty years ago, and a letter upon the question of Fixed Exchange. The paper may have some interest as a very early defence of the movement for the consolidation of business enterprise, of which so much is said in the third and fourth papers. Perhaps it will go to confirm the general contention in these papers that a radical increase in the scale of business organisations is not only inevitable, but to be welcomed in the public interest: in any case it is a proof that the views expressed there are something more than hasty impressions, or a mere reflection of the fashion of the day. As to the Letter, it may serve to throw a little additional light on the very brief reference to the subject on p. 106 of the text.

Taking the papers as a whole, it may fairly be claimed that the suggestions they contain have been justified in the main by the subsequent course of events. The independent rate for foreign money, and the lower rate for bills, recommended in the

second paper, were ultimately adopted, though only after a delay which has cost the nation dear; the war loans have been effectively popularised; and some steps have already been taken by certain banks towards the more disputable suggestion of fixed exchange made in the fourth paper. On what are perhaps the main contentions of the volume, there is now very general agreement. *The Times*, in a leader of Sept. 23, 1918, speaks of continuous borrowing and the bank amalgamations as "the two novel features which must always make the past twelve months a remarkable period in our domestic financial history," and gives very good reasons for approving both. Business fusions, of course, have not been confined to banks, or to this country. They are in active progress in various forms of enterprise, and in all the principal countries, and may fairly be regarded as the most striking economic feature of our time.

It must be confessed that in one respect the work of writing these papers has been difficult and unsatisfactory. Just at the time when a scientific handling of our finance is most urgently required, the investigator is deliberately deprived of the necessary statistical basis for his inquiry. It cannot be for the reason so often assigned, for some of the most important facts so withheld are known to numbers of persons, and must certainly be known by the enemy, if they interest him. The Statistical Abstract

for 1916 is only announced as I write these lines: the Mint Report for that year has not yet appeared: even the meagre monthly reports of the banks ceased, when they would have been most instructive, in the middle of the year 1915. This policy of secrecy and mystification is the most ugly feature of our war *régime*. It is to be hoped that it will end with the war. Publicity is the salt without which democracy (and we may add, bureaucracy) would soon become rotten; it is the indispensable condition of the healthy operation of public opinion.

It only remains to discharge a pleasant duty. For permission to reprint these papers, most cordially given to me, I wish to thank the Editor of the *Economic Journal*, the Council of the Institute of Secretaries, and the Council of the Institute of Actuaries. I am also under obligation to the Editors of the *Post Magazine* and the *Insurance Record* for assistance derived from excellent reports in their Journals.

CAMBRIDGE, *September* 25, 1918.

I.

BRITISH WAR FINANCE.[1]

British War Finance, 1914-15. By W. R. LAWSON. (London: Constable and Co. 1915. Pp. vi+367.)

War and Lombard Street. By HARTLEY WITHERS. (London: Smith, Elder and Co. 1915. Pp. viii+171.)

Manual of Emergency Legislation. Financial Edition. To June 4th, 1915. Pp. 205. Edited by Alexander Pulling, C.B. Published by Authority. (London: Darling and Son. June, 1915. Price 1s.)

"THE financial position to-day is serious." This declaration of the Prime Minister, made in circumstances of more than usual formality, on November 2nd, 1915, suggests that a brief survey of the war finance, and of the financial problems that now confront us, may not be altogether untimely. Three weeks earlier the Financial Secretary, in a remarkable speech on the Finance Bill, had given what to the public generally was the first official intimation of the real nature of the situation, and of the uncompromising transformation of our ordinary economic life which it demands. It is further convenient for

[1] An article contributed to the *Economic Journal* for December, 1915.

a review of the whole position that we have in the Chancellor's recent Budget speech authoritative figures and estimates which bring the necessary data for discussion nearly up to date.

Many similar reviews have already appeared, and anyone writing on the subject must, in particular, be under obligation to the works of Mr. Lawson and Mr. Withers mentioned at the head of this page, as well as to the admirable compendium of war legislation, edited by Mr. Pulling, the financial volume especially. Mr. Lawson and Mr. Withers both deal with the past rather than with the future: with the war crisis rather than with the fundamental finance problems caused by the war expenditure. But the history they have sketched so admirably, and the acute criticisms with which the books abound, are full of instruction for fuller inquiry. Their work will serve as a text for a good deal of what can here be said.

Mr. Withers's book may be first noticed as the earlier of the two. It seems to have been written in December, 1914, and naturally is almost exclusively concerned with the war crisis and the various emergency measures by which it was met. It is an oft-told tale, now pretty familiar to the public; but Mr. Withers's account, especially the part that deals with the bill market, will have permanent value. The position at the eve of the declaration of war was tersely summed up by Mr. Asquith last

March.[1] "We were confronted at that moment with the double risk—the risk of a shortage of internal, and of a general discredit of international, currency." The shortage of internal currency was more or less universally experienced, by neutrals as well as belligerents. But international currency means, for the most part, the London bill: and the discredit of this currency, involving as it did a mass of paper estimated at 350 millions sterling, was a special danger of the gravest kind for the London market.

The shortage of internal currency was met in most countries by an expansion of the note circulation, sometimes of regular, sometimes of emergency issues. There seems generally to have been a run on the banks, as well as a remarkable scarcity of small change. On the Continent we find Governments, Banks, Municipalities, and even Chambers of Commerce issuing small notes; in some cases for values as low as a mark or a krona or a franc; even quarter franc notes were issued in France.[2] This scarcity of small change, it is said, was due partly to mobilisation needs, but mainly to hoarding. It does not seem to have been seriously felt in this country. Nor was there, so far as can be judged, any appreciable run on the banks,[3] apart from the

[1] The whole statement will be found in Lawson, pp. 11, 12.

[2] M. Théry tells us (12th Nov., 1915), that the scarcity of small change continues in France, in spite of issues of 1 and 2 franc notes to the amount of 43,567,500 francs by sixty-six Chambers of Commerce.

[3] "Not even on a savings bank."—Lawson, p. 103.

inevitable demands of an August Bank Holiday, though contrary statements have been made. There is, at any rate, no trace of any such movement in the Monthly Bank Returns. The proportion of "cash" shown for the month of August was 20·1 against 15·2 for July; and the amount £125 millions as against £91½ millions. The July figures were quite normal, showing exactly the same proportion of cash as the previous year. Too much must not be made of these figures. Our bank returns are deplorably inadequate, concealing precisely what it is most important to know: "dim candles, lit to make darkness visible," as Mr. Withers aptly puts it.[1] Returns apart, however, it seems that so far as can be discovered by inquiry, there was nothing deserving to be called a run upon the banks. The public fortunately had entire confidence in them. It was the bankers, not the public, who were panic-stricken, and who, like the United States banks in 1907, did most of the hoarding. Some of them seem to have obliged their customers to take notes instead of gold, and so caused pressure on the Bank of England which might have had serious effects. The old tradition against direct re-discount with the Bank seems to have been thrown over. Mr. Lawson speaks euphemistically of the "extreme prudence" of "some of the clearing banks, who joined in the rush to the

[1] Even these meagre returns have been suspended since June last. Nothing could be more calculated to destroy public confidence.

Bank of England, and dumped their own bills upon it" (p. 19).

When we consider the absolute inadequacy of our reserve position, even for ordinary emergencies, the bankers' panic is intelligible enough. They were well aware that if the public generally had demanded in gold 5 per cent. of the sums standing to their credit, whether for purposes of export or hoarding, or even for extra pocket-money, the whole system would have collapsed. It would have been impossible at that time to obtain assistance from the Bank of France, as on three recent occasions. Again, we stand alone among the great commercial countries in having no provision for emergency issues of legal tender money. In other countries the National Bank can make such issues. The absurd Act of 1844 makes this impossible in England, and thus deprives our note of that elasticity which is the special virtue and *raison d'être* of this form of currency. In France, Germany, and the United States further provisions had been made. In the United States the Aldrich-Vreeland notes were ready, and were issued to the amount of over £75 millions, besides a Treasury issue of nearly £25 millions, and the usual Clearing House certificates. In Germany notes which could replace gold coin had been introduced before the war. As early as 1912, £15 millions worth of 50- and 20-mark notes had been issued. In France, they were ready for the emergency. Notes of 20

francs and 5 francs had been prepared in advance and sent out in good time; the actual issue began on July 31st. Nothing of the kind existed here, though it had long been foreseen that it would be required. We were as unprepared financially as in a military sense.

The abler bankers had constantly protested that more substantial reserves were necessary. It was considered enough to say in reply that the Bank of England, in virtue of its peculiar position in the market, could always create credits amply sufficient to meet internal requirements, and that England, as a creditor country, could always command gold from abroad. But it is obvious that the Bank of England credits could not meet a run on the banks for gold. No doubt a great creditor country can always meet a sudden strain by withdrawing accommodation from those whom it has taught to expect it. But this is not usually considered good banking. It is certainly bad business. Here it is hard to agree with Mr. Withers. He assumes that our banks acted in this way, and finds in the deadlock thus produced the best proof of London's supremacy in finance (p. 78). To others it will seem a proof of weakness. Nothing is more likely to endanger that supremacy than action of this kind: two or three such financial victories would be fatal. We may be fairly sure that nothing but extreme necessity would have driven English bankers to such a shift. Even creditor countries

require strong reserves if their banking reputation is to be maintained. There was a smart set of city writers who went still further in their opposition to larger reserves. If prudent banking, they said, meant sitting on a heap of gold, then any fool could be a banker. The real art of banking consisted in the economy of gold. There seems confusion here. By all means economise gold in the circulation and in the outlying banks. The last place for such economy is the central reserve. But these were the views which have prevailed in the City.[1]

Thus the outbreak of war found us with a banking reserve so cleverly "economised" that, as just stated, a 5 per cent. run on their huge deposits would have broken the banks. The situation would have been an anxious one in any case. But it was made incomparably more serious by the complete collapse of the great markets which are so intimately connected with the banks, and which, as Mr. Conant so justly maintains, it is a primary function of the banking reserve to support. Next to their "cash," the banks rely chiefly on three lines of resources. There is the money at call, their holdings of bills,

[1] It is only fair to mention that leading bankers are believed to have agreed on a scheme, a few weeks before war broke out, which if it had been adopted would have distinctly improved the position, though not perhaps in quite the best way. But this scheme, of course, required the assent of the Bank of England, and the reform of the Act of 1844. Nor would it have been really effective until it had been in operation for two years or so, nor unless more adequate banking returns had been set up. It was too late.

and their securities. As to their securities, the London Stock Exchange closed on July 31st. Wall Street "did not open." Most other bourses were already closed. It was clearly impossible to realise securities. The bill market too was paralysed. The Bank of England acted with its customary public spirit, but could obviously only deal with a fraction of the bills current. As for the call money, it has always been an open secret that the short loan market is the danger point in times of general crisis.[1] The system is only possible on the assumption that what one bank calls, either another bank or the Bank of England will be ready to lend. It must inevitably break down whenever there is general pressure. Thus the bankers found that what they usually regard as their liquid assets were now, in Sir Edward Holden's phrase, frozen.

It was a desperate position, and it was not eased from the bankers' point of view by the fact that Government had conceded a Bill Moratorium. This Bill Moratorium was probably an inevitable measure. It seems in some form or degree to have been everywhere adopted. But it did not improve the banking situation, except in so far as the banks were acceptors. The bankers not unnaturally came to Government for relief. What their demands were we can only conjecture. The concessions they obtained were

[1] Lord Goschen insisted upon this in his speeches on the Baring difficulty in 1891.

stupendous. First the Government very wisely extended the August Bank Holiday by three days: a period not so long as to cause alarm, and yet long enough to give time for consideration. It then proceeded to provide emergency currency on a scale never before dreamt of. The Treasury were to issue full legal tender notes for £1 and 10s., payable in gold at the Bank; and the bankers might obtain advances of these notes, at Bank rate, up to an amount not exceeding 20 per cent. of their deposit liabilities—say a total sum of £225 millions. The same Act empowered the Bank "so far as temporarily authorised by the Treasury . . . to issue notes in excess of any limit fixed by law." Postal orders were put on the same basis as to legal tender and redemption at the Bank as the currency notes. Further, Scottish and Irish notes were made full legal tender, and banks in Scotland and Ireland were not under obligation to pay their notes except at their head offices, and might pay, if they thought fit, in the currency notes.

These provisions might have been thought amply sufficient to maintain cash payments. But on the same date (August 6th) as they were enacted, the moratorium already granted in regard to bills was made with certain exceptions general. Thus cash payment became optional, not only from banks, but generally; the only important exception from the banking point of view being that notes were still payable in cash.

"The flag was lowered," as Mr. Withers has it: "for the first time since the Restoration," Mr. Lawson says, "the collection of current debts was interfered with." The general moratorium was undoubtedly the most unfortunate of our emergency measures, and in all probability we shall not be allowed to forget it.[1] In comparison with it, the suspension of cash payments by the Bank in 1797 seems a comparatively modest precaution. It may, of course, have been necessary: but the necessity is not apparent to observers who have only the ordinary means of information. Mr. Lawson (on p. 111) states very fairly the arguments for and against the measure. Though he abstains from passing a final judgment, it is pretty clear what his judgment would be.

It can hardly be doubted that the relief measures erred by excess rather than defect. Out of the £225 millions offered to the banks, the banks actually borrowed less than £13 millions, which was soon repaid. Some of the greatest banks made no use of the moratorium. Mr. Lawson says: "Without declaring a moratorium the Americans gave themselves the benefit of it. On the other hand, we declared a moratorium, but most of us paid our debts all the same." There is a good deal of truth in this.

[1] Cf. Mr. A. D. Noyes's article in the *Yale Review* for October, 1915. He speaks of the "stupendous loss in economic prestige which London has already suffered." The language is somewhat over-coloured, and perhaps reflects the known aspirations of New York to displace London as the world's financial centre: but it deserves note.

But why did the New York exchange rise to $7, if Americans were not trying to pay their debts?

But whether the relief measures were or were not excessive, the huge scale on which they were granted is some indication of the kind of provision the banks thought necessary for the situation created by a European war. Why had no approach to an adequate provision been made? The war could have been no surprise to bankers. It had long been expected and prepared for in the great European centres; and after the experience of the summer of 1911 our bankers could have been under no illusions. Innumerable warnings had been given: the very date of the declaration of war had been foretold by well-placed observers. By Mr. Lawson, at any rate, war was seen to be inevitable two years before the actual outbreak. Writing in 1912, he said: "It is no longer any secret that we are drifting into a trial of strength with the most powerful of European States." [1] But here a question has been raised which seems to deserve more consideration than has been given to it by either Mr. Lawson or Mr. Withers. Would any reserve provision that could reasonably have been made in advance have appreciably strengthened our position in view of a war crisis? There are some who think it would. They think that reasonable reserve and emergency provision would have made a general moratorium

[1] *Modern War and War Taxes*, p. 138.

unnecessary. Granting that a bill moratorium was inevitable, they think it open to question whether it would have been necessary to suspend all the usual finance and acceptance business, or even to make a prolonged suspension of the stock market (subject, of course, to the necessary restrictions on trading with the enemy). The question is bound up with another. Did the collapse of the great markets paralyse the action of the banks, or was it the withdrawal of adequate banking accommodation that paralysed the markets ? [1] The absolute suspension of the markets was a heavy blow, not only to the banks, but to the general business of the country. Might they not have been kept alive, though with their functions restricted, if due and timely preparation had been made ? It is a difficult question on which no one could be anxious to dogmatise. One thing may fairly be said. The object was so vitally important that it was worth while to have made a determined effort to secure it. No such effort was made.

Mr. Lawson's book throws valuable light on these matters. The position of the great bill and stock markets during the crisis, and under the emergency

[1] A competent observer, Mr. Spalding, says, "The consensus of opinion, outside banking circles, seems to be that the action by the banks, in calling up all their loans from the discount brokers and other similar borrowers, to some extent precipitated the crisis."—*Foreign Exchanges*, p. 98.

The main purpose of a banking reserve is to make such pressure unnecessary.

measures, is very fully treated by him. His book is much wider in scope and more fully documented than Mr. Withers's sketch, and brings the history down to a later date. What that date is does not always clearly appear. The impression one gets is that the book is to some extent a collection of articles written at different times. But the whole is well arranged and forms by far the most important contribution to the critical history of the war crisis which is at present available. The bill market is not so prominent in his pages as in those of Mr. Withers: but Mr. Lawson gives a useful account of the estimates that have been made of the bills in circulation at various times. Both writers accept the general opinion that at the time of the crisis something like £350 millions of bills were current in the London market. Both writers, again, find that the value of the earlier forms of relief was overrated. Mr. Withers endorses the very general view that the banks might have "shown greater readiness to assist in the task of reorganising exchange" (p. 74). Mr. Lawson is less inclined to criticise the banks, but justly lays stress on the supreme services rendered by the Bank of England. It was, as he truly says, the mainspring of all the emergency measures. "Without it there could have been no heroic bill-discounting, no conjuring with Treasury guarantees for all sorts of financial and commercial debtors. The Bank of England furnished the

talisman, and the Chancellor of the Exchequer applied it" (p. 13).

The services rendered by the Bank were certainly remarkable. The White Paper recently issued shows that in the five days ending July 1st the Bank had made general advances to the amount of £27 millions; while its total advances to bill-brokers are estimated at £30 millions. In the week ending August 5th its gold reserve declined £17 millions, notwithstanding a receipt of £5¼ millions, leaving the amount as low as £11 millions. The proportion dropped in a fortnight from 52 per cent. to 15 per cent. The Bank state that they had refused no legitimate applications for assistance. The whole mass of liability on account of relief measures, nominally assumed by Government, of course fell in the first instance on the Bank. Some idea of the amount of this liability may be gathered from the statement in the Revenue returns that £160 millions had already been repaid. It is clear that the Bank Directors showed their usual courage and did all that could possibly have been expected of them.

Passing to the Stock Exchange position, we find Mr. Lawson here at his best. He is not satisfied that this market need have been closed. Securities had been depreciating for a long time before the war, and in the ten days before the House closed there was a further fall of no less than £188 millions (or 6 per cent.) in the representative securities scheduled

by the *Bankers' Magazine*. The open account, too, was small. So Mr. Withers (p. 121): "It was generally agreed by most active stock-brokers in the middle of July that they had never seen the Stock Exchange account so small." Subsequent returns showed it to be about £80 millions for London and £12 millions for the country; hardly one-quarter of the liability in the bill-market. Mr. Lawson thinks that the banks had much more at stake than the members of the Exchange,[1] and that they exerted their influence in favour of closing, a step which he does not believe the Committee would have taken on their own responsibility. But he admits that direct pressure was put upon the Committee by a section of the members. "The Stock Exchange was made the scapegoat of the more powerful and higher-placed offenders. . . . After hours on July 30th, forty large firms are said to have notified the Committee that if the House re-opened they would have to hammer themselves" (p. 54). There we must leave the matter. Of the provisions made for immediate relief to the Exchange, and for facilitating the postponed settlement of November 18th, Mr. Lawson seems to approve. The undertaking of the "banks to which currency facilities are open" not to press for repayment of loans

[1] "It is estimated that the banks had lent £250 millions to their customers against stock exchange securities as collateral."—Withers, p. 122.

until after the war seems, as he says, to have been of the nature of a *quid pro quo*. But he is very critical of the arrangements made on the re-opening of the Exchange. Chapters IX. and XII., in which he deals with these matters, are among the best in the book. Incidentally he shows that our habit of fortnightly settlement and the contango methods, though extremely convenient in many ways, have their disadvantages, as Americans have always contended, and certainly proved awkward in this war crisis (pp. 128-9). It is a point that deserves careful consideration; though we are hardly likely to change our practice. But there will be much sympathy with Mr. Lawson's general view as to the restrictions. He complains that from first to last the Stock Exchange was treated as though it were a national danger, instead of an essential piece of the nation's economic machinery. The re-opening regulations were unnecessarily drastic. The prohibition of new issues except by special license (sometimes, as a recent case has shown, most arbitrarily withheld) played directly into the hands of Wall Street. In a later passage, written after three months' experience of the new rules, he says that, as he had anticipated, "their effect in stimulating American competition has been very remarkable" (p. 244). So in regard to the minimum price rules. He thinks the fear of German liquidation exaggerated. "First, the bulk of it was done before the war

commenced; second, the completion of it was effected chiefly through Amsterdam and New York. . . . Treasury regulations of any kind would have been futile, and those actually issued were far more embarrassing to our market than to Berlin." The C.P.R. method of refusing to transfer shares out of enemy names was an infinitely more effective check than any Treasury restrictions could be (p. 187). The provincial Exchanges seem to have been allowed more freedom. Mr. Lawson says "they faced the crisis more boldly and wisely than the metropolitan one was allowed to do. They also offered a stronger resistance to the encroachments of the Treasury" (p. 58). It is hard to avoid the conclusion that the restrictions were excessive, and that not merely the Exchange, but the country, has suffered in consequence. It is obviously desirable, for instance, to encourage the sale from this side of anything marketable on Wall Street. Yet the enforcement of Leeman's Act and the obstacles to arbitrage have so impeded free dealing as greatly to obstruct such sales. You cannot cramp one of the vital organs of an economic community without impairing its general economic strength.

The Treasury issue of Currency Notes, which was one of the earliest emergency measures, has been the subject of so much, and such divergent, criticism that it seems to call for special remark here, all the more as neither Mr. Lawson nor Mr. Withers seems

quite satisfactory in his handling of the matter. We have an influential Committee of the British Association recommending that the issue should be withdrawn, and that if paper money is required to replace sovereigns and half-sovereigns it should be provided by Bank of England notes of these denominations. It is a curious recommendation because, as everyone knows, the Bank of England issue is practically made by the Bank as the mere instrument of the Treasury. The Directors of the Bank have no control or discretion whatever in regard to the issue, which is purely mechanical. Sir Richard Cooper, on the other hand, demands in the House of Commons that the Government should take over the present Bank issue. Now there is, of course, one important distinction between the two issues as now conducted. Neither issue is a bank issue in the ordinary sense of that term. But the Bank of England issue is made under conditions which are defined by statute, and which in practice limit its uncovered element. Even here, however, it must be observed that the Treasury may be and has been invested by Government with power to suspend the statutory conditions. But the new Currency Note issue is at present absolutely undefined. So far as the Act is concerned, "Currency Notes may be issued to such persons and in such manner as the Treasury direct." This may be a reasonable arrangement at a time of crisis, but, as Mr. Withers objects, is hardly

defensible as a permanent arrangement. Definite statutory regulation, however, could easily be provided. What is still more objectionable than the absence of regulation is that the actual method of issue is concealed, and the whole weekly return "quite incomprehensible except to those who have privileged access to an understanding of its mysteries" (Withers, p. 113). This is one of the many examples of the policy of secrecy and mystification which has done so much to undermine public confidence during the war. It makes useful criticism almost impossible. As Mr. Lawson says, "The first condition of thorough and effective inquiry is a relaxation of the severe reticence which characterises most of our banking returns" (p. 51). But one point should be clear enough. The Currency Notes are certainly payable in gold on demand. Why then does Mr. Lawson speak of "the fiction of their being gold notes"? They are as clearly convertible, under section 3 of the Act of August 6th, as the regular issues of the Bank are. Indeed, as Mr. Withers properly observes, this Act imposes a new liability on the Bank not recognised in its weekly account (p. 117). It is not so clear whether the Bank has any control over the gold reserve of £28½ millions now held against the notes. This, again, is not shown in the Bank return.

But what is, or should be, the purpose of an issue of this kind? Some definite conclusion on this

point is surely essential before we can pronounce on the expediency of the issue. It does not seem to have been duly considered by the critics, and this may explain their very various utterances. Perhaps the difficulty partly arises from the extreme ambiguity of the term "note." This name is given to a variety of documents which have little in common but their physical character and their currency. Some are issued by Governments, some by private persons: some are legal tender money, some merely forms of bank credit, like the cheque or the credit against which the cheque is drawn. Some, like the gold and silver certificates of the United States, are really convenient substitutes for coinage, backed by their face value in metal. Our Bank of England notes come near to this type. Others, again, are issued as auxiliary to existing metallic currency, whether of standard coin or small change. Again, the occasions of the issue may be quite different: the notes may be issued to meet quite different purposes. Mr. Conant insists upon three of these as primary.[1] Notes may be used to meet (*a*) a seasonal demand for currency, (*b*) a crisis or emergency demand, (*c*) a demand for the concentration of the stock of gold. To this one might add that notes may also be used (*d*) as the simplest form of bank advances

[1] *Bankers' Magazine* (*New York*), Sept. 1915.—"The Modern Field for the Bank Note: its Service in Emergencies and in the present War."

(cf. the early Scottish banks), or (*e*) as a cheap form of till-money, an instrument of banking economy; and lastly they have too often been used, especially if inconvertible, (*f*) as a last resource for financing Governments, a kind of forced loan. Perhaps we may assume that there has been no question, so far, of using currency notes in this last fashion; and they clearly cannot serve uses (*d*) and (*e*). Coming back, then, to Mr. Conant's three primary uses, the currency notes were neither intended nor required to serve as seasonal currency, after the manner of the monthly and quarterly issues of the Reichsbank. We rely on Bank of England credits to discharge this function in England.

The real question, then, is between Mr. Conant's other two uses. Are we to regard the currency notes as an emergency issue or as a means of concentrating our stock of gold? At the outset, no doubt, these notes were issued and intended purely as an emergency issue. The primary object was to allay the bankers' panic and to prevent the development of panic in the general public. Later, too, it may have been used in somewhat similar fashion to lessen the strain on the banks caused by the subscriptions to the enormous war loans. But if this were the real ground for the issue, it ought long ago to have been withdrawn from circulation. It certainly was not the purpose for which such an issue had long been planned. The normal function of

the currency notes was to serve as a means of increasing our financial strength by the concentration of all our available gold at the centre. Germany had largely effected this before the war by the issue of smaller Reichsbank notes; and since the outbreak of war, first Germany, and then France, have increased their central holding of gold in a quite remarkable way. For more than a generation past, some of the ablest Governors of the Bank of England had steadily held in view the adoption of a similar policy in this country. They regarded our gold currency as our first line of defence in a serious war. Hence they were opposed to a £1 note issue in peace; because if such an issue had been made on the ordinary lines, a large part of the coin replaced would never have been held in reserve, but would have left the country. But in a war issue, Government can control the terms of issue, and might so have arranged it that by this time some £100 millions of gold would have found their way from the circulation to the central reserve. A costly gold circulation is one of the first luxuries we should economise in time of war. But the concentration of gold is not merely an economy in expense. It is an immense increase of our economic resources. £1 in the central reserve, Lord Goschen used to say, is worth £5 in the pockets of the people.

From this point of view the Treasury issue has been very largely a failure. We do not know how

much additional circulation is required by the heavy military expenditure and the rise of wages. The currency notes may have done good service in preventing withdrawals of gold from the Bank for this purpose. But while in Germany the gold reserve has increased by some £55 millions since the last pre-war return, and the French reserve by some £40 millions in the last four months, there is no evidence that any appreciable amount of gold has reached the Bank of England.[1] Between July 29th, 1914, and July 28th, 1915, the Bank lost £22 millions to the general circulation. Some £15 millions of this may have come back since; but the Bank has been wholly dependent for any increase in its resources on purchases of imported gold. Meanwhile the Treasury issue, though it has failed to discharge the only purpose which could justify its continuance now that the time of emergency has passed, shows a steady increase, and has now reached an amount of £90 millions odd, having doubled in five months. Where is the gold which this large issue must have superseded, and would, if rightly managed, have brought into the national reserves? With the exception of the £28,500,000, which has long been set apart as currency note reserve, we are forced to the conclusion that most of the gold is being hoarded

[1] "So far gold has not been added to the Bank from internal circulation, but rather the reverse."—*Bankers' Magazine*, October, 1915, p. 485.

by the banks or by some of them. It was in the power of the banks to make the issue a great success. They might perhaps have been compelled to do so if suitable conditions had been imposed when assistance was first given them by the Government. The public behaved well. They gave the currency notes a good reception, and often voluntarily brought in gold to the banks. It is not their fault if the issue has so far failed. Of course, the failure is not complete. If the gold is not yet where it should be, in the central reserves, large quantities, at any rate, have been withdrawn from the hands of the public. This is a step in the right direction. To recall the Treasury notes, as some advise, would only be a retrograde movement, even if it were practicable. What is wanted is to complete the concentration of gold which the notes make possible.

The question of Ways and Means does not enter into the scope of Mr. Withers's book. Mr. Lawson deals with it energetically and at some length. His chapter on "Our Intricate and Perplexing Taxes" is full of useful suggestion. What strikes him, and so many other observers, is the remarkable disregard of administrative difficulties and indirect consequences so often shown. A recent illustration of this was the proposal to make bankers collect income tax on deposits, and, again, the scheme for levying income tax on wage receivers by quarterly instalments. Mr. Lawson considers that it is the lower middle

class who are most heavily penalised by current taxation.[1] He strongly disapproves of the Vote of Credit system. All expenditure under this system is made on dummy estimates and withdrawn from Parliamentary control. The procedure was condemned by the Treasury Minute of February 14th, 1880, which he quotes on p. 313. Mr. Lawson foresees "the doom of the One-Man Budget"; and apparently looks forward to the institution of a Standing Committee on Finance, such as exists in France. His general criticism may be summed up in a single sentence: "The two most essential elements of sound finance have been very little heard of, namely, business management and administrative economy."

The most recent parts of Mr. Lawson's book do not seem to be later in date than May, 1915; and he does not go into detail as to the methods, outside taxation, by which money has been raised. But the outstanding feature of our finance has been the remarkable success of the Treasury Bill. This applies more especially to the system of continuous issue at fixed rates: which has the great merit of suiting the convenience of the money market, and at the same time giving the central authority an effective control over the market rate of discount. These bills have been current to an amount of £275 millions

[1] In his Income Tax Table, p. 298, there is an obvious slip of shillings for pence in the rates.

without any of that disturbance which a loan of the same amount would cause. It is clearly impossible to meet the enormous demands of the war without recourse to longer-dated obligations; but when we consider that the greater part of the money borrowed is being constantly returned by war expenditure, the presumption seems to be in favour of continuous, rather than catastrophic, loans. Mr. Drummond Fraser and Mr. Gibson have advocated the continuous issue of War Bonds of various amounts and dates, down even to the value of £5, and period of one year; and their arguments seem to be well worthy of consideration. It has often been asked, too, why the lowest denomination of Treasury Bill should be £1,000. This excludes a great mass of possible private investors in these bills. Here we touch closely on another issue which has come very much to the front in the war finance of all the great countries. Is it better that Governments should be directly financed by the public, or mainly by banks using the money of the public? Neither Mr. Withers nor Mr. Lawson touches on this point. Mr. Gibson has more than once expressed decided views in favour of direct subscription; but some of his arguments are not convincing. Each method seems to have its own advantages, and it is hardly possible to dogmatise on the question. We can all agree in accepting Mr. Gibson's general account of the problem of war finance. "The whole art of loan raising is to

substitute scrip for goods with as little financial disturbance as possible."

But so far, to use a phrase of Mr. Lawson's, "we have only been shuffling the cards for the real game which is to come." We have simply been dealing with matters of account, with the machinery of finance. If we were, as Germany now practically is, a self-sufficient country, the problem of finance would be fairly simple, though it must necessarily run into alarming figures. If the production and consumption of the nation were so adjusted as to leave a margin above the civil consumption sufficient to furnish the extra supplies of food, munitions, etc., required to carry on the war—then the question of arranging for the postponement of payment for the cost of the war consumption could be settled without any great difficulty. It might even prove, as Mr. Gibson thinks, that the war could be financed at 4 per cent.,[1] for, as he says, the success of war loans is more dependent on the right mobilisation of the national industry than on the rate of interest. But here we come to the real crux of the situation. The real problem concerns the economic conditions which lie behind the Chancellor's figures of account, viz., the balance of national production and consumption. What is absolutely essential, and after more than a year of war we have hardly begun upon it, is the reorganisation of our whole economic life, consumption as

[1] *Bankers' Magazine*, August, 1915, p. 147.

well as production, upon a war basis. Production must be increased, or non-military consumption cut down, until there is a sufficient balance to meet the military consumption. When we consider that the extra consumption due to war (including advances to Allies) is estimated for the next financial year at £1,625 millions, as against a normal annual consumption of little over £2,000 millions, we can see how very serious the position is.

The necessary reorganisation ought to have been put in train at the outset. It *must* have been, if, like Germany, we had been a nearly closed State. But our sea-power enabled us to obtain temporary assistance from outside. This was a doubtful boon. The assistance disguised the real position, without providing any permanent amelioration of it. If it had been given on terms of long-dated loan, it would still have increased the weight of debt the country has to carry; but it might have been worth our while to incur this inconvenience rather than to put severe restrictions on national consumption. But the neutrals in this war are all borrowing, not lending nations. Hence our purchases were made on ordinary commercial "cash" terms, that is, by short bills (sometimes, we are told, actually by cash in advance). The result is that we now find ourselves faced with an exchange problem of a much more urgent character than any question of loan liability. The consequences of failure to meet cash liabilities are well

understood. They stand on a quite different plane from the difficulties imposed by borrowing for long terms. A great business may prosper on borrowed capital; but inability to meet its bills is fatal. What the present amount of our adverse balance on exchange is can only be roughly guessed. We have no definite figures as to our earnings on freights, as to expenditure of foreigners in England, as to remittances to relations from abroad, as to the value of our financial and commercial services to foreigners, nor as to the interest on our foreign investments. We may be certain that the war has disturbed all normal estimates for these items. Nor do we know the exact figures of our advances to our Allies,[1] nor the amount of imports on Government account: both items of first-rate importance. But six months ago estimates were made which put the adverse exchange balance for the year at £500 millions. We must take this as a minimum figure. Of course, this adverse balance has been largely set off by special operations. Apart from the normal adjustments of exports and imports, whether of goods or services, there are four main methods by which exchange can be rectified, and we have used them all. We have exported gold, we have sold securities, our banks have made private finance arrangements, and, finally, we have raised a dollar loan in New York, jointly with France, for £100 millions. We have

[1] Lately estimated by Mr. McKenna at £423 millions for the year 1915-16.

also cut down rigorously our foreign investments. How far all these operations have gone towards reducing the adverse balance can only be matter of conjecture. What is certain is that all the chief neutral exchanges are against us, by percentages ranging from about 1½ per cent. to 9 per cent.; the New York exchange, most important of all, having dropped at one time to 7½ per cent. discount, and standing now at about 5 per cent.

The remedial measures were carried out in a way that is certainly open to criticism. There are two sides to every exchange question, just as there are to the question of high prices. There are obvious objections to low exchange, which makes payment for imports costly. But on the other hand, it is all in favour of exports of goods and of the sale of securities. Hence it is eminently desirable that the various operations for rectifying exchange should be carried out by some concerted arrangement, if not by one authority. Our resources in the way of securities marketable on Wall Street are limited, and it is desirable to sell them to best advantage, *i.e.* on a low exchange. If the bulk of them could be sold by a committee of experts, much as Barings' securities were realised after 1890, then gold exports, bank finance, and loan operations might be so arranged as not to clash with the sale of securities.[1] The

[1] After these lines were written, we learn from the Press that arrangements of the kind suggested may be made: a year too late.

American loan itself was only a qualified success, as might have been expected. Up to the war the United States had been a great borrower from Europe. In spite of the stimulus which the war has given to her trade she cannot suddenly become a lender upon a large scale. What she was able and willing to lend might probably have been obtained with less fuss if special subscriptions to the regular war loans had been opened in New York, with interest payable in dollars, not subject to British income tax. If the amount obtained in this way proved inadequate, it would then be possible to supplement it by private finance arrangements of the familiar type, but perhaps for longer terms. The plan adopted of raising a special loan seems to have created some political difficulty, and hardly improved the national credit.

In any case, our resources for rectifying an adverse exchange balance are strictly limited. None of the four expedients to which we have resorted can be continuously available to any considerable extent. The exchange difficulty is only the symptom of a more radical difficulty. The real significance of the adverse exchange is that our national economic life is very far from being organised on a sound war basis. The margin between the output of our industries and the consumption of our civil population is not sufficient to furnish the military supplies which we have undertaken, and are obliged, to

provide. This is the fundamental issue, and we ought to have faced it long ago. Our credit is excellent and our financial methods sound. But the best finance in the world cannot enable a nation, situated as we now are, to go on continuously consuming greatly in excess of its production.

Our papers are never tired of dwelling on the weakness and artificiality of German war finance. Too much can easily be made of this. It will prove awkward for Germany when the final settlement comes. But till then, what is important is not so much the machinery of finance as the national organisation behind it. If Germany, after supplying her population with bare necessaries, is still able to produce what is required to keep her armies in the field, then, however artificial her finance may be, it will not prevent the carrying on of the war. There is a passage in the rather flamboyant speech of Dr. Helfferich on the Third German Loan which is not without instruction for ourselves. "The wealth," he says, "to which our success is due is not the sum of our savings, but rather our whole economic technical apparatus. It lies, above all, in the living labour power of our people, who, in war, work and create for war. . . . We carry victory within ourselves."

If victory does not lie within us, we certainly cannot find it elsewhere. The modern Englishman is apt to think he can. The popular trade

philosophy, which studiously ignores the importance, almost the very existence, of political frontiers, has allowed us to drift into a complacent dependence upon foreign nations. Nothing but our sea supremacy makes the position possible, even in time of peace. But war emphasises the always vital importance of the nation; and in a world-wide war like this, when the only neutrals are borrowers and not lenders, it is clear that the belligerent groups must in the main be self-sufficient. We must rely on our own resources; it is high time we began seriously to organise them. Maximum efficiency, minimum expenditure: these must be our objectives. Fortunately there are wide margins for economy in both directions. But they must be utilised to the utmost.

II.

WAYS AND MEANS.[1]

THE financial position remains serious enough, but it has improved in certain respects during the last three months. Broadly, one may say that while the pressure of the enormous war expenditure continues to increase, our machinery for dealing with it has received important developments, and is working as smoothly as could be expected. The purpose of this article is to consider one or two points of immediate interest, upon which more or less difference of opinion exists, in regard to the details of this machinery.

A glance at such estimates as are available will give some idea of the burden the nation has to bear, and may help us to judge how far it can be met by taxation, and what will remain to be raised by borrowing. We shall begin the next financial year with our debt more than trebled by the war, at about 2,400 millions, subject to an interest charge increased to fourfold, say 80 millions, or, perhaps, if adequate

[1] An article contributed to the *Economic Journal* for March, 1916.

sinking funds are provided, standing at 100 millions. For the current year, 1915-16, the national expenditure is estimated at 1,590 millions, of which about one-fifth may come from taxation. The estimate is for a revenue of 305 millions, but this may be exceeded by some 20 millions. For the next fiscal year the expenditure is estimated at 1,825 millions; some think it will reach 2,000 millions. Taxation, as at present fixed, is expected to account for 387 millions, or hardly one-fifth of the increased charge. If revenue continues to be in excess of estimate,[1] this figure might be put at 400 millions. It should be noted that more than one-fourth of the current year's expenditure represents loans to Allies, and that similar loans enter into the estimates for next year.

The figures may be given per day and week, which for some purposes is more convenient. In 1916-17 we shall probably spend from 5 to 5½ millions a day, 35 to 40 millions a week. An increase of 15 per cent. in the taxation now arranged for that year would give us 460 millions, or 1¼ millions a day, say 9 millions a week as an outside estimate. If taxation could be increased 37 per cent., say to 550 millions a year, it would give us 1½ millions a day, or 10½ millions a week. Perhaps this is more than we can expect at present: but we ought not

[1] Both revenue and expenditure may be expected to increase above estimates in consequence of rising prices.

to be content with much less. For if the war lasts till the close of the year 1917-18 the gross debt[1] will be about 5,000 millions, and the total charge to be defrayed out of revenue, when interest, sinking funds, pensions, etc., are taken into account, hardly less than 600 millions. Whatever the necessary taxation may be, the limit must be reached before the artificial prosperity of the war ends. It will be impossible to increase taxation in the trying period of the transition to peace conditions.

These figures are necessarily very rough, and will no doubt be made more precise in the coming Budget statement. But they go to show that we shall not be safe in assuming that the amount remaining to be raised, otherwise than by taxation, will be less than 26 millions a week in the next fiscal year. It may very well be 30 millions. There seem to be only three ways in which this sum can be raised (for a favourable balance of trade is out of the question). It must be raised by loans placed at home, by loans placed abroad, or by the sale of securities. It is estimated that the balance of international indebtedness will be 600 millions against us for next year. To rectify the exchanges, then, we must raise loans abroad, or sell securities, to the extent of 600 millions. This is probably the extreme limit of what can be obtained. Of this sum

[1] Loans to Allies must be deducted to get at net debt, but Great Britain is immediately responsible for the gross amount.

it has been estimated that not more than £250,000,000 will be available for Government, as distinguished from commercial, purposes. Call it 5 millions a week. We are thus left with from 21 to 25 millions a week to be financed at home.

The national savings before the war were supposed to reach 400 millions a year. Some think that in the current fiscal year they will reach double that amount, or, say, 16 millions a week. It is not clear whether in this estimate the sale of securities to purchase War Loan is regarded as "saving." Perhaps, for our present purpose, it may be. We are certainly able to save more than was saved last year. But the margin to be made up in the next fiscal year, if these estimates are at all correct, is from 5 to 9 millions a week, or nearly as much as our total savings in normal times. It comes to this, then, that next year's saving, like next year's taxation, must increase by the whole amount obtained in normal years. It seems well within our power to secure each result, but only by a very serious exertion of economy and thrift. The available machinery, both of loan and taxation, requires careful consideration.

The methods by which the English Government usually borrows are well known. Important sums were raised by issues of funded debt, carrying no obligation of repayment; really, in fact, permanent annuities. Smaller amounts, which it was not desired

to fund, were raised by Exchequer Bonds (five-year, as a rule); and temporary deficiencies in Supply by Treasury Bills, of which there were seldom more than 20 millions running. At the time of the South African War, Lord St. Aldwyn (then Sir Michael Hicks-Beach) made a new development, more on French lines, by issuing a 30-million ten-year loan, redeemable at par, taking the form, at the option of subscribers, of either inscribed stock or bonds to bearer. This loan was a great success, and was subscribed more than eleven times over. In 1910 its place was taken by Exchequer Bonds, which reached a maximum of 26 millions in 1911. Even these maxima for Treasury Bills and Exchequer Bonds, modest as they now seem, were considered by many to be excessive. The normal method of borrowing was assumed to be by way of Funded Debt.

In the course of the present war this system of borrowing has undergone changes of the utmost importance, amounting almost to a complete transformation of our financial machinery. Borrowing on Perpetual Annuities has been discarded—for good, let us hope—and its place taken by redeemable loans (1925-8 and 1925-45); there has been a very large resort to Bills and Bonds; large advances have been obtained from banks, especially from the Bank of England; the convenience of the investor has been considered in the variety of options offered;

and for the first time appeal has been made to those of small income, by whom in France the national *Rentes* are so largely supported. Above all, the plan of continuous borrowing has largely superseded the old methods of borrowing by large loans at long intervals. This latter change deserves careful consideration.

In the early months of the war it was financed either by Treasury Bills or advances from the Bank. The Treasury Bills, in the absence of the usual supply of commercial and international paper, were readily taken up. By November 14th, 1914, over 100 millions were current. The issue of the First War Loan, on November 17th, 1914, made further sales of Bills unnecessary for the time, and the amount dwindled a little; but it was over 100 millions again on February 25th, 1915. The issue of some 30 millions (net) of five-year Exchequer Bonds, on March 6th, 1915, brought with it a second decline in the amount of Bills; but on April 13th they again exceeded 100 millions. On April 14th a radical change was made in the method of issue. Hitherto Bills had been issued at irregular intervals, in fixed amounts and maturities, and sold by tender. After April 14th, 1915, they have been issued continuously and without limit, at rates of discount announced by the Bank, and subject to variation at intervals. At first only three months', six months', and nine months' maturities were offered; on May 8th, 1915,

twelve months' maturities were added. The new mode of issue was very well received. In the first three months, up to July 10th, 1915, the amount of Bills current had increased to over 250 millions: at the rate therefore of 1·65 millions a day, or 11½ millions a week. The issue of the Second War Loan on this date naturally caused a decline; but the lowest point reached (in October, 1915) was only 30 millions below the previous maximum. In November and December the applications increased rapidly, and the year 1915 ended with a total issue of nearly 400 millions (£395,565,000).

Here we must stop to notice a further application of the same principle of continuous borrowing. On December 16th, 1915, the Bank announced a new issue of 5 per cent. Exchequer Bonds, for which applications would be received until further notice, in denominations of £100, £200, £500, £1,000, and £5,000; such Bonds to be receivable at their face value for subscription to any further loan, and to be repayable at par December 1st, 1920. Thus a five-year security is now put on the same footing as the Treasury Bills; and there is no reason why ten-year bonds should not be offered in the same way, if longer term loans are desired.

Both Bills and Bonds have been well taken up. In the forty-three weeks from their first issue to February 12th, 1916, the Bills, notwithstanding the set-back caused by the second War Loan, have

brought in 428½ millions, say 10 millions a week: while the Bonds up to the same date have realised 100¾ millions in eight weeks, say 12½ millions a week. The issue of the Bonds in December seems to have somewhat checked the issue of Bills, and both had to contend against exceptionally heavy revenue collections in January and February of this year. Still, if we take the total yields of each since the Bond issue began, we find that in the eight weeks ending February 12th the Bills yielded 57⅓ millions, or 7⅙ millions a week; and the Bonds 100¾ millions, or 12½ millions a week. This gives a joint yield of about 19⅔ millions a week, or 1,027 millions a year; supposing that the issues proceed at present rates.

In view of this remarkable result of the system of continuous borrowing, it must be admitted that it is working very well; it is hardly too much to claim that it is the most successful financial device yet adopted. We have seen that the revenue required to be raised by loan at home, supposing that we can increase the yield of taxation by 37 per cent., is from 21 to 25 millions a week. It looks as if we might depend on the system of continuous borrowing to provide this amount, and that in a fashion most convenient to investors, and causing the minimum of disturbance to the banking system.[1]

[1] As these sheets are passing through the press (Feb. 1916), both Bill and Bond subscriptions are declining. But this seems to be largely due to anticipations of a New Loan at higher rates. It furnishes another example of the unfortunate effects of the big loan system.

Yet we hear talk on all sides of the necessity for a new War Loan; and it is not obscurely hinted that, if the new loan is to succeed, it must be offered at a higher rate than the last: which means, of course, that this higher rate will also apply to the Second War Loan and to the new Bonds, for these may be subscribed as cash for their par value into any new loan. It also means that we should see another heavy depreciation in securities. These and other objections to a new loan are so serious that one expects to find some solid considerations in its favour. Hitherto these have not been forthcoming. Sir Felix Schuster made an interesting reference to the subject in his address on January 27th, 1916. He thought that "if the public response to the issue of Exchequer Bonds now being made was large, a further loan might be delayed for a little while; but the amount of Treasury Bills now in circulation was so considerable that it would hardly seem advisable to add to that form of indebtedness, convenient though it might be to both the Government and the market. The probabilities, then, pointed to the issue of another large loan." The rate should be "attractive," and the instalments spread over a long period. In other words, the amount of short paper now issued is excessive, and it is desirable to convert some of it into Bonds or funded debt running for longer terms. But if this be so, and Sir Felix Schuster's opinion naturally carries great weight, the difficulty

can surely be met without disturbing the system of continuous issue.

The fact is, that while the system is sound, the present terms of issue are open to criticism: they are exactly calculated to bring about the result of which Sir Felix Schuster complains. Since November 12th, 1915, the Bills have been issued at a "flat rate" of 5 per cent. for all maturities, and the same nominal rate is payable on the new Bonds. If the rate really were as "flat" as it looks, the three-months' Bill would still be a more eligible investment for bankers and financiers than the five-year Bond. But owing to the way in which the discount is calculated, the nominal 5 per cent. rate yields £5 1s. 4d. on a three-months' Bill, £5 2s. 7d. on a six-months' Bill, £5 5s. 3d. on a twelve-months' Bill. What is much more important, while income-tax is deducted at the source on the Bonds, it is only the *profits* made on investments in Bills which are liable to tax; and these profits may very well be only half, or less, of the gross yield. This adds at least ½ per cent. to the nominal yield of the Bills, and increases their real cost to the State by the same amount. It is clear, then, that the present "flat" rate puts a heavy premium on investment in the shorter paper; and there have been signs lately that even the small investor, who cannot directly buy a £1,000 Bill, has contrived to make indirect investments in them to secure the advantages they offer over Bonds.

No wonder if the amount of the Bills is excessive. But it would be easy to correct any excess by a suitable adjustment of the rates. A British Government Treasury Bill has always ranked as the most coveted banking investment in the world. Four and a half per cent., or even 4 per cent., would be an ample rate for these Bills. At 4½ per cent. the twelve-months' Bill would yield £4 14s. 3d.; at 4 per cent., £4 3s. 4d. Even so, with income-tax at present rates, the Bill would probably be preferred to the Bond by large classes of investors.

But when it is proposed to lower Bill rates, objection may be made. One of the objects aimed at when the continuous issue was first introduced was the control of the market rate of discount. In the early part of 1915 that rate had been unduly low. The terms conceded to subscribers to the First War Loan had put the Bank at the mercy of the market.[1] On February 23rd, 1915, 20 millions of six-months' Treasury Bills were allotted at an average rate of £1 12s. 4d., having been tendered for three times over. The exchanges, which had been in our favour in 1914, were beginning to set against us, and it was obvious that the market rate indicated by such a tender was dangerously low and required to be raised. But it does not follow that we need now

[1] Subscribers to this Loan were given the right, extending to March 1, 1918, to obtain advances from the Bank, to the amount of the issue price of Loan stock deposited, at 1 per cent. below bank rate.

maintain a minimum rate, for the shortest Government paper, of over 5 per cent. This is to go to the opposite extreme. New York rates seem to be fully a point below ours. On December 24th, 1915, ten days' paper was at three per cent., ninety days' at 4 per cent.[1] On January 27th, 1916, 25 million dollars of New York State 4 per cent. Bonds were placed at a price yielding only 3·85 per cent. to the investor, though here the low rate may be partly due to considerations connected with domestic taxation.[2] Again, it is just cabled as we write that an issue of some 3½ millions of Argentine One-Year Treasury Notes has been well received in New York on a 4·70 per cent. basis. On the other hand, we have the suggestion by the City Editor of the *Morning Post* that in October, 1915, American balances had been withdrawn in gold because 4 per cent. investments were not obtainable (presumably for call money, since 4½ per cent. was then obtainable on Treasury Bills). So, too, Mr. E. F. Davies stated (November 30th, 1915) that there was reason to think that a recovery of the exchanges had been due "to a certain extent" to remittances for the purchase of Treasury Bills. Neither statement is very positive. Evidently caution is required; but it is a question of the amount of remittances affected and of the balance of advantage. Upon the whole this seems

[1] *National City Bank Circular*, January, 1916.

[2] *Ibid.* February, 1916.

in favour of a lower rate for short paper; in fact, for all Treasury Bills.[1]

Many would prefer that any necessary adjustment should be made by raising the rate on the Bonds; and it seems to be assumed by most people that the rate offered must rise for every successive loan. It would be difficult to find any solid basis for this assumption. It is certain that if rates are raised, either for the continuous loans or a new large loan, there will be a corresponding depreciation of all existing securities, except in the case of those which carry conversion rights, and here another heavy burden would be thrown on the taxpayer. It does not appear that anything would be gained. Foreign money will certainly not be subscribed to loans liable to unlimited income-tax. Nor is it easy to see how home savings or home investment will be increased. As new issues are very properly under control, there is no question of the competition of alternative forms of investment. Indeed, it might be doubted whether the present 5 per cent. rate was really necessary. It is probable that, if the continuous system had been introduced at the outset, all the requirements of the country could have been

[1] It is, moreover, open to question whether large holdings of short London paper in foreign hands are desirable. There were great complaints on this score after the South African War. It was said that the market was persistently depressed because so large an amount of Treasury Bills was held abroad, in regard to which it was difficult to judge whether or not they would be renewed at maturity.

financed at a maximum of 4½ per cent., or even, as Mr. Gibson holds, of 4 per cent. But a 5 per cent. rate should in any case be offered for one year and longer small Post Office investments, not only for simplicity of calculation, but because the sacrifice of saving is far greater in the case of those with small means, who require stronger inducements to make it. Our present system gives the easiest terms to the *haute finance*. But we are now committed to the 5 per cent. rate for five-year Bonds. Surely we may stop there, and neither increase the rate on the Bonds nor extend the Bond rate to a colossal loan. The better policy would seem to be to lower the rate on the shorter paper until five-year or longer Bonds are taken up in the desired proportion. Foreign money requires independent treatment. It can only be attracted by loans placed abroad, in foreign currency, free of all British taxes, and issued at whatever may be found the necessary rates. If we depreciate the national credit by raising our home rates this will only further raise the rates we shall have to offer abroad.

If we suppose that rates have been properly adjusted, so as to secure the right proportion of longer paper or Bonds, does any reason remain for a big spectacular loan? It may be said that our friends the French, excellent financiers as they are, thought it necessary to have a large consolidating loan in November last. But the history of French war

finance, viewed as a whole, seems to confirm the argument for continuous borrowing. It is noteworthy that the Loan of Victory was the first raised by France in this war. Up to November 16th, 1915, France had raised about 1,040 millions sterling, or 69 millions a month, without resort to loans: 276 millions by advances from the Banque de France, 487 millions by continuous issues of Bonds and Bills, 220 millions out of revenue or "unused credits," 60 millions from foreign loans (the Anglo-Franco-American loan *not* included). Of this only one-sixth, or 180 millions, was spent abroad.[1] The great bulk of what was lent, then, *so far as the question of account is concerned*, was returned to the country by the Government expenditure, in what M. Théry calls a "*mouvement giratoire*," so that banking disturbance was reduced to a minimum. M. Théry gives figures which go far to support his claim that the amount of floating money and power of subscription increased in proportion to the military expenditure. The Victory Loan absorbed some of the floating fund; but Government expenditure will soon restore it, when the "*mouvement giratoire*" will resume its old proportions. It must always be remembered that there was a special reason for a consolidating loan in France. The outbreak of war not only struck an exceptionally heavy blow at

[1] In November, 1914, Mr. Lloyd George said that four-fifths of our war expenditure would be spent in the country.

French finance, but it caught her market at a most inconvenient time. A new loan had just been issued, but not yet transferred to permanent holders. The position required regularisation in many respects. Nor was it so much the short as the long French paper which was absorbed in the Loan. Out of some 150 millions sterling of Bonds, 127½ millions, or nearly 84 per cent., were converted. Out of 360 millions sterling of Bills, only 89 millions, or about 25 per cent., were converted. This, though the Bonds yielded 5·60 per cent., the Bills only 5 per cent. Short paper is so attractive that we cannot trust to a big loan to reduce the proportion taken up. Here, in London, we have already had two large loans, the last of which was a consolidating loan, giving conversion facilities. Things are now running smoothly with us, and no special reason exists for a third loan.

It may be said, however, that the five-year Bond is too short. If so, Bonds of longer date should be offered. Mr. Drummond Fraser, one of the earliest advocates of continuous borrowing, recommended the issue of Bonds for three, five, seven, and ten years; and there is much to be said for giving this wider option. The French Bonds are redeemable in five or ten years at the option of the Government. The fourth German Loan just issued consists of 4½ per cent. Imperial Treasury Bonds at 95, divided into ten series, redeemable by yearly drawings from

1923 to 1932; and also of a 5 per cent. Imperial Loan issued at 98·50, and not redeemable before 1924. The Germans have good reason for preferring longer bonds. They expect financial trouble when the war ends. We need not. But whatever term for redemption may be considered desirable, this term can be applied as easily to continuously issued bonds as to a new funded loan. Even a loan must be redeemable at some not distant fixed date. The risk of depreciation must be limited.

There are some who advocate the big loan on the ground that if a really colossal issue could be made it would stimulate investment at home and have a useful political effect abroad. The political effect is doubtful: for it is well understood that the larger the loan, the more artificial it must necessarily be. The kind of advertisement required to stimulate investors is being well arranged by bankers and brokers. Their timely hints to customers will in the long run be more effective than the nine days' wonder caused by the splash of a big loan. The big loan, too, will require heavy subscriptions by the banks, and corresponding creations of bank credit. This will cause inflation and further rise of prices, thus increasing the cost of the war, and involving the country in a kind of rake's progress. Each successive large loan, too, seems to make an epoch, and is held to imply a rise in the loan rate. The continuous system, with its absence of definite

breaks, is free from this costly defect. In short, the continuous form of issue seems to hold the field. Its various options are convenient to the investor, and therefore cheap to the State; it is smooth in its working, putting the minimum pressure and loss on the banks; it enables Government, by the adjustment of rates, to obtain loans for precisely the terms which from time to time seem desirable; above all, it tends to base our loan subscriptions on real economies rather than on artificial finance.[1]

Reference has been made to the point that a certain amount of loan may have to be raised abroad, if only to rectify exchange. The exchange position has greatly improved in the last three or four months. Large sales of securities have been made, and much has been done to centralise the various operations affecting the exchange.[2] The result is encouraging. The Dutch exchange, which fell heavily at the turn of the year, is still some $5\frac{1}{2}$ per cent. against us; but the more important New York exchange seems well in hand. This state of things can only be maintained, however, by continued efforts on our part. We must either raise further foreign loans, or, preferably, further sales of securities must be

[1] It need hardly be said that the more artificial the loan, the more certain it is to depreciate.

[2] Similar concentration has taken place in Austria-Hungary and Germany, and, as we now learn (February 22nd), in Petrograd.

made and private credits arranged. We may, and should, diminish our imports; we can hardly expect to increase our exports. In the first eleven months of 1915 the Bank of England exported between 80 and 90 millions of gold;[1] almost the whole of the world's supply for the period (say 97 millions a year). Perhaps 50 millions of the 1916 supply may be exported this year. But it would be doubtful policy to seriously reduce our modest store of gold. The national reserve still carries huge responsibilities, and we do not know what further liabilities may be incurred. The French call upon us to correct the Dutch exchange by a gold export. They do not take similar steps to correct the Paris exchange on London. If they were to remit direct to Holland they could at the same time right both exchanges. It is not certain that this would be wise. The Bank of France, in its Annual Report, gave good reasons why it might not be. Similarly with our New York exchange, heavy exports of gold might be mischievous. New York is already glutted with gold, and further exports would only raise prices against us on our large balance of imports. The importance of correcting exchange is very much a question of the volume and the character of the transactions affected by the exchange. It is perhaps most important to us, because, if the loss of parity goes too far, it may interfere with the freedom of our gold

[1] *Morning Post*, December 2nd, 1915.

market, which we desire to maintain. To other nations this consideration does not appeal. In estimating their position too much is usually made of the discount on their exchange, perhaps because it is always clearly in evidence and quotable. Under war conditions it cannot be held to prove either decline of national credit or depreciation of currency. A striking example of the exaggeration of exchange indications is seen in the contention of a distinguished writer that we should relax the blockade on German imports in order to increase the discount on the mark exchange. The blockade may be vital to the issue of the war. The discount on exchange is evidently not considered of such importance in Germany as to warrant the export of gold to correct it.

But in our case exchange operations are very large; and, as has been said, the rate is otherwise important. Sir George Paish, who will not be accused of pessimism, estimates our adverse balance for next year at 600 millions.[1] If we could finance so much of this as relates to Government expenditure, say 250 millions, by loans or credits secured abroad, we might perhaps make up the balance by sales of securities.[2] It is, however, doubtful if we

[1] *Statist*, January 8th, 1916.

[2] Sir George Paish estimates that we hold some 1,770 millions of securities (South American and Canadian are included in this figure) which American investors might conceivably be willing to buy. The *Times* of January 24th, 1916, mentions a New York estimate that the

can depend on the United States to finance the whole of this huge sum. That country has surprised the world by the unexpected financial strength it has shown under the strain of the war: but we need not look solely to New York. Very large profits have been made in Holland and Scandinavia. The Bank of the Netherlands has a gold reserve of more than 80 per cent. against its note issue, treble the amount held in normal times (nearly 39 as against 12½ millions sterling).[1] The Bank of Sweden is so glutted with gold that it has obtained the repeal of the law obliging it to buy all gold offered at a fixed price. We are not without powerful friends in these countries. They are all in close relation with the Amsterdam market. Why not offer them a loan with interest payable in florins in Amsterdam, and of course tax free? At present we hear that the New York loan is being bought for Dutch account. It would be a fitting compliment to the strength and international importance of Amsterdam if the next foreign placement were made there. The hoarded wealth of India has been proverbial for ages. Is it impossible that a well-planned rupee loan should be floated in that country? Japan, the only other possible lender, whose recent prosperity is remarkable,

United States has absorbed 350 millions sterling of securities since May 1st, 1914.

[1] The *consortium* of Dutch banks lowered their deposit rates to ½ per cent., "the lowest figure ever known in Holland," February 24th, 1916.

is now rendering effective service to the Allies by financing Russia, and by buying back the 4½ per cent. loans she raised in London. She can hardly be expected to do more.

In regard to the sale of securities abroad, as in so many other respects, our national finance largely depends for its success on the efficiency of the Stock Exchange. It is still necessary to insist on the importance of freeing this great market from arbitrary restrictions. Much has been done in the last three months by way of removing minimum prices; but while each successive removal has left the market stronger, it has emphasised the unfairness of such minima as remain. This has been especially felt by the unfortunate payers of death duties. The pressure of this tax, always difficult to finance, has been trebly increased. The war has multiplied the occasions for its imposition (in direct proportion to the public sacrifices of the families concerned); the rate has been raised; and, owing to the minimum prices enforced, although a partial allowance has been made, it is often found that the securities passing have been assessed above real market values. What is gained by this artificial system? Bankers and others may be concerned at having to write down securities in their balance-sheets. But official minimum prices do not alter real values; they only destroy marketability on the official market. It is notorious that transactions are being carried on at prices nearer

to real values by outside dealers, who are not subject to any of the rules imposed in the public interest on members of the "House." Is it really desired to drive the public into the hands of these outside firms? After all, and in spite of the partial abolition of minimum prices, the fall in values has been remarkably small. The 3,000 odd millions' worth of securities scheduled every month in the *Bankers' Magazine* only lost 6·6 per cent. in value between January 20th, 1915, and December 17th, 1915. Half of this fall was consequent upon the issue of the 4½ per cent. War Loan, which radically altered the basis of valuation.[1]

If we consider the change in the rate of interest caused by the immense war loans, the fall in capital values is astonishingly small. Indeed, if we reckoned our holdings, as the French do their *Rentes*, by their yield, it is doubtful whether, on average, there would be any serious loss to bring to account: for there have been profitable exchanges from American securities into war loans, and large conversions from older loans into loans at higher rates. Whatever the loss, it is more than set off by the immense advantages of an effective, active market, with real instead of merely nominal values.

An able American writer has said that it is impossible to conceive the modern banking system in

[1] By the return just to hand, it appears that, in the two months since the last return of December 17th, 1915, the fall in aggregate values has only been 0·6 per cent., in spite of the removal of minima from Colonial Government Stocks.

the absence of an effective stock exchange.[1] To no banking system is it more important than to our own, which makes so large a use of securities as collateral. Nor is it less essential to public finance. Some of the earliest and ablest defences of the London Stock Exchange contend that it was absolutely indispensable to our system of funded loans, by the help of which the British Empire was built up in the eighteenth century. Pinto, and other experts, held that its efficiency, and the volume of its business, were a principal reason of the transference of financial supremacy from Amsterdam to London. In view of the huge and unprecedented financial operations now confronting us, it is surely desirable to give all possible facilities for the free working of what is still the world's greatest market for securities. The part it has to play in maintaining the Empire at this crisis in our fortunes is hardly less vital than the part it played in its creation.

When the position of the Stock market is regularised, our loan machinery will be in good order; at any rate, so far as the ordinary investing classes are concerned. But a difficult problem remains. The people as a whole must be brought in; the War Loans must become national institutions. The difference in this respect between Consols and *Rentes* is extraordinary. Men at the university, attending

[1] Cf. Prof. H. C. Emery, *Speculation on the Stock and Produce Exchanges of the United States*, 1896, p. 157.

lectures on economics, have been known to ask what Consols were. *Rentes* are a household word to the humblest Frenchman. They serve as a savings bank to the peasant, and the middle class go in and out of *Rentes* instead of keeping a current account with a banker. They can be bought *and sold* in the smallest amounts at every Post Office; in fact, down to the sum of three francs (*i.e.* 100 francs, or £4, stock). It is a very old maxim in this country that the best way to attract gold is to give every facility for taking it away again. The French have applied this sound rule to savings. By their consideration for the small investor they have made their *Rentes* the best held funds in the world. In 1908 there were 4,631,857 holders of *Rentes* against 255,112 holders of Consols; and if we do not take into account Consol certificates, the average size of the holding of *Rentes* is one-nineteenth the average size of the holding of Consols. Their funds, like their National Bank, are thoroughly democratic; and they are taking care that it shall be the same with the new War Loans. French Treasury Bills (three months at 4 per cent., six months and twelve months at 5 per cent.) are being issued down to 100 francs (say, £4: our limit is £1,000 !). Bonds can be bought in amounts as small as 5 francs and 20 francs at every Post Office, where they are at once handed over against cash.[1] As M. Théry well says, the

[1] *Écon. Eur.* February 18th, 1916, p. 105.

creation of these Bonds answers rather to political than financial considerations; but it is certainly worth while. Small savings are thus enlisted in the finance of national defence; and the reflex effect on economy is equally important. We have lately taken useful steps in the same direction. Much has been done to reach the small investor through the Post Office, the only kind of financial machinery he understands. The arrangement for the custody of Bonds by the Post Office is excellent. Best of all are the provisions recently announced making the new Certificates and Scrip Vouchers under £5 payable in cash on demand. It would be well if this system were extended, so that amounts of War Loan under £100 might be dealt in at the Post Office at just remunerative commissions. The institution of savings banks, and still more of the Post Office banks, gave an immense stimulus to thrift. Perhaps a still greater advance would be made if we could give our national funds something of the position and popularity the *Rentes* enjoy in France.

Thrift, it may be hoped, is now coming into its own again. The War has found out many weak points in our policy, none more glaring than our recent attitude towards thrift. It has been the fashion, even with some of our economists, to decry it as a sordid and mischievous vice. Politicians have held it up to odium, and punished it by extra taxation. Worse still, the State has described

income derived from saving as "unearned," a term which to most men carries the meaning of undeserved. Income derived from saving is really twice earned. To the majority, people of small means, the effort of saving is much harder than the original earning of what is saved. The exercise of faculty in earning wages, salaries, and profits is often agreeable; and some day, when labour is ideally organised, we may hope it will be agreeable to all of us. But saving will always involve self-control and self-sacrifice. It ought not to be *too* hardly felt; every facility should be offered, and all possible concessions made, to small savings. Like every other useful habit, saving may be carried to excess. But in due degree it contributes a very necessary element to character; and we should have less waste, and a more thorough utilisation of wages and incomes, if saving were more common. Nor has there ever been a time in history when saving was more imperatively necessary. Even before the War there had been a serious rise in the rate of interest, which went far to compensate the saver, in automatic fashion, for the burdens imposed on him by the politician. But there must be an unprecedented shortage of capital after the War. To establish habits of economy should now be the first concern of the statesman.[1]

[1] Even in the United States, to which the War has brought nothing but prosperity, a Thrift Campaign has just been inaugurated by the American Bankers' Association.

It will be extremely difficult to make England thrifty. Thrift involves intelligence no less than self-control. Above all, it requires what is really the highest quality of mind, I mean imagination. Nothing is harder than to actualise the future; to realise that its wants will be as urgent as those felt in the present, and for older persons, more expensive to provide. It is their education, spirit, and intellectuality which have made those two brilliant peoples, the Scotch and the French, the most thrifty of European nations. Perhaps this explains why the English do not take so kindly to saving. So it has been for centuries past. There was no better judge of national psychology than the great Daniel De Foe. Here is his estimate of us in 1704. "Good husbandry is no *English* vertue, it may have been brought over, & in some places where it has been planted it has thriven well enough, but 'tis a forreign species, it neither loves, nor is belov'd by an *Englishman*. . . . Tho' this be a fault, yet I observe from it something of the natural temper & genius of the nation; generally speaking, they cannot save their money. 'Tis generally said, the *English* get estates, & the *Dutch* save them. . . . *English* labouring people eat & drink, but especially the latter, three times as much in value as any sort of forreigners of the same dimensions in the world."[1] Another brilliant observer, M. Taine, says that the Englishman

[1] De Foe, *Giving Alms no Charity*. 1704.

provides for the future, not by his savings, but by his expenses. There is something to be said for this solution, for we must never encourage people to starve themselves into inefficiency. But it does not establish the habit of thrift, nor meet the need of the hour.

There is, however, another equally well-marked trait of our national character which might be turned to account. Sentiment apart, there seems no solid objection to utilising for the national profit the inveterate and irrepressible desire to "try one's luck," which is so often found in healthy, and therefore optimistic, human beings. In spite of our prudery on this point, there is no country in the world where this desire is so strong as in Great Britain, or so grossly exploited by rascality. Very much of what is euphemistically called "sport" is really gambling, and sometimes worse. As things are, the gambling instinct cannot be suppressed, and often leads to ruin. Why not furnish an innocent means of gratifying it, which will actually develop habits of thrift, and where the result of the stake, so far as it is uncertain, will be due to pure chance, and not to a mixture of chance and fraud? This seems to be the object of the proposal to issue premium or bonus bonds. These bonds would carry $2\frac{1}{2}$ or 3 per cent. interest in any case, together with rights to a chance of a bonus in addition. Thus the "sportsman" would become a "*rentier malgré lui*"; and, perhaps,

in due time, the unfailing virtue of interest might come to be held more substantial than the mere chance of luck. Such an issue by the Government has been declared perfectly legal. It seems the only way to get hold of the spare cash of a large class who squander most freely.

In any case a popular campaign will be required. The imagination must be stirred. The people are everywhere waiting for a lead. Except for the invaluable example of H.M. the King, they have not had one that makes an adequate appeal. They see waste everywhere, and on such a huge scale that their small private economies seem useless; for they cannot appreciate the magic of large numbers. If one-tenth the energy ordinarily spent on party struggles were devoted to the advocacy of economy, our financial problems would be solved.

It is in the public service that waste is most flagrant, and its example most discouraging. It looks as if all the old checks on expenditure were in abeyance, or at least ineffective. Army supply officers have been heard to say that the whole population of Belgium could be supported on the waste of the British army in France. After allowance for the vigour of expression which we like and expect to find in the soldier, it is certain that not only abroad, but at home, expenditure has been reckless. Everyone you meet can give you a score of examples of it from personal observation. It is startling to

hear that at a single stroke the expenditure on shells could be cut down by £400,000 a week! Another source of serious loss is the imperfect utilisation by the State of requisitioned resources, as, for instance, in matters of transport; and the failure to find work for so many highly skilled men, engineers, for example, when others are being heavily overworked. Abundant supplies of funds to huge bureaux of officials is another cause of waste. If it be true of the English generally that they are apt to take the amount of their incomes as a kind of indication of what they are justified in spending, this is still more true of English officials, public or municipal. They seem bound to justify their existence by some kind of activity, sometimes merely obstructive, sometimes, as where there are Works Departments, seriously wasteful. Local authorities, with less excuse, have been almost as bad as the central authorities. Local rates have doubled in twenty years. The "unproductive" local debt has more than doubled in the same time. The only way to check these abuses is to cut down the supplies. Grants from national funds to local authorities should be withdrawn during the war. Officials will spend all they can get without provoking a kick from the tax-paying Issachar. But they know when it is wise to stop. They will in general cut their coat according to their cloth, and avoid unduly raising rates.

Example and appeal should be used for all they

are worth; but you cannot extemporise national habits. It must come to pressure in the end, before the necessary economy will be secured. Either high prices or taxation might serve the purpose. It would seem that in Germany they have mainly relied on the effect of high prices, aided in certain cases by the system of rations. The consumption of the masses, whose wages have not risen in proportion, has thus been reduced. Certain classes have made large profits, but these are the classes who naturally save. Moreover, their increased resources are easily visible in bank balances, etc., and means are found to induce the investment of these resources in the German loans. It used to be said that mediaeval sovereigns used the Jews as a financial sponge. They were allowed to absorb wealth from the people, to be periodically squeezed into the coffers of the prince. Germany seems to be using her wealthy classes, and Austria-Hungary her bankers, in similar fashion. This policy is not open to us. While a certain number of employers have made large profits, the bulk of the classes who normally save have been hard hit by the war. The working classes, who are unusually prosperous, are not as a rule savers otherwise than by subscriptions to societies. The best way to tap the extra earnings of both employers and employed is by taxation.

It is generally more equitable to tax by diminishing incomes than by raising prices; but it will be

difficult to tax wage incomes directly. Commodities, especially certain imports, must be taxed, and prices will rise in consequence. But every effort should be made to check any avoidable cause of a rise of prices. They should not be allowed to rise through disorganisation of transport, or artificial finance, for example. The rise aggravates our financial burdens, upsets all estimates, and causes social friction. It is already excessive. Prices have risen 46 per cent. since the war began, and $10\frac{1}{2}$ per cent. in the two months, December, 1915, and January, 1916. Not more than 3 per cent. of this rise is due to gold supplies. A large part is due to the increase of purchasing power (either currency or bank credits) caused by the abnormal war demands. Much of this is inevitable, though it can be reduced to a minimum by continuous borrowing. Sir George Paish thinks nearly *one-half* of the rise is due to rise of freights. This urgently requires correction. It is only in so far as prices are raised by methods that create revenue that we can regard them as a useful instrument of finance.

To taxation, then, and heavy taxation, we find ourselves driven at last. The raising of loans is connected in so many ways with the nature and amount of taxation that neither question can be satisfactorily handled without reference to the other. But limits of space, already strained, prevent a discussion of tax-policy here. A few brief suggestions

only can be made. True economy, whether in time of peace or war, rests on a rational adjustment of values. Taxation can do something to enforce this. Such expenses as are merely ostentatious or conventional form the best possible subjects of taxation; there is no loss of essential utilities, and the labour released is urgently needed for necessary services. There is no economy within the reach of the middle classes at all comparable with what would be gained by the reduction of domestic service. Heavy taxes might be imposed on all servants (the necessary exemptions made for the sick, young children, hotels, etc.). Indeed, all licences should be raised, and re-transferred, for the period of the war, to the Consolidated Fund. If these taxes proved prohibitive, large savings would at once be possible; if not, they would at least raise revenue with a minimum of hardship. Consumption of all but the poorest may be substantially reduced. Professors Hopkins and Wood, after a careful study, estimate that 60 millions might be saved in food by those earning more than 30s. (say, now, 35s.) a week. It is certain we should be none the worse if 100 millions were saved on alcohol. The heavy taxation of spirits is obviously indicated on all grounds. Lifelong smokers have found that it is possible to dispense with tobacco. The consumption of cigarettes is enormous. Here an expensive import might be checked. The expenditure on

amusements, which seems higher than ever, should be taxed; so, too, advertisements and photographs. The Italians have a tax on men of military age exempted from military service. This tax is said to have met with general approval. Taxes on war profits are in all countries recognised as obvious and equitable.

Whatever special taxes are selected, certain general aims must be kept steadily in view. Taxation has seldom been what Adam Smith said it should be, a mere instrument of revenue. The great Colbert used the tax-system as a sort of *claveçin*, or keyboard, by the manipulation of which he could control the direction and development of the national industry. Afterwards it was used to foster colonies and extend empire. In modern times it has become the fashion to use it as a means for redressing inequalities in the distribution of wealth. To-day the question of revenue is certainly urgent; but the main objectives of taxation must be to check unnecessary consumption, and especially unnecessary imports; and generally to enforce economy and promote thrift. Relatively, our resources are good if we are willing to use them to the full, and intelligently. Nothing less will serve.

III.

THE NATURE OF THE INDUSTRIAL STRUGGLE.[1]

THIS time last year I had the pleasure of inviting your attention to the financing of the War. I propose this year to treat of another form of finance: the financing of business.

This is obviously a question of the first importance, and the active discussions to which it has given rise of late show that its importance is recognised. One may fairly say, too, that they reveal a certain doubt whether the particular methods of business finance in vogue here are as complete and effective as they might be, or perhaps are in other countries. Now it is beyond question that at the conclusion of peace the demands of business for financial assistance will be quite unprecedented in their extent and their urgency. It seems desirable, then, in spite of our natural preoccupation with the War, that this form of finance, and our provision for it, should receive a share of public attention.

[1] The first of two lectures delivered at the Royal Institution on April 19th and 26th, 1917; afterwards printed in the *Economic Journal* for September, 1917.

I had originally intended to deal in these lectures exclusively with the machinery of this business finance, itself a more than ample subject for the time available. But it has been borne in upon me of late, in reading certain public utterances, that the utmost diversity of opinion prevails as to the nature of the struggle for which business is to be equipped. It seems idle to discuss machinery without some definite conception of the general purpose it is designed to serve. I have thought it might be better, therefore, in this first lecture to take a bird's-eye view of the business struggle itself before passing in the second to consider the best methods of financing it.

What, then, is the general character of economic or business competition as it exists to-day ? Nothing, it may be said, is more familiar to Englishmen than competition, whether as a scientific conception or as a feature of our social life. The *fact* of competition sums up a large part of our economic activities, and on the *concept* is built up most of our economic theory. Yet we shall find that very opposite opinions are held as to the nature of the competitive struggle, and that very few careful attempts have been made by economists to define the term in its scientific use. What is most familiar is not always most accurately known ; it is too often taken for granted.

I do not propose to-day to consider competition in its theoretical aspect, as an assumption or postulate of economic science. I want to consider the thing

itself as it figures in the social life of the time: the system of business habits, business methods, forms of business rivalry—in short, the general welter of business activities, which, subject to restraints imposed by the law, constitutes the modern struggle for wealth.

There is the widest possible difference of opinion as to the essential character of this struggle. Adam Smith, a very shrewd observer of the world, described it as a "species of warfare, of which the operations are continually changing." His estimate would be widely endorsed, and the conditions of the time perhaps predispose us to adopt it. But we are often presented, more or less authoritatively, with an entirely different view. Take this pronouncement from a memorandum of the Garton Foundation issued last October, 1916: "The conflict of war and the competition of trade are different in kind, as well as in degree. The object of conflict is to inflict injury. The object of business competition is to serve a customer." To oblige, in short, as the retailer would say. To the ingenuous Garton writer and his school, competition is a generous emulation in good works, where every transaction confers a benefit on both parties; like mercy, twice blessed. Adam Smith, whose realism gives a spice of cynicism to his judgment, regards it as a struggle for supremacy, carried on by methods devised to damage the economic power of rivals, whether rival firms or rival nations.

To others again, like Carlyle and Robert Owen, competition is essentially unmoral and anarchical. Carlyle views its turmoil with aversion and contempt, and regards it as a baser form of war. You remember how he figures it in *Sartor Resartus*. "Weltering, shall I say, like an Egyptian pitcher of tamed vipers, each striving to get his head above the rest"; and again, "Where each, isolated, regardless of his neighbour, turned against his neighbour, clutches what he can get, and cries 'Mine!' and calls it Peace, because in the cut-purse and cut-throat Scramble, no steel knives, but only a far cunninger sort, can be employed." The man in the street has no very definite or considered view. Perhaps we may say that to him competition is something of which everyone complains in his own case, while he has a vague feeling that somehow or other it may be good for other people.

Here are views differing radically as to what may be called the essential character of modern business activity. We can hardly expect to agree as to the principles of trade policy until we come to some understanding as to where the truth lies in this divergence of opinion.

The question is, after all, one of fact. Difference of opinion, here as elsewhere, is due to first impressions based on incomplete observation. It can only be reduced by that method of patient induction, of which the history of this Royal Institution shows so many

brilliant achievements. The field to be surveyed is immense, embracing a very large fraction of human activity; hence the answer cannot be a very simple one.

The forms of business practice are of infinite variety. They differ in their objects, their methods, their rules of conduct, their standards of honour; in no two occupations, perhaps, are these precisely similar. We may group them, for convenience of view, under three general heads, broadly distinguishable, though the distinction is often only in degree, and hence not so easy to draw in practice:

1. All business activity counts on profit as an ultimate return. But in some cases profit is pursued through efficiency; the immediate objective is efficiency; profit is expected as the result of efficiency.

2. In other cases the aim is profit at all costs, by fair means or foul. Profit is the primary objective; efficiency only one of many means to the end.

3. In a third group of cases competitors fairly matched in efficiency devote themselves frankly to the destruction of the economic power of their rivals and the capture of their markets.

These forms of competition are so different in their nature and social effects that it is evidently hopeless to bring them all under any general characterisation.

Take, first, the competition aiming honestly at efficiency in production or service, the kind so many English economists presume to be typical, not to say

universal. Probably a great part of the activity of producers and manufacturers is really of this type—that is, a genuine attempt to give good work or good service. Even here, however, we have vital differences in practice. Some are intelligent and scientific, others mere slaves of habit and routine. Some are equipped with the necessary capital and plant; some, notably amongst our smaller industries and in agriculture, are not. Some have only the crudest notions as to the organisation and handling of labour; others may fairly claim to be capable captains of industry. It may seem incredible, but many English business men are ignorant of the very elements of scientific accounting. I was told by a very high authority that a large proportion of the firms in one of our greatest industrial cities "did not know whether they had made a profit or a loss on the year's working until they had called in a professional accountant." On some of these deficiencies the war experience has thrown a vivid light. Even granted, then, that much of modern competition is aimed at efficiency in production, it certainly does not guarantee it. Competitors seem to be able to hold their own in spite of striking defects in efficiency.[1]

But further, though the aim may be efficiency, there

[1] Sometimes, perhaps, because shortcomings in efficiency are made good at the expense of labour, or by imposing on the consumer. But it is doubtful whether these considerations entirely account for the economic paradox, which deserves more attention than it has yet received.

is a wide difference in the *conventional methods of competition in various callings*, very important to the national interest. Take two brothers brought up under similar influences. One becomes a doctor or a man of science. All his discoveries are made matter of common knowledge, placed at the disposal of his profession and the public; though he might have made great personal profit by monopolising them. The other brother goes into a great manufacturing firm, where he makes inventions of similar value. As a matter of course these are reserved, so long as the law allows, for the profit of the individual firm. You may have shades between the extremes: where valuable knowledge is pooled with associations or contributed to trade journals. I do not want to praise or blame; my object is simply to insist on the fact that under the vague term "free competition" are included practices very different in tendency, very different in their effect on the public interest.

This kind of honest competition for efficiency is often assumed to lead to "the survival of the fittest." No doubt it tends this way. If the assumption were rigorously true we should have to regard competition as merely a transitional selective process, logically ending in monopoly. For the fittest should become a monopolist.[1] [In practice, of course, this theoretical limit is seldom, if ever, reached, for reasons I need not notice here.]

[1] See the paper on Monopoly in the Appendix.

There is, unfortunately, a second type of competition to be considered, in which efficiency is quite subordinated to profit. Its objective is profit at all costs, by any means, fair or foul, subject, as the American phrase puts it, to "*keeping outside prison bars.*" Competition of this kind sometimes cloaks its operations under the pretence of affording cheaper products; but cheapness and real economy are usually the poles asunder. Let us glance at some of its methods.

Adulteration is so extensively practised that the Courts often have difficulty in deciding what a good delivery means. Falsification is so easy, and so difficult for the consumer to detect, that this dishonest practice often succeeds. Read the very notable book, *Food and its Adulterations*, containing the Reports of the Analytical Commission of the *Lancet* in 1851-4. Thousands of products are analysed; adulteration is shown to be rampant. What is worse, many of those who then adulterated largely are now among the best-known firms; many firms whose products at that time were described as "commercially pure" are now unknown, at least to me. *The fittest have not survived.* Short measure of all kinds is another trick having similar effects; and still more serious is the resort to degradation of quality both in materials and in work. When the Exhibition of 1851 was held, people were astonished to see how far this degradation of quality and craft

had gone as a result of half a century of unbridled competition. Again, patents are stolen, trade-marks are falsified, agents are bribed; but time will not allow me even to hint at the innumerable forms this perverse type of business activity has taken.

There is quite a large literature of works on dishonourable competition in German, French, and Italian, and not a few by English writers. I may refer those who are interested to one of the latest of these, the valuable Report of the U.S. Bureau of Corporations just issued on "Trust Laws and Unfair Competition." More than 400 pages of this Report are concerned with unfair competition and the various attempts made in various countries to deal with it. Herbert Spencer was a close observer of the business practice of his day. Let me quote two sentences from his *Morals of Trade* (1859): "Illicit practices of every form and shade, from venial deception up to all but direct theft, may be brought home to the higher grades of the commercial world. Tricks innumerable, lies acted or uttered, elaborately devised frauds are prevalent, many of them established as 'customs of the trade'—nay, not only established, but defended." "A system of keen competition, carried on as it is without adequate moral restraint, is very much a system of commercial cannibalism. Its alternatives are, 'Use the same weapons as your antagonist, or be conquered and devoured.'"

Thus at length we come to a state of things in which we find two different standards of honour and morals at the same time and in the same country. "Between gentlemen," is to be a rule confined to private life and the professions; in trade, a critic will be told, "Business is business." This would have startled our ancestors in the so-called Dark Ages, whose guilds were religious no less than business societies. I lay stress on this seamy side of competition, because nothing is more necessary, if competition is really to have the beneficent effects often claimed for it, than to maintain the best business standards of honour against a certain tendency of inferior practices to drag them down. There is a kind of Gresham's law at work in business. The best men often find their own standards degraded by an irresistible pressure of circumstance, as, *e.g.* in the Russian trade when double-invoicing prevailed. This is the "iron law" of the business world under unregulated competition. Legislation and State inspection may do something to check these evils; but I am more inclined to rest my hopes upon trade organisation and the modern tendency to an increase in the scale of business. Large firms are more intelligently conducted and less disposed to resort to base tricks. They are easier to inspect, and have so much at stake that it is not worth while to risk exposure. Publicity is even more important than regulation. It is well known that many disease germs are sterilised by

sunlight, and business will be most effectively purged of these abuses by publicity. American experience is emphatic on this point. Let the facts be known; public opinion will do the rest. The larger a business is, the more sensitive it is to this control.

I pass to a third kind of competition, very vital for our present problems. This is not concerned with production, honest or dishonest, but with sale, and, above all, with what is called the capture of the market. Superior efficiency is often enough to command the market. But when a general level of high efficiency prevails, other methods are resorted to. The *à priori* academic economist is very fond of saying that products make their own market: goods are bought by goods. There is an element of truth in the position: but business men know that in practice it is often less difficult to make a good article than to find a market for it. Jeremy Bentham, in one of the most brilliant of his writings, addressed to the National Convention of France, advised them to set free their colonies. They were not wanted as markets, he thought. "It is quantity of capital, not extent of market, that determines the quantity of trade." This *dictum* was long a first principle with English Free Traders. But however this may have been in Bentham's time, it is not in scarcity of capital that trade finds its effective limit to-day. Capital is now cosmopolitan in its habits; it is as mobile as quicksilver: a sound 10 per cent. profit proposition

will usually obtain, on terms, whatever capital it may require. But markets are jealously guarded, and increasingly difficult of access.

Hence a constantly increasing proportion of business energy is being directed to the conquest of markets. Where these markets are not new creations, but acquired at the expense of rival firms, or rival countries, we may call the competition *predatory*. From the point of view of efficiency, this predatory competition represents sheer waste, though it may sometimes be important, and even necessary, from a national or political standpoint. In Adam Smith's phrase, it is "a species of warfare." It is a warfare which enters largely into modern economic life. As Professor Mackenzie says, "When a State becomes industrial, it remains military. The difference is that the war has become civil: it is a *bellum omnium contra omnes*." But it cannot be limited in this way. This predatory competition has never been confined within national boundaries. It is avowedly international in its scope to-day.

What are its methods? "Sound production," says a German writer, "is largely subordinated to successful sale. This again is found to depend largely on advertisements, commissions, discounts, anything except genuine excellence of products." Let us glance at these expedients. Advertisement, with its "damnable iteration," if I may use a Shakespearean phrase, is one of the most wasteful and

mischievous. Our forefathers had a saying that "Good wine needs no bush." It will sound to many hopelessly behind the times. But there are firms to-day whose products have world-wide sale, and who never seem to advertise. I was brought up to believe that an advertised article was probably inferior or a fraud; and such experience as I have had has shown me my teachers were not far wrong. It may be that a more ignorant public is in the market to-day, which confuses notoriety with reputation; anyhow, different views seem to prevail. Mr. Lowes Dickinson tells us that, even in China, "the skin-disease of advertisement is beginning to disfigure the face of the country, and German *art nouveau* appears in the stations of the railway from Tsinam to Pekin. The grip of the West has begun to close, and will more and more be felt in the general dissemination of ugliness, meanness, and insincerity throughout the Empire." Observe that all this semi-fraudulent appeal to ignorance absorbs large activities at enormous cost. I noticed some years ago that a firm, in making a return under the Companies Act, showed a rapidly increasing expenditure on advertisement, which had at last exceeded in amount the whole net profits of the business. Mr. Goodall, in one of the latest works on advertising, estimates the annual expenditure in this country as from £80 millions to £100 millions; enough to pay more than half the interest on the war debt. Surely it is the business of

the honest retailer to inform the public as to the best products on the market. If more is wanted, moderate advertising in the Press should suffice. Nine-tenths of this expenditure might be saved with positive advantage to the nation. The public is not interested in the transfer of trade from one trader to another.

Predatory competition is not exhausted by advertisement. A whole army of commercial travellers is enlisted to push sales with retailers. The main objection here is the expense, which might be greatly reduced if our producing firms were larger or more closely associated. There are less innocent methods of pushing trade. Retail prices are fixed, and retailers are induced, by the attraction of larger discounts, to buy and recommend inferior articles; thus entirely betraying, though under unfair temptation, the trust placed in them by their customers. Worst of all, trade has been subject to a dry-rot of direct corruption, by double invoicing, secret commissions, and the like, on the extent and mischief of which our highest judges have again and again remarked.[1]

[1] The *Financial Times* of Oct. 2nd, 1918, calls attention to a passage in a recent circular, issued by the American Exchange National Bank of New York, on the prevalence of commercial bribery in the United States. The writer says:

"Bribery of purchasing agents and foremen is an ancient evil which was reduced to a scientific system by German salesmen throughout the world and formed an essential part of Germany's war for the control of international trade which she will attempt to resume after peace is

I say nothing here of the immorality of such action. It is fairly obvious, and has been forcibly pointed out by the Courts and the Press in connection with a recent legislative measure. What the economist should note is that so far as such practices prevail the ordinary assumption as to the benefits of competition is absolutely reversed. The fundamental advantage of free and healthy competition is that it gives room for a variation of methods, out of which we may hope for that selection of the fittest, whether natural or self-conscious, which is the prime cause of progress. But the effect of corruption, as of adulteration, is that not the fittest, but the most unfit, survive. Instead of progress you get degeneration. Unless the proper measures are taken to deal with these forms of dishonourable and predatory competition, there is no guarantee whatever that the honourable competition for efficiency will succeed. There is ample evidence to show that it may fail. When, then, we are told, as recently by a great iron-master, that all his trade needs is "to be relieved of the fostering care of the State," for which he would

restored. The Federal Trade Commission has found the practice to be so common, so unfair and so corrupt that it has asked Congress to penalise it. State laws against such bribery are not effective. Commercial bribery of employees adds to the cost of the goods. In some cases employees exact a commission of 20 per cent. and we may be sure that it figures in the bills employers pay. The only remedy is to make such bribery a crime and punish both briber and receiver of bribes."

The *Financial Times*, while it doubts whether the practice is as rife here as in the United States, is glad that it is likely to be taken in hand on the other side.

like to see substituted "some wholesome neglect," we are inclined to ask how he proposes to deal with these evils. If the trade itself will take them in hand, well and good. If not, it is clear that the public interest is concerned. The State cannot content itself with merely keeping the ring for the combatants. It must see that the fight is fairly fought. Everything depends on the rules of the great competitive struggle. Those who capture and control markets can largely impose their own rules. If only for this reason, we could not afford to neglect attacks on our markets.

As a matter of fact, the force of these considerations is generally recognised. All modern States do concern themselves, more or less effectively, with the regulation of the competitive contest. So far as their own subjects are concerned, *laissez faire* has long been abandoned. Some States profess to adhere to the old maxim so far as international relations are concerned. Others go to the opposite extreme, and have embarked on a formidable predatory competition against the subjects of other nations. In practice all States find some sort of national trade policy forced upon them, if only by way of defence.

There is another reason to be found for a national trade policy in the enormous size of some of the competing units, and the consequent increase in their power of injuring rivals. Industry, trade,

and transport are more than ever coming under the control of huge combines or cartels, wielding powers almost comparable with those of the State. Like the old Hanseatic League, they almost rank as States themselves, and compel recognition in national policy. When the State associates itself with the aims and operations of these combinations, and places its resources at their disposal, their powers of aggression are dangerously increased. Germany furnishes the best example of such a national organisation.

Naumann, in his *Mittel-Europa*, says with much truth that the old individualistic capitalism, of what he calls the English type, is giving way to the new, more impersonal, group form; to the disciplined, scientific capitalism he claims as German. He describes this as "a mechanism of work based on trained and educated workers, a spirit of industry inspired by reason, a systematic working alliance between thought and business; better organisation; in short, systematised national economy." "Our great merchants," he says, "are almost economists by profession. Into everything to-day there enters less of the lucky spirit of discovery than of patient, educated industry. To put it otherwise, we believe in combined work. The German is at last becoming, heart and soul, a political economic citizen. His ideal is, and will be, organic unity, and not freedom of action; reason, and not the blind struggle for existence. The regulation of production from the

standpoint of political necessity is the end he has in view. This conception of national economic business has been imposed on Germany by the war; an event of the first importance in international economics. The German spirit has received its baptism of fire." [1]

It follows, says Naumann, that the period of imitation of the already declining English economic system has gone by. [I may observe that the declining English system has given a very fair account of itself since these words were penned, as the Germans have reason to know.] The new developments, he affirms, imply that the future rests with Germany. Organisation, especially on scientific lines, he thinks foreign to the English genius. This genius was supreme when private enterprise was the order of the day [say 1780-1880]. But the times have changed. The present age is one of methodical, scientific organisation, the speciality of Germany, which is even regarded with aversion in France and England.

[1] For the latest development of the German conception of "national economic business," see "Walter Rathenau et l'Organisation Industrielle d'après-guerre en Allemagne," by Henri Hauser, *Revue d'Économie Politique*, Mars-Avril, 1918.

Hauser calls it a kind of productivist socialism. I should rather describe it as militarism in business. But perhaps this is only a verbal difference. All socialism must end in militarism: nothing less than irresistible force could impose such violent restraints on personal liberty and inclination as socialism necessarily involves.

It seems hardly credible, but the import into this country of German books is prohibited. Hence Rathenau's writings, such as *Die neue Wirthschaft*, read everywhere else in Europe, are unobtainable here!

There is a certain truth in all this, in spite of exaggeration. We shall do well to consider it. After all, if individualistic enterprise cannot altogether meet the needs of the time, it has at any rate left us, as a nation, with a quite exceptional power of adapting ourselves to new conditions. We must use this power for all it is worth. We have a good deal of leeway to make up.

It is certainly the case that a prejudice against science and the expert is characteristic of the English business world. English opinion holds that scientific ability is of little use in business, and indicates this pretty clearly by the miserable remuneration and inferior *status* assigned to such a modicum of scientific service as it may in some cases employ. Yet a scientific training, if a really liberal one, and not too specialised, is the best qualification for many of the highest forms of business activity. The greatest achievements in business, as in science, have been due to the faculty of imagination. In Germany a large number of her foremost business men are scientists and men of high university training. There will have to be something like a revolution in the present attitude of the English business world towards science if we are to hold our own. The trouble has arisen out of the curious divorce between the two worlds in this country. The result of this unfortunate insulation is that scientific men are unfamiliar with affairs, while business shows a

quite remarkable neglect of the most obvious and assured results of science, or, if you like it better, shows a complete freedom from scientific bias. Both science and business stand to gain by a more intimate association; if I may judge from my own studies, it is hard to say which would gain the most.

Fortunately the war has brought home to us our inadequate use of the resources of science; and it may be hoped, in spite of the long-standing prejudice on which Naumann relies, that we shall soon overtake Germany in this respect. It is equally important, I think, that we should change our attitude on the other matter he emphasises; I mean the question of combination.

There has been a general hostility to combination in this country, and perhaps still more in France. English feeling is well expressed in our Common Law, the whole spirit of which is adverse to combination as "in restraint of trade." But it is beyond doubt that unregulated competition has destroyed more honest trade than all the combinations in the world. Even in England, legislation has been more occupied in restraining competition than monopoly. The social history of the nineteenth century has been one long protest, one great legislative reaction, against the mischiefs of unregulated competition. I think I was perhaps the first English-speaking economist to put in a word in defence of business combinations. In a paper read at the Bath meeting of the British

Association nearly thirty years ago (September 7th, 1888) [1] I showed that they were a natural development, and offered certain unique advantages. I have watched their growth ever since, and have seen no reason to alter my conviction that they have come to stay. Organisation on a large scale, whether for production or trade, is inevitable and essential, if only as a consequence of the immensely increased facility of communications. Our age is witnessing a Battle of the Giants, in business no less than in war. Huge economic combinations, backed by national resources, are competing for industrial and trading supremacy, on which they count to build up political power. Individual competition is outclassed; in a struggle of this kind the individual will be ground between the upper and nether millstones, or smashed like a crock between iron vessels. It is as absurd to think that we can grapple with the scientific national trade policy of such a State as Germany, for instance, on the old lines of haphazard, untrained, individual enterprise, as it would be to defend ourselves against a German military attack by a general uprising of *francs-tireurs*.

Quite apart from attack or defence, there is still much to be said for the big organisations. They permit of the fullest use of standardisation, with all its outstanding economies and conveniences. Again, the useless duplication of the more ordinary

[1] Reprinted in the Appendix to this volume.

products, which necessarily arises where the producing firms are small and numerous, is avoided, and it becomes possible to turn out a wide range of grades and varieties. Where a small boot factory can only supply half sizes, a large one can as easily supply quarter sizes.[1] Large organisations, too, tend to attract and consolidate the inventions and advances in the industrial arts. They will probably be long-lived, and thus they insure a sort of perpetual succession and unbroken tradition to the mysteries and secrets of a craft. They have obvious advantages in buying and selling; not the least of which is that they can reduce advertisement to a minimum. Their output is so large that it advertises itself. In these and other ways, too numerous even to note here, they can operate with a maximum economy otherwise unapproachable. Above all, they will be more likely to appreciate the value of scientific research and scientific direction. It will be well worth their while to secure the very highest ability in their managing staff. If they succeed in this, they will probably escape what seems their greatest danger, a certain tendency to routine and stagnation.

Again, high standards of business can only be maintained at home, or imposed on foreign rivals, by powerful agencies of this kind. We look to them

[1] Mr. Milton C. Sharp, in his able address to the Bradford Dyers' Association, February 28th, 1917, pointed out that so far as dyes are concerned, the supply of a very large range of shades is essential, if we are to secure our command of the market.

to do for business to-day what the guilds did for it in the Middle Age. Mr. Chamberlain tried to revive and modernise the guild. Something may be done in this way, especially where the industrial conditions indicate production on a small scale; and I should be the last to underrate the value of the services rendered by Chambers of Commerce, by the trade Press, and by the numerous ably-conducted trade journals. But on the whole I expect more from a general increase in the scale and organisation of business operations. It does not seem to me that the value, nay, the urgent necessity, of developments in this direction is open to dispute.

No doubt the thing can be carried too far. When nations enter the competitive arena in their collective capacity, and these huge combinations are manipulated, with all the resources of a great State, for the purposes of predatory competition, a situation is created which requires to be very seriously studied. These immense resources are now directed, not so much to the increase of efficiency at home as to the capture of markets and the crippling of foreign rivals.

Developed on a scale of this magnitude, predatory competition is hard to distinguish, either in aims, methods, or results, from war of a military form. Indeed, the capture of markets has been the chief motive of modern wars. It was the avowed motive of the wars of the eighteenth century. The attempt

to inflict direct injury on the productive power of a rival country is certainly not less hostile in character than the conquest of its markets. "In Germany," says Henri Hauser, "the economic struggle is a war, like other wars, subjected also to the rules of Clausewitz." He gives ample grounds for his statement.[1]

Let us glance at some of the methods of this trade war, as waged by Germany. The cartel, or selling combine, has been one of its most effective instruments. [It is not altogether unknown in countries which profess free-trade principles.] A German writer, just before the war, said that "it is evident Germany owes the conquest of foreign markets in large measure to her cartels." They have great advantages in buying and selling, in regulating production, and maintaining output on a large and therefore economic scale; by the well-known weapon of dumping they can often strike a heavy blow at less powerful rivals. The State itself may take a hand in these cartels. Both together may embark on campaigns of wholesale corruption, of espionage in all its forms, of what is euphemistically called pacific penetration or permeation. The capture of key industries is an effective weapon. It gives power to inflict vital damage on a foreign country in critical times. Similarly,

[1] "Germany appears to regard trade and commerce as acts of war, and shapes its policy not for competition, but for conquest." The late Mr. G. H. Pownall, *Presidential Address*, Institute of Bankers, November 8th, 1916.

measures are taken to secure control of necessary raw material: this has been a great motive of colonial enterprises. Great transport agencies are able to assist by establishing preferential rates and influencing emigration.

The State has its own special machinery. It often controls important forms of transport. In that case it can manipulate rates so as to serve the interests of its nationals as opposed to foreigners, and generally to subserve the national trade policy. Many authorities regard the railway system as the most powerful instrument of the political economy of the German Empire. I need only mention the Tariff: the importance of this weapon, one way or the other, is perhaps unduly stressed by most people. The State can exert immense power by its educational provisions. Every form of necessary trade technique is taught in German State institutions, notably in the commercial high schools. I may remark especially the elaborate instruction in the technique of exportation, and the various export bureaux, which latter seem to be used indifferently to obtain information and as channels for corruption. It is well known how all these activities are aided and guided by the Foreign Office and the Consular Service. I do not now refer to the question of finance, because I shall deal with this in my second lecture.

All these and many other formidable trade activities are centred in the German State. The American

economist Cooper used to insist, as our free traders so generally imply, that a nation is only a grammatical expression, something that has no real existence. You will admit that for a nonentity the German State has done pretty well. Hauser's estimate is more rational. "By means of the concentration of all its energies under the State, by this unity of control, economic Germany has become a power nearly as formidable as military Germany, and of the same species: a power of domination and of conquest." Naumann, who ought to know, says "the war was only a continuation of our previous life with other tools, but based on the same method." According to Hauser, "the Imperial German Government considered that it would be quicker and cheaper to attempt to gain its economic ends by victory on the field of battle." If so, they perhaps realise now that they made a profound blunder. There was more wisdom in the advice given by the Sieur de Bouciquault to Louis XIV. He told his sovereign that by a judicious trade policy it was possible to "make conquests in time of peace." I agree with M. Bougarel's dictum: "Had the Germans only known how to keep the peace, they might easily by their backstairs, underground methods have conquered the world, the East thrown in. Luckily for the world they overrated their military power."

The contrast between War and Peace is greatly exaggerated. What is vaguely called competition

turns out on closer examination to be largely a struggle of force. True, the forces engaged are styled economic, not military; but the ends are often not very different, and the effect the same. In both the weaker go to the wall; the wreckage is sometimes worse in the industrial conflict than in war, as General Leonard Wood has shown in his Princeton lectures. It depends on the rules of each game. Before the Germans debased all the standards of military and naval warfare, it had become in many respects more honourable, less brutal, than some forms of business conflict. *It must be the mission of the Allies to raise the standards both of Peace and War.*

Meanwhile we must be ready for all emergencies. Lord Curzon in his *Appeal for the School of Oriental Studies*, published last October, tells us that "it is clear that a long and fiercely waged commercial war will follow immediately upon the cessation of hostilities." "Will be resumed," he might have said: indeed, there has hardly been any break of continuity, for preparations have continued even during the war.

What should our attitude be in face of this prospect? We do not want to form our ideals or our policy on German lines. I should like to see the predatory element in competition reduced to a minimum, just as I should like to do away with war. But both aspirations seem Utopian for the present. So long

as we are exposed to attack we must prepare the necessary means of defence. We must have more organisation, on a national scale, supported by a national economic policy. But we need not adopt economic Prussianism. We need not emphasise the predatory aspect of business, or make a Moloch of the State. The two vices are closely connected. In Germany, at any rate, the morbidly predatory spirit is largely due to an excessive exaltation and worship of the State. We can avoid their blunder. Let our organisation be in the main voluntary, not bureaucratic; controlled by the State, where this is necessary, but not administered or managed by the State. The caution is required, for the experiences of the war period, during which the functions of the State have necessarily assumed quite abnormal proportions, seem to have led many simple and uncritical folk to place an almost German trust in the State. To the business expert this will appear ridiculous. But it can hardly be doubted that when the war is over, and the period of reconstruction begins, there will be a popular movement for nationalisation of industry on a wide scale. It is impossible to discuss the question here. I only mention it to say that when I urge the importance of organisation it is not the bureaucratisation of business I have in view. If the verdict of history counts, this policy would lead to disaster. That way lie stagnation and decline.

IV.

THE FINANCING OF INDUSTRY AND TRADE.[1]

In the previous lecture my object was to give you a broad sketch of the general nature of the present industrial struggle. I tried to show that modern competition makes a considerable use of debased and predatory methods, and that when its activities are international these unfavourable features are often developed on a very serious scale, as, for instance, in the foreign trade policy of Germany, which is not easily distinguishable from economic war. So long as such methods were used it was for us to defend ourselves against them. For such purposes of defence, as well as in the interest of the general efficiency of our industry, it seemed clear that we should require larger business organisations, more scientifically equipped and perhaps linked in wider combinations or cartels.

The question now arises whether we are ready to *finance* the new organisations. To instal thoroughly

[1] The second of two lectures delivered at the Royal Institution on April 19th and 26th, 1917; afterwards printed in the *Economic Journal* for December, 1917.

up-to-date establishments on the scale now desirable must clearly be a very costly matter; and not only for this purpose, but to secure foreign markets, and to provide for the reconstruction of industry after the war, very large financial provision must be made.

In one country, at any rate, quite exceptional attention has been given to this question of industrial finance. The German banking system, from its first inception in the 'fifties, has devoted its resources mainly to this purpose, and with remarkable success. No doubt, as Riesser shows, the industrial bank was in its origin a French creation; the movement sprang from the enterprise of the Pereires and their Crédit Mobilier, and ultimately from the genius of their master Saint Simon. None the less, the French idea received its fullest development in the banking system of Germany. Germany has gradually elaborated her financial organisation until it has now become a principal, pérhaps *the* principal, instrument in the extension of her foreign trade and political power.

We have now to consider the situation thus created, and to inquire how far English traditional banking policy is adapted to deal with it, and what new developments are most urgently required.

The question is not new to experts. As long ago as 1909 it was raised in the *Times* by a very able article dealing, amongst other matters, with the now classical case of the Rand Power Company.

This was a case in which we lost orders for over two million pounds worth of turbines and other electrical plant, because German banks undertook to find a large proportion of the capital required on condition that their associated firms obtained the bulk of the orders. It was said that the banks incurred no great risk, because they only held the debentures themselves, and placed the shares on the English market! The writer recommended the establishment of "several industrial banks on Continental lines, with a paid-up capital of five to ten millions each." His concluding paragraph so exactly expresses my own views that it may well serve me as a text. "There is a saying that 'trade follows the Flag,' but it is none the less true that nowadays 'trade follows the Bank.' Successful commercial warfare cannot be carried on by means of small independent units, and it is only by strict co-operation between the industrial, commercial, and financial communities that this country can retain its position among the nations of the world." [1]

Business was not particularly brisk in 1909; the world had hardly recovered from the American crisis of 1907. But practical men had no time to attend to the matter, and the article only served as an illustration for academic discourses. There has been no lack of similar illustrations in subsequent years.

[1] *The Times* Financial Supplement, October 8th, 1909.

We owe it to Mr. Runciman, more perhaps than to any other single person, that the question has now become one of practical politics. Speaking in the House of Commons, January 10th, 1916, he observed: "If we are to do more in the future our banks must be a little more adventurous. If they cannot, in consonance with their present system, be more adventurous, let us have some additional institutions. At all events, commercial banking must play a large part if we are to hold our own against Germany." As might have been expected, the term "adventurous" acted on our bank boards like a red rag on a bull. The annual addresses of bank chairmen during the next month were a series of protests against the Minister's advice. But it will be noticed that Mr. Runciman was careful to speak conditionally. In some way or other our banking and finance must be more intimately associated with our industrial and commercial enterprise; but not necessarily by direct assistance from what we in this country call "banks"—that is, the great deposit or clearing banks.

Whatever form the connection takes, it must involve the system in some share, though not necessarily a dangerous share, in the "venture" inseparable from enterprise. If we are going to abandon adventure to the United States and Germany we may look forward confidently to the decline of our commercial supremacy. It was precisely by adventure

it was originally won. The famous companies who called themselves Merchants Adventurers knew that. The extraordinary development of German business in the last twenty-five years, both at home and overseas, is largely due to the adventure, wisely considered and carefully planned, of her great banking groups.

But it does not follow that it is the proper business of the English deposit banks to engage in this adventure, at any rate in a direct fashion. Bagehot, writing forty-four years ago, and with our English type of bank in view, says: "Adventure is the life of commerce, but caution, I had almost said timidity, is the life of banking." The dictum has been widely approved; but like most epigrams seems a little strained. After all, even the accepted type of deposit banking is one great adventure. Jevons's famous estimate, in 1876, of the English banking position will not soon be forgotten. "The whole fabric of our vast commerce is found to depend upon the improbability that the merchants and other customers of the banks will ever want, simultaneously and suddenly, so much as one-twentieth part of the gold money which they have a right to receive on demand at any moment during banking hours." [1]

There seems a spice of adventure, then, even in the present system of deposit banking; and it

[1] A banker in 1890 put the proportion at $\frac{1}{40}$th: Cobb, *Threadneedle Street.*

explains the bankers' panic at the outbreak of war. The fact is that banking, no matter of what type, is, like insurance, a question of probability. It is a question of statistics or "experience," as the insurance companies say, whether any given business risk may be wisely undertaken. This applies equally to deposit banking and to industrial finance. Dr. Riesser is inclined to think that the danger to a banking system arising from an extension of deposits is even greater than that arising from a possible lock-up of funds in industrial finance. But perhaps both Germans and English tend to over-rate the danger of business with which they are less familiar.

It must be admitted that our deposit banks are not equipped so well for the business of industrial finance as their Continental, and especially their German, rivals. They carry enormous call liabilities on a minimum reserve, and they work mainly with their customers' capital, not their own. "My own brains, and other people's money," was Lord Overstone's pithy description of his business. Lord Inchcape recently protested that English banks could not engage in industrial finance, because they ought not to risk their depositors' money to make larger dividends. His protest was very widely endorsed; but it seems entirely beside the mark, not to put it more strongly. Do the German banks trade with their depositors' money to make higher dividends? On the contrary, German bank dividends

are less than half those declared in this country; and for the good reasons that they trade mainly on their own resources and hold larger reserves. Riesser tells us, as the result of an inquiry into 169 banks, that the paid-up capital and reserve of these banks was 45 per cent. of their liabilities. The proportion in this country at that time was about 9 per cent.; it is now as low as 7 per cent. Hence the German banks can extend their industrial and trading ventures without serious risk to depositors, especially as their shareholders are content with modest dividends. It is possible, as Riesser's criticisms imply, that they may have carried their ventures somewhat too far; and it is evident that they were beginning to drift into the easier courses of deposit and financial banking. But there can be no sort of doubt that the older type of industrial banking has been a main cause of the remarkable expansion of German trade.

If we survey the world generally, and the mass of economic literature, we shall find that opinion is unanimous, except perhaps in this country, that the proper and primary business of a banking system is to finance [1] industry and trade. This was eminently the case with the old Scottish system, which has been praised by experts in all countries, and often described as the classical banking system. How comes it, then, that there should be any doubt

[1] I use this word in contradistinction to mere discounts and short loans.

as to the suitability of such work for the English banks of to-day ?

The fact is, and it is very important that we should recognise it, that in England we have developed a system of banking quite peculiar to ourselves. The late Mr. G. H. Pownall, whose death at this juncture is greatly to be deplored, laid stress on this point in his last published work. "The British banking system," he tells us, "differs from all others . . . and it cannot conform to the conditions of the half-bank, half-investment, or pioneering conditions of foreign concerns." [1] Even if we accept his inference, it only goes to show that our banking system requires some supplement, for we cannot afford to neglect business which all foreign banks regard as essential; and this is the case of the critics. But what is the peculiar character of English banking, and in what way does it limit its power of financing industry ?

When Englishmen speak of their banking system they do not include under the term, as a foreigner would, the whole financial machinery of the London market. They have in view the great deposit banks, connected by the Clearing House, in intimate relation with the Bill Market and the Stock Exchange, and centring in the Bank of England. Outside this system lie a large number of firms and institutions of the utmost importance for sound industrial finance,

[1] *English Banking : Three Lectures at the London School of Economics*, 1914, p. 24.

but usually ignored in current discussions, because these discussions have been almost wholly concerned with the "banks." We shall have to return to these outside institutions later. Our present question relates to the "banks." What were their main activities, the chief economic functions to which their resources were devoted? Their resources were for the most part engaged in the creation and circulation of two great currencies: one national or domestic, the other international, a world currency. The first currency is the well-known cheque, or bankers' money, in which the bulk of our domestic payments are made; the second, the still more widely-known London bill, the great clearing instrument of the financial world. The flotation of these currencies involves the banks in the heaviest responsibilities, because it is absolutely essential to keep each at a rigid parity with gold, convertible on demand. How serious the responsibilities are was shown to the least expert observer by the events of August, 1914. Now it is important to notice that neither of these responsibilities has to be borne to any important extent by foreign banks. In Europe generally the note takes the place of the cheque with us, the cheque currency being relatively small. The note is, in practice, and generally in law, legal tender; and hence the issuing bank is not subject to the danger of a run due to internal panic. It is a usual rule that the amount of the issues must not

exceed three times the "cash" held by the banks of issue; but this cash reserve is not definitely earmarked as issue reserve, as with us, and may carry other banking liabilities. It is clear, then, that the Continental banks, in consequence of their comparative freedom from our currency responsibilities, are better able to turn their attention to other banking duties.

But this is not to condemn the policy by which English banks have built up these currencies. We can hardly exaggerate the services thus rendered by them. They have carried the machinery of remittance to the point of absolute perfection; it is extremely convenient, prompt, and costless. Internal exchange rates, the plague of European countries even to the end of the eighteenth century, have completely disappeared in Great Britain since that time.[1] It is possible that improvements may not stop here. During the war we originated a system of gold deposits in foreign centres—Ottawa, Cape Town, Bombay, etc.—which we may hope to see developed after the Peace, until, at least within the Empire, external exchange may also disappear.

Of course, remittance is not in these days the most important of the services a good banking system is expected to render. Still, it is very easy to under-

[1] They still exist, with small charges, in the United States; though the new Federal Reserve Board is promoting measures to abolish them.

For further illustration of this matter, see the letter on Fixed Exchange, in the Appendix.

rate its value. Remittance was once the merchant's greatest difficulty. It caused the rise of modern banking expedients. It would be unfair to overlook the valuable facilities of our English remittance service just because it works so smoothly and cheaply that we rather take it for granted. Both our banking currencies are of national importance, not only in their immediate and obvious effects, but in their indirect consequences. This is recognised far beyond our shores. Many foreign countries—France, Holland, Russia, and Germany in particular—are making great efforts to extend the use of the cheque; and I need hardly say that our position as the world's clearing-house, in virtue of the wonderful currency of the London bill, is at least equally envied. Both currencies have served us well under the stress of war. The cheque system has enabled us to avoid large issues of notes and to minimise inflation of currency; while the reputation of the London bill has greatly facilitated the operations of our colossal war finance, and the adjustment of exchange difficulties.

Our banking, in short, is quite first-rate of its kind; but, naturally, it has the defects of its qualities, and these have much limited its sphere of action. I have said that the maintenance of the two currencies involves heavy and incalculable responsibilities. They work with marvellous smoothness in fair weather, but they almost presuppose it. If

the conditions of credit and foreign trade are seriously disturbed, as they were in August, 1914, the international currency may involve the banks in almost insuperable difficulties. The domestic or cheque currency weathered that storm remarkably well, but the extraordinary measures of relief conceded to the bankers may be taken as some measure of their apprehensions.

Hence the banks which carry these liabilities are all for short-term loans on the most easily realisable security. They often claim that goods in their process from raw material to the finished product in the hands of the consumer at home or abroad will always be freely financed by English banks.[1] No doubt; but what they have in view when they say this is mainly short loans, not the long and often large loans necessary, not only for the inception, but even for the extension and reconstruction of an enterprise. It is a further consequence of their position that our banks must incline to prefer financial to industrial business. Stock Exchange loans are usually for fourteen days; bills can be bought in the bill market for the shortest maturities; money can be lent at call. What investment could be more ideal than a three-months' Treasury Bill? Millions can be invested in this way without a moment's thought or consideration. What infinite pains and inquiry

[1] I have heard a great banker say he would advance on anything that was marketable, even sardines. But these are short loans, not finance.

would be necessary to invest the same amount in industrial loans! Again, most financial loans are on first-class collateral security, security which can be instantly realised, so long as the banks are able to rely on an effective and vigorous Stock Exchange.[1] This is, indeed, an essential condition of financial banking, but London is admirably situated in this respect.

The inevitable consequence of these considerations is that there is a natural tendency, not confined to this country, but stronger here, for banks to prefer financial to industrial banking. This is an old story. As long ago as 1797, Sir Francis Baring complained that the discounts of commercial paper at the Bank of England were very small compared with its financial operations. This is perhaps necessary in the case of a national bank. But it is the same with the joint-stock banks, specially founded to supply industrial and commercial needs. A distinguished Manchester banker wrote last February that "in contradistinction to banks of the German type our banks are financial institutions." If the difficulty is more acute here, it is felt in some other countries. The French Government appointed a Commission in May, 1911, to study the question of making

[1] *Ceteris paribus* securities are more marketable in proportion to the amount of the issue. Big foreign loans will therefore be preferred as collateral to usually smaller industrials. This is another argument for larger industrial combinations. Cf. the German Dyers, with their £35,000,000 of capital.

adequate provision for industrial advances. Even in the United States, where banking has never been afraid of adventure, we find the *Wall Street Journal*, as early as 1904, complaining that "the special temptation to which our banks are now subjected is the temptation to turn from commercial to financial banking." The new Federal Reserve Act contains a provision expressly inserted to discourage this tendency. Only "commercial paper" is to be admitted to rediscount by the Federal Reserve Banks.[1]

With us, everything is sacrificed to "liquidity," though liquidity must certainly break down under any serious strain, as it almost implies fairly normal conditions. The net result is that English money goes to finance foreign industry instead of our own. Mr. Grant tells us that in 1912, out of £191,000,000 of new issues on our market, only £17,500,000, or less than one-eleventh, represented home issues; in 1913 the proportion had fallen to one-thirteenth, or, according to the Hon. R. H. Brand, to one-seventeenth. It is open to German banks to take up unlimited funds in our short-loan market (and similarly in Paris) to finance German industries, or to finance foreigners on terms which rob us of our natural share in their trade. Our own money is thus used against us because our great banks are too timid to take primary risks. They prefer to

[1] There is, however, some talk now of relaxing this regulation.

give acceptances, as Sir Edward Holden says his bank does, of bills "of the leading banks in the world." The bills thus accepted can be discounted in London *ad libitum*, and at the lowest rates. The amount usually lent on short loan here can hardly be less than £150,000,000; while Mr. Keynes put the total of London acceptances before the war at £350,000,000. It was estimated that in 1912 we were financing Germany by acceptances to the extent of £70,000,000 a year.[1]

Thus our own industries go a-begging, or are driven to the tender mercies of the company promoter, while we lend large sums through foreign banks, on terms which deprive our industrials and merchants of trade.[2] It is a great sacrifice to make at the altar of Caution. Judicious Adventure might in the long run prove a better investment. Some will say perhaps that it is unfortunate, but that London can only retain its position as the world's clearing-house on condition of allowing international finance

[1] The power of the London market is enormous: as was shown by the ease with which it carried nearly £1,150,000,000 of Treasury bills in December, 1916.

[2] Prof. Henri Hauser says that the position is much the same in France, where they have not quite the same excuse. "A French merchant may see the counters of one of our credit establishments closed to him, while a German banker thereupon opens for him a credit, thanks to the resources assured to the German banker by the French establishment. This is truly disconcerting." It is, indeed; for German finance means German control, German espionage and "penetration." See an illustration of this in the *Jour. Inst. Bankers*, November, 1917, p. 342.

of this type. This may be doubted; but in any case we should not overlook the other side of the account. The preference for financial banking is intelligible enough. It may conceivably be necessary for banks of the peculiar English type. But it is certainly disastrous for English industry and trade. They require long loans and large loans; and this not merely to instal new undertakings, or to equip older ones with up-to-date plant, but even in many cases to enable going concerns to obtain big competitive contracts. Our enterprise would equally benefit by the skilled advice which a great financial house or a bank of the German type is often able to give. Neither kind of assistance can be obtained from our banks. The only alternatives are resort to the company promoter or the sale of debentures to a finance or trust company. These are mere makeshifts, utterly inadequate.

After all, the financing of industry and trade should be the main business of banking, using that term in its broader sense. It is the banking system which collects and concentrates the savings of the community: it should be its chief care to see that these are placed at the disposal of its own industry and trade, under the best possible conditions for success.[1] This is precisely what the German banks

[1] It by no means follows, as so many people are now clamouring, that these credit facilities should be extended to all kinds of business indifferently, big or small. Nothing would be gained by such a policy, which might indeed be considered retrograde. A recent report of the

have done. They have done it with such conspicuous success, and by methods and machinery so radically different from our own, that a study of their methods is perhaps the best way by which we Englishmen can approach the subject. German methods are all the more suggestive for our present purpose because German success is mainly due to organisation, and it is precisely the organisation of our ample existing resources, rather than the creation of new institutions, which is our most urgent need.

German Banking Methods.

The German banking system is in its general structure not unlike our own. Unity of control and discount policy is secured by the position of the Reichsbank, whose influence in the money market is at least as great as that of the Bank of England, fortified as it is by legal powers which our

British Chamber in Brazil deserves notice in this reference. The Committee reporting agree that there is something to be said for helping able young men to set up for themselves. But their general view is thus expressed: "They think that at present ample credit facilities are obtainable by all well-established British firms in Rio de Janeiro, and that these firms would not welcome any desire on the part of the banks to give (further) credits. Experience has shown that an increase in credit facilities means that third- and fourth-rate firms are thereby enabled to compete for business which ought to be in the hands of first-rate firms, and excessive speculation and cutting competition are the results," etc.—*Jour. Lond. Chamber*, November, 1917, p. 275.

It would be easy to criticise the view so ingenuously expressed: but there is truth in it. It is possible that excessive competition may injure business, as I tried to show in a previous article; and the multiplication of small firms does not make for efficiency.

Bank does not possess. It is surrounded by joint-stock banks which in size are not far behind our own. Indeed, one of them, the Deutsche, claimed, as the result of its latest amalgamation (February, 1917) with the Nord-Deutsche Credit-Anstalt and the Schlesische Bank, to be the largest bank in the world.[1] Taking the mark at its pre-war parity (a great concession) the paid-up capital and reserve of this bank were (March, 1917) £25,000,000, and its total resources £185,000,000.

Here we may stop to note that in all systems there is a tendency to large-scale banks; even in the United States, where legislation has put many obstacles in the way of their growth. Big banks are the order of the day. It is idle to inquire whether the big banks have made big business, or whether it is the scale of business that has determined the size of the banks. One might as well ask whether the egg or the hen came first in time. Big banks and big business are necessary consequences of the same general trend of development, which makes big finance essential. Bagehot foresaw this nearly fifty years ago. The days of small banks, he said, would soon come to an end. Riesser holds that

[1] It is now left well behind by the London City and Midland Bank, which, since its union with the Belfast Banking Company in June last, shows a total of deposits over £200,000,000! [The Deutsche figures were stated as £283,465,000 on Dec. 31st, 1917; the deposits of the London City and Midland, since the recent amalgamation, are £294,797,450. Five clearing banks now hold deposits to the amount of over £1160 millions.]

"banking business, even of a domestic nature, cannot be undertaken by establishments of only moderate size, because heavy risks have to be taken. This applies in even greater degree when it is a question of foreign operations, because the risks are still more serious." Hence bank amalgamations are in progress everywhere. Canada and Sweden present some of the latest examples. They have nowhere gone further than in this country. The movement has been justified by its results. As Mr. Drummond Fraser showed ten years ago, it is the big banks that progress most rapidly. The smaller banks can barely hold their own.

This question of scale apart, the difference between English and German banking is most marked. Organisation, elaborate and methodical, is the characteristic of the German system and the source of its power. In banking, as in industry, though individual units are often very large, they rely on the method of the cartel rather than of the combine. Each of the leading banks has a large group of allied banks working in general co-operation with it. Thus the Deutsche group, even before the last amalgamations by the Deutsche, had a (paid-up) capital of nearly £50,000,000; the Disconto group a capital of £33,000,000; the Dresdner more than £16,000,000; the Berliner Handelsgesellschaft £15,000,000; the Darmstädter £13,000,000; the Schaafhausen £10,500,000. Thus the six leading banks controlled a capital of

£137,500,000. The whole British banking system, the Bank of England excluded, only holds paid-up capital and reserve to the amount of £110,500,000.

Further, in addition to this primary grouping, the German banks are specially organised in other ways to deal with large financial propositions. They combine to carry on particular classes of operations; classes based sometimes on geographical and sometimes on industrial or technical conditions. Thus you have combinations for Chinese or for South American trade, and, again, combinations for financing the electrical or the dyeing industries, or for special operations of a technical kind overseas. They also form syndicates or *Konsortiums* for handling particular loans or other big financial ventures. It need hardly be said that such organisation as our banks have is mainly concerned with matters of banking practice in the narrow English sense of the term, and is not aimed at co-operation in finance.

The result is that in Germany risks which even the largest banks might regard as dangerous are made quite manageable by distribution. There is a regular standing machinery for underwriting. All risks, too, can be more safely taken because the capital of the German banks is so much larger in proportion to their liabilities than in England. Some of our largest banks only show a proportion of 5 per cent. as against the German 45 per cent.

The two systems differ still more in the character

of their business. Where we confine ourselves to short loans, they go in for finance. The German system has always been in the closest relation with German enterprise. The late President of the Institute of Bankers, Mr. Pownall, voicing the general banking tradition in this country, says: "A banker ought never to be a partner." Rightly or wrongly, this is exactly what the German bank is. German banks are partners, often controlling partners, "predominant partners," in many of the largest and most successful German enterprises. Many of these have been nursed from their earliest beginnings by the banks, and largely owe their success to guidance received from them. Georges Lachapelle tells us that in 1911 the Deutsche bank was represented on 134 different boards, the Disconto on 114, and the Dresdner on 112. Their all-pervading influence is well described by Mr. W. R. Lawson. "German banking does not stand aloof from industry and commerce as ours does. . . . The men who direct the German banks are all the time in close touch with the iron and coal industries, the manufacturing and trading classes, and the ocean steam lines. With them finance, industry, and transportation go hand in hand, and are regarded as integral parts of the same problem. . . . The German banker has a finger in everything that is going on. He is represented directly or indirectly on the boards of manufacturing, trading, shipping, and mining companies. He has

his eye on all the staple markets. The Bourse is an essential part of his domain. Underwriting is one of his recognised functions, and Germany is thereby spared many of the scandals of British company promoting. He has correspondents in every foreign city of any consequence. . . . These are no trifling advantages in the coming struggle for international business. What have our London banks to set against them? Simply the old Lancashire maxim of 'Every man to his own job.'" [1] As the *Economist* puts it, "The German banks . . . are stock, bill, and exchange brokers and dealers, banker-merchants, trust, financial, and promoting companies, etc. What may be described as their chief merit and defect is their intimate connection with German industrial life. There are few commercial or industrial German ventures, be they private concerns or joint-stock companies, which do not have at their disposal a fixed credit—uncovered (Blanko Kredit) or covered by very unliquid securities—with one or more banks. Not only have the banks promoted most of the industrial joint-stock companies, and retained part of their share capital, but their managing directors remain members of the boards of these companies, and draw personally large incomes for their services in this capacity." [2] Owing to this remarkable

[1] *Bankers' Magazine*, July, 1906.

[2] *The Economist*, October 21st, 1911.

variety in their activities, the German banks have been styled "*allerlei Enterprisen*," maids of all work, a kind of financial Universal Providers. It is easy to jibe at their combination of functions which it is the practice with us to specialise ; but it is possible to carry specialisation too far, unless it receives its necessary supplement in organised reconstitution. The intimate connection of German banking with German industrial life, while it has elements of danger for the banks, is undoubtedly the main cause of the success of modern German enterprise.

In the descriptions of German banking just quoted stress is laid on the important part it plays in the business of issue and flotation. Here we have one of the most striking contrasts with English practice. This delicate business, which we leave to the company promoter, is the special care of the banks in Germany, where the company promoter scarcely exists. The banks, with their large staff of industrial experts, not to speak of the highly trained men they have on their boards of directors, are able to give the most intelligent examination to all schemes put before them ; and to insist, before they accept any new proposition, that the necessary provisions are made, whether as to capital resources, management, or scientific assistance, to ensure that the undertaking shall have a fair prospect of success. The company promoter, like Gallio, cares for none of these things. His concern is simply with the

profits of the promotion. As soon as he has contrived to get his issue quoted at a premium, and his underwriters have unloaded at a profit, his interest in the enterprise ceases. "To him," as the *Times* says, "a successful flotation is of more importance than a sound venture." When it is remembered that our company law is less exacting in its safeguards than that of any other great business community, except perhaps the State of New Jersey, the result of this type of promotion can easily be imagined. Here is a German estimate of the situation. "English banks furnish the money for the flotation and stock-exchange business without thereby securing the slightest control for themselves over the business of speculation. Up to this time the English deposit banks have not suffered much from this, but it is well known that English speculation is in a very bad way because no influence is exerted upon it by the banks. Nowhere are so many extravagant speculations launched as on the London Stock Exchange. . . . Our banks have been the pioneers of industrial development . . . for this our thanks are due chiefly to our system of mixed banks, and to the proper use of this system." [1] The German

[1] Dr. Jaffé, *3rd German Bankers' Convention, Hamburg*, September, 1907. There is always a certain arrogance in Dr. Jaffé's criticisms, but there is more truth than usual in this one.

Cf. Adolf Weber. "Wohl kaum ein Land hat hinsichtlich der Folgen einer ungesunden Kreditgewährung so reiche, aber auch so bittere Erfahrungen gemacht, wis gerade England." Some of his

bank issues have been enormous. From 1885 to 1900 they issued on the German market securities for more than £1,200,000,000. The Deutsche alone made fifty-eight issues in 1907. In 1906 the banks placed £33,000,000 in industrial issues, besides debentures to the amount of from £5,000,000 to £15,000,000 annually. That this direct co-operation of expert financiers with the promotion of industrial enterprise is of the greatest value to industry hardly admits of doubt. The German banks have rendered invaluable service in this way.

In another direction German banking has not been so well advised. Not content with undertaking the business of issue, which may be called the manufacture of securities, the German banks are also the principal dealers in securities. The big banks are themselves small stock exchanges. They do not use the market, as our banks do, through their brokers, but they make a market themselves, dealing directly with their own customers. By these encroachments on the proper business of their Stock Exchange, already the victim of unintelligent legislation, they further weaken it very seriously. Their Stock Exchange is out of all comparison inferior to our own. But an efficient stock exchange is absolutely essential to financial and banking supremacy.

examples, however, relate rather to bill finance than to the financing of industry by company promotion. *Depositenbanken u. Spekulationsbanken*, p. 109, 1902.

It was largely owing to the efficiency of the English Stock Exchange that London took the place of Amsterdam as the chief financial centre of Europe. No doubt Germans were always able to use the London Stock Exchange through the London branches of their banks. They may not find the same facilities there after the war. German stock-exchange policy has been a marked weakness of their system. Our own banks are not altogether blameless in this respect. In so far as they finance speculative operations outside the market, the existence of which is not revealed at the usual fortnightly settlements, they make the market uncertain and apprehensive. The jobbers become timid, uneasy until they have evened their books. Thus their work and the efficiency of the market generally are impaired.[1]

The German system has many strong points which I must only glance at. Their banks have a remarkable network of alliances with foreign banking houses; as, for instance, their powerful New York connections with firms like those of Morgan, Speyer, and Kuhn Loeb. Again, there are many important foreign banks which they have either founded or brought under German control. This was the case with a famous Italian bank, through whose agency German banks obtained immense

[1] It was given in evidence, before the Stock Exchange Commission of 1876, that £300,000 of Consols had been sold, just before closing, without putting down the price one-eighth against the seller. Could this have been done of late years?

power over Italian business. It was much the same with the Banco Alemán Transatlantico at Buenos Ayres, the Deutsche-Asiatische Bank for the Far East, and the Orient Bank for the Near East. In every Balkan State there was an institution of this kind, working in the closest harmony with Germany's financial and political aims. A mere list of these institutions would occupy a large folio. In all their foreign work, too, the Germans have shown singular ingenuity in carrying out their schemes with foreign capital. "Germany," says Professor Hauser, "has effected the surprising *tour de force* of securing her financial supremacy in foreign countries while locking up very little of her own capital." Of the £5,200,000 capital of the Banca Commerciale Italiana in 1914,[1] only £180,000 stood in German names, or less than 3½ per cent. Yet Germany, at that time, held practical control of the bank (the situation has since been happily altered). So far as industrial undertakings are concerned, it has been estimated that Germany contrives to obtain control by an investment of not more than one-eighteenth of the capital controlled.

I have referred in a former lecture to the various agencies, none too scrupulous, by which Germans promote their export trade. The banks furnish the necessary financial support, and at the same time they utilise the influence thus acquired to capture

[1] Now, July 3rd, 1917, £8,628,000.

insurance business for the German companies and to place in foreign hands shares in the German undertakings they have floated. The credit policy of German traders is a well-known means by which they have contrived to establish themselves in already occupied foreign markets. Here, too, it is by the aid of their banks they have been able to relax the sound but somewhat severe rules of credit practised by rivals. Last, but not least, they have in all their work the assistance of an elaborate system of publicity, usually based on the subsidising of local publications and the local Press.

The machinery thus planned by the banks, and in which they play the leading *rôle*, is clearly admirably adapted to its purpose of fostering German trade. Suppose a railway is wanted in China. The Asiatische Bank, supported by its powerful German group, is able to provide the necessary funds, stipulating that the contract must be placed in German hands. The Deutsche, or some other German bank with a special railway connection, will take care that the contract is placed in competent hands. The whole business will have been astutely written up in the local Press, and every available means used to obtain the concession. The railway may be half built before we could have floated a company to raise the capital; and so a valuable contract, with all the incidental business connections, is lost to Germany. With Germany finance and trade go hand

in hand. The banks never forget to insist on the *quid pro quo*. The placing of business in German hands is the invariable condition of German financial assistance.

The Position in this Country.

What provision have we in London, or are we making, to do the sort of work which has been described? Nothing, it must be said, that is at all adequate. Of course, it is true in a sense that every kind of financial business can be put through in London, if not by what we call "banks," yet by other financial machinery; and nowhere in the world do financial institutions of the highest class abound as they do in London. A glance at the *Bankers' Almanac* or any similar work will show that the financial resources of London are absolutely unrivalled. Any kind of finance might be managed in our market, most kinds are. The real question is whether the business is being done in the best way, on the necessary scale, with the necessary promptitude, with the best use of available experience, and with the proper co-ordination of energies and resources.

The fact is that we had carried specialisation to an extreme. Foreign exchange was relegated to special firms, largely foreign houses, or, if English houses, managed by foreigners; or else carried on by foreign and colonial banks. Bill discounting, again, was mostly left to a special body of bill-brokers, hardly to be found

elsewhere. Foreign trade was largely catered for by colonial and foreign banks and by the exchange houses. Issue business was principally done by merchant bankers or issuing houses, and was for the most part on account of foreign countries. Home industry was left to the company promoter and the various finance and trust companies;[1] assisted, no doubt in many cases by some of the larger stock-broking firms, and particularly by certain firms of provincial brokers.[2] I do not say that there was not a certain amount of informal co-operation between these independent agencies. But in general there was no systematic and regular co-ordination of their operations. The system, if it deserves the name, suffered from excessive specialisation and almost complete lack of organisation.

We have made some progress of late years. Our regular banks have greatly enlarged the scope of their activities. They have developed foreign exchange departments, often very large and important. They are taking a large share in acceptance business, as to which much might be said. They have begun opening branches, or controlled establishments, in foreign countries, notably in France, Spain, and Russia. Better still, they are entering into intimate

[1] Sir George Touche suggests that these latter companies should be organised, so as to secure some "unity of action." Mr. Robert Fleming puts their aggregate capital at £100,000,000.

[2] For instance the firm of George White & Sons, Bristol.

relations with foreign banks, as, for instance, with the two great Italian banks, the Banca Commerciale and the Credito. Again, many new banks for foreign trade have recently been established, as, *e.g.* for the Russian and Scandinavian trades.

All this is very good as far as it goes. But it seems to me open to a fundamental objection. It lacks its natural basis in an intimate connection with the national industries. The proper foundation for overseas finance is well-financed home industry. All the foreign enterprise of the German banks was based upon an intimate knowledge of the resources and aptitudes of their own industries, obtained by careful study in the course of such preliminary financing. Now our colonial and exchange banks are quite distinct from our home-banking system, and neither are in touch with home industry as the German banks are. The regular banks are always ready to accommodate industry with temporary loans on excellent terms. But they do not regard it as their province to concern themselves with the original equipment of large-scale enterprise, whether at home or abroad, as, for example, a great issue house would. They have not made a special study of industrial technique, or industrial problems generally, except so far as they affect short-loan business. Industry has thus lost the valuable advice a German bank or an issue house could offer, advice more valuable often than the mere capital loan; while the banks in their turn

lose a certain insight into the industrial and trading situation which might go far to compensate them for any risks inherent in the more difficult type of finance.

The loss to our home industry is only too obvious. It cannot obtain from the banks the means of making adequate original installations, or the extensions and reconstructions made necessary by the progress of industrial technique, or by the developments of rival firms in other countries; nor, again, the large loans which are often, in practice, essential to the securing of big foreign contracts. Finance of this kind involves a lock-up of resources which our deposit banks, without special supplementary organisations, cannot entertain. In most foreign countries this finance can be arranged by "banks" of some kind. German banks lay themselves out for it, and so do certain credit institutions in France.

If our great Issue Houses would take up this business their help would be invaluable. They are accustomed to make exhaustive examinations of propositions submitted to them. They employ expert engineers, accountants, and lawyers; and every pertinent detail in regard to process of manufacture, plant management, earnings, labour conditions, and past history is taken into account. But the issue houses fight shy of ordinary home industrial propositions. They prefer those put forward by foreign Governments, municipalities, or the very largest

transport companies. As a rule our English industries are too small in scale to attract the issue houses; the securities would not be marketable. Thus we are involved in a vicious circle which it will want some courage to break. Our industries are inadequately capitalised, because they cannot get properly financed; they can't get financed because their capital is inadequate. Even if this difficulty were removed, as it must and will be, another would remain. The English investor does not take kindly to industrials. The issue houses would not find it so easy to unload those they had become responsible for. It seems clear that either by relating themselves to large banks, or to credit institutions of a different type, they must endeavour to distribute the inevitable risks of having to wait some time before the issues are completely taken up. Those who ought to know tell us that even in the United States issue houses will seldom take up a concern in its initial stages. They leave this, curiously enough, to the weaker houses; in proportion as the house becomes strong, it tends only to consider going concerns. The question hardly arises in London, where the issue houses scarcely cater for home industry at all.

The small contribution made by the issue houses to industrial finance is a matter for regret. It is certain that the experience at the disposal of these houses is most valuable, and ought not to remain

exclusively in the City, to be employed on foreign enterprise, but should be made available for the guidance and stimulus of our own industries. We are told that banks and issue houses alike are waking up to the fact that in many respects the management and plant of our home industries are not nearly so good as they had assumed them to be ;[1] and that if this condition of things is to be remedied there must be greater co-operation between the City and Industry than there has been in the past. Banks and issue houses should keep in closer touch with our industrial establishments, and associate themselves to a greater extent with their managements and their methods. No one has more to gain by such an association than the so-often victimised investor. "The real issue," writes Mr. Lawson (February, 1916), "is, where do we find the best industrial results? In the slop-work of the British company promoter, or in the scientific work of the German bank? . . . There is a widely-felt need for some kind of bank or trust company which could guarantee to the investing public a reasonable amount of administrative, financial, and technical skill in the management of new ventures."

[1] As an illustration, a writer in the *Round Table* for December, 1916, makes the following almost incredible statement: "A very large proportion of the coal used in this country is still used in plants involving a coal consumption from five to fifteen times greater than the best that can be done to-day," p. 35. I do not know on what authority these figures rest. But that a large proportion of our industrial plant is very inefficient is patent to the ordinary observer.

The establishment of the new British Trade Corporation, chartered last April, is the latest response to this need. Until it has embarked on actual operations it will not be easy to ascertain the precise functions it will serve. It is to have an Information Bureau and an Intelligence Department, much like the machinery of an issue house or a firm of merchant bankers. There are representatives of commerce and industry on its board, and it is to be aided by a staff of technical experts. The chief appointments hitherto made have been generally approved. Its own initial capital is £10,000,000; and it hopes to be further aided by contributions from the banks. It has taken powers to do acceptance business, and it is stated that it is not to interfere in any way with the operations of the British and colonial banks. From these last, and other statements that have been made, I find it difficult to conjecture what the precise character of its operations will be, and criticism can only be hypothetical.

It may be said at once that it is a step in the right direction, and we hope that its foundation may give an effective lead to public opinion. There are some indications that it aims primarily at foreign rather than home developments. I hope this impression may prove to be unfounded. If not, as I have already said, we are beginning at the wrong end. It was the close union between the financial expert and the captain of industry that gave German industry its remarkable efficiency, without which its

foreign trade and overseas competition, however ingeniously financed, must have failed. We look in vain for financial institutions in England which have the knowledge, and are prepared to play the part, of these German banks. Mr. Brand tells us that "London knows very little of British industries"; that it has "no institutions whose aim it is, as it is the aim of the German banks, to act as a kind of general staff to industry"; and that there is "a peculiar lack of contact between the chief financial centre of the world and the industry of its own country." It did not require the revelations of the war period to show that this isolation of industry from finance has been most unfortunate.

It seems very unlikely that any one institution, however ably directed, can do more than a small part of what is wanted. It is clearly impossible for it to make an adequate survey of all industries, at home and abroad. Nor is this necessary. So far at least as foreign business is concerned, ample and more than ample machinery already exists in London. I would rather see the resources of this great corporation devoted to the organisation of our existing institutions than to the addition of a new competitor with them. So far as home finance is concerned, for which no doubt new machinery is required, I think Mr. Drummond Fraser's new proposals are more promising.[1] His idea is to establish local credit

[1] See his *Finance After the War*, February, 1917, pp. 26, 27.

associations at great industrial centres; for instance, in such places as Manchester, Bradford, Birmingham, etc. He thinks such associations might be largely financed by the banks working in the respective districts; and it is believed that a scheme of this kind is already on foot in the Manchester district. Local credit associations of this type would have an intimate knowledge of the industrial conditions and *personnel* such as could hardly be expected in the case of a house working in a great international market like London.

We are too apt to ignore existing resources. When the British public gradually begins to recognise the immense importance of things experts have long been trying to do with inadequate means, and no intelligent support, the cry is always for a brand-new institution. It would generally be wiser, and certainly in this case, to utilise, and extend, and suitably organise, the vast resources that already exist, but of which so much more might be made.

Whatever form our industrial finance may ultimately take, it will probably be better to provide machinery for the purpose outside, though not out of relation to, the existing system of deposit banks; and it will be as well to avoid using the term "bank" in connection with work of this kind in Great Britain, because the term has a specially narrow meaning here. As Sir Francis Piggott suggests, the French term *Crédit* is more to the point: *Crédit Foncier*

and *Crédit Mobilier*; we want them both; we have neither, at least on the scale required. Whatever we do, while working in harmony with National Policy, let us avoid hampering ourselves by State assistance, or even, so far at least as home finance is concerned, by State control.

To sum up a rather long exposition, I am convinced that the radical fault of our system lies in the fact that our financial, as distinguished from our banking, institutions are out of touch with our industries, with the natural consequence that these industries, or the majority of them, are defective in their organisation and equipment. If this is so, then the value of any proposed reforms must be judged by the probability that they will remedy this defect.

A word in conclusion. If I have spoken a great deal of Germany in this lecture, it is because she has shown strength precisely where our own system is weakest; and there is much to be learnt from her experience, either for adoption or avoidance. But I do not fear German rivalry in the future, now that the world is awake to her unscrupulous use of financial power, and that we are becoming sensible of our own deficiencies. There is only one country in the world that has a financial future at all comparable with our own. While we have been talking she has been striding ahead. I refer, of course, to our oldest colony and latest ally, the United States.

V.

THE BANKING RESERVE.[1]

I DO not think I need apologise for calling your attention to this subject of the banking reserve. I say the banking reserve, and not the Bank reserve, because, as will presently appear, what I have to say does not merely or primarily relate to the Bank of England. It is of the reserve position of our banking system as a whole that I desire to speak.

Now, considering that Mr. Goschen, in his memorable speeches of 1890 and 1891, nearly eighteen years ago, regarded this matter as absolutely urgent, while the difficulty of the position has certainly not diminished since that time; considering that the present Premier during the last two or three years has more than once impressed on the banking community the necessity of some action; considering, too, that some half-dozen of the most prominent practical bankers in the City have in the most formal way called public attention to this matter, it is pretty evident, I think, that the question is one which presses for some

[1] A lecture delivered by invitation to the *Chartered Institute of Secretaries*, Feb. 24th, 1909.

practical solution. Bankers are, by habit and by tradition, exceedingly cautious, and they would not have spoken so strongly as they have on this subject unless they felt that it was really imperative that something should be done, and done without delay.

I do not think you could have a more favourable opportunity for strengthening the reserve than we have to-day. Money has never been more plentiful. The gold yield last year was in the neighbourhood of eighty-five millions sterling. Rates of discount were very easy. Continental banks strengthened their position by sixty to seventy millions; the Bank of France alone by over thirty millions. So far as I can make out, in this market we did absolutely nothing. The reserve at the Bank of England was positively lower by about £1,800,000 odd in February, 1909, than in February, 1908. We lost an exceedingly good opportunity.

This was not for want of due warning. Sir Felix Schuster repeatedly insisted on the unique opportunity which times of easy money offer for increasing our gold holdings. But nothing was done in this country, whilst in almost every other the great banking institutions, including the Treasury of the United States, have made large accessions to their reserves.

Mr. Palgrave, in the *Bankers' Magazine* of February, 1904, tells us that "much of the legislation which regulates banking in England is now altogether out of date, and mischievous where it is not useless."

I would hardly have ventured, on my own unsupported opinion, to put the matter so strongly. But this is the verdict of a man who has long been one of the highest banking authorities of this country, and who is a director of one of the largest joint-stock banks.

If Mr. Palgrave is right in his estimate, and for my part I should entirely agree, there is no reason for that excessive reluctance to disturb existing arrangements on which foreign observers often remark. There is plenty of room for the revision of our present methods, and for some new departure in a system which has been untouched for sixty-five years.

It cannot be too clearly recognised that this is not a question that merely affects the money market. The whole nation is intimately concerned in the provision of an effective banking reserve; and this not merely because we are all of us in these days the clients of banks. No doubt, anybody with £5 can open a banking account, and is, therefore, interested in the solvency of the institution with which he is thus connected. But the poorest man in the country is as greatly interested in this question as the richest depositor. The question of unemployment is to the front now. It has always seemed to me curious that while in the many discussions which it has provoked we get all manner of extravagant and Utopian solutions proposed, from land nationalisation to a stringent protective tariff, it does not seem to have occurred

to the majority of persons who are dealing with the subject that the recent abnormal increase in unemployment was consequent upon the banking crisis in the United States. The argument *post hoc propter hoc* requires to be used with great caution in economic discussions. But I think it is beyond dispute that the sudden increase in the rate of unemployment (the percentage in 1908 was double that of 1907 [1]) was due almost exclusively to the failure of the banking organisation of the United States and the consequent effect on the world's trade. I say, then, that the whole nation is concerned in this question, and the poor, perhaps, more than others, as they have smaller resources to fall back upon at such times.

What is Banking Reserve?

Those who have addressed the public on this question, though they all agree on its urgency, appear to agree on little else. The solutions they propose are most divergent. I think that is partly because people have not come to terms precisely as to what they mean by bank reserve. I must ask you to excuse me, then, if I try to define the term "reserve." I should be inclined to say that a reserve is "a public provision of money, not required in the ordinary

[1] Unemployment is the most notable and distressing of modern social facts. Yet we have no adequate official returns of its fluctuations. But, so far as the trade union figures show, it was not much above the average in 1907. In 1908 the percentage rose from 3·7 to 7·8.

course of business, held available to meet exceptional emergencies."

Some will think this rather a strict definition, while to others it may appear obvious; but it rules out a large proportion of what is commonly regarded as reserve by bankers themselves, and even by the legislation of some important countries. Let us go into the point a little more fully. A banking reserve is not merely sound assets. A bank may have the soundest assets in the world, but it is impossible to regard all assets which may be good in case of a liquidation as necessarily good banking reserve. Take the case of the United States. It is not too much to say that when the banking system of the United States suspended payment in 1907, the banks held two thousand millions sterling of tolerably good assets: it was not for want of assets that they suspended payment. Nor can we admit that much of the so-called liquid assets is properly banking reserve. The term "liquid" is always a doubtful term. Securities freely marketable to-day might be practically unsaleable to-morrow. The whole question of the convertibility of assets is a very difficult one, and we must allow very wide margins when we are considering the price tolerably good assets will realise at the time of stringency. Bankers will probably include money at call, if not among their reserve resources, at least among their liquid assets. But many authorities are of opinion that the large

amount of money at call is the most dangerous feature of our market. I suppose the bankers have 120 millions at call or at short notice. How much of this could they get in in time of crisis? A very small proportion.

Mr. Pownall tells us, in an interesting paper on *Bank Reserves*, what Viscount Goschen thought on this subject in 1890. He says, "The last time we had a crisis (in 1890) the then Governor of the Bank of England and the Chancellor of the Exchequer fixed on this point as the vital one. Their anxiety appears to have been that the bankers should stand solidly together, and not attempt, by individually withdrawing money from the brokers, to protect themselves at the danger of a general discredit. There was undoubted solidarity of interest; what was needed, and was secured, was solidarity of action. If the banks were unable or unwilling to lend, it was of the highest importance that they should not destroy the equilibrium of the short-loan market. To do that would have been to force the brokers on to the Bank of England, and thus risk a panic of incalculable calamity. I fear that a Chancellor's letter would have availed little." [1]

Holding these views, it is not surprising to find

[1] *Economic Journal*, September, 1899. I may say that the late Mr. Lidderdale was radically opposed to applying for a Chancellor's letter. He told me more than once about that time that he could not conceive circumstances in which he would feel justified in resorting to this expedient.

Lord Goschen saying, at Leeds, in 1891, that "money at call is a valuable asset, but it is not an asset which constitutes a reserve useful to the general interests of the community at large."

Cash, then, or what will at once be accepted as money by those who have a right to demand money, is the only real banking reserve; and the cash must be unemployed. Pressure in one part of the market may be relieved by withdrawing short money lent to another part: but such an operation causes new disturbance, and only increases the general pressure. An employed reserve is really a contradiction in terms, if we are considering the market as a whole.[1]

Coming now to cash, can all cash be counted as banking reserve? First we must notice that the term "cash," as used by bankers, is extremely ambiguous. Mr. Palgrave gives a list of seven different things which are sometimes called cash by bankers. Some bankers regard as cash their actual holdings of metallic money in their own tills, others include Bank of England notes, others notes of other banks,

[1] Thomson Hankey has put this point admirably. "Ready money," he says, "is a most valuable thing; it cannot, from its very essence, bear interest; everyone is therefore constantly endeavouring to make it profitable, and at the same time to make it retain its use as ready money, which is simply impossible. . . . It is the constant attempt to perform this miracle which leads to all sorts of confusion with respect to credit.

"The Bank of England has long been expected to assist in performing this miracle; and it is the attempt to force the Bank to do so which has led to the greater number of the difficulties which have occurred on every occasion of monetary panics during the last twenty years."—*The Principles of Banking*, 1867, p. 25.

others cheques on other banks, others cash balances at the Bank of England, others balances at their London agents, others money at call and at short notice.

It is plain that we want much more specific returns before we can arrive at any definite knowledge of what is meant by and returned under the heading of "Cash."

When we get down to metallic money we seem to have got to bedrock; and there are persons who would include every form of metallic money as banking reserve. But it is quite clear, I think, that we cannot do this. A large portion even of the gold held by the banks is necessary till money. At least four leading joint-stock bank authorities admit that till money cannot be regarded as reserve; that is to say, the money which a bank finds it necessary to use to keep its doors open and to carry on its ordinary business is not money available to meet emergencies. It cannot be seriously reduced, otherwise the bank would have to close its doors. All the greatest authorities on banking are agreed on that point. The problem, then, is, How much cash is held by joint-stock banks other than what is necessary on the average to carry through the ordinary business of the bank? It is very difficult for an outsider to form any opinion on this point. We hear representatives of banks sometimes speaking of "hoards" which the banks are forming for them-

selves. On the other hand, Mr. Palgrave says very definitely that practically there is nothing held by the banks in an unemployed form. He tells us, "The tendency of business is to leave no unemployed money outside the Bank of England";[1] that is to say, that there are no hoards of any importance, of any magnitude, which are not potentially in use, and therefore no money to meet emergencies, outside the Bank of England. Moreover, any such unseen hoards, because their amount is unknown and their existence uncertain, lose much of the power they might otherwise have to steady the market. A true reserve must be a *public* provision of money.

It must be remembered, too, that a large proportion of our metallic money consists of silver and bronze. Neither of these, since 1816, is full legal tender, and, though silver might for many purposes have been a good remittance before 1873, it cannot possibly count as bank reserve here since that date. Now, we were told yesterday by the Chancellor of the Exchequer that against an estimated amount of about £100,000,000 of gold in our currency, there was about £24,500,000 of silver and £3,000,000 of bronze. Thus, £27,500,000 of "cash," or, say, nearly twenty-five per cent., is not gold and not reserve. How much of this is in the hands of the banks? According to returns made in June, 1905, they held, say, £5,250,000 of silver, and their holding had increased

[1] *Bank Rate and the Money Market*, 1903, p. 225.

£750,000 since a previous return in 1892. We have no return of the holdings of bronze, but the silver and bronze together must be well over £6,000,000. All this counts as part of the "cash in hand" held by the banks. But it is certainly not reserve, from the point of view of a foreign drain on our market, and it can only be available to a very limited extent to meet internal demands. The old device of "paying in sixpences," resorted to by the Bank itself in 1720 and 1745, was effectually barred by the Act of 1816.

But, last of all, no resources, however good, not even gold itself, can be counted as reserve unless they can be used in an emergency. Locked-up money is not reserve. That brings me to the case of the United States. The national banks there have reserves of gold which would be an exceedingly valuable asset if they went into liquidation. We know that they are obliged to hold 25 per cent. reserve against their liabilities in the larger or reserve cities, and 15 per cent. in the country towns. But that is not strictly reserve as we have defined it, because they cannot part with it. They cannot pay out any part of this 25 per cent. without reducing their liabilities—*i.e.* their accommodation to the public—by four times the amount thus paid away. Hence, as their reserve dwindles down to 26 per cent. and 25½ per cent., panic seizes on the public, because they know that the next step will be that the banks cannot pay out any more. That is one reason why we can never

establish an effective banking reserve by regulations that banks shall hold such and such a proportion of gold against total liabilities. Gold held under these conditions may be a good asset when the bank goes into liquidation, but it is not a banking reserve, and will not prevent the necessity of liquidation, which it is the purpose of a bank reserve to avert.

We ought to be quite clear, I think, on that point. Mr. Lawson, always witty and incisive, says: "Perhaps the American idea of creating money simply to lock it up as bank reserves was borrowed from the railway stations in Germany, where there must always be one cab on the ranks." Well, it seems to me that that cab might as well be in the stables. The reserve, then, must be available, otherwise the gold may as well be in the mines.[1]

The Present Position.

What is the actual position in this country, taking reserve as above explained? The total liabilities of the banks of the United Kingdom may be put at about 1,000 millions sterling. In this sum I do not include liabilities on account of capital and reserve, which are liabilities to shareholders, not to outsiders.

[1] Since these remarks were made, the reserve ratios mentioned have been altered, and the whole reserve position in the U.S. enormously improved, by the Act of December 23rd, 1913, and its subsequent amendments, creating the Federal Reserve System. The argument, however, still holds as against any attempt to legislate for reserve on the basis of a fixed ratio to liabilities.

Nor have I included anything on account of the liabilities of Foreign and Colonial banks, which it would be very difficult to assess for this purpose. Savings banks' liability, which seems to me of a quite different kind, is also excluded; as well as insurance and other liabilities, which may at times cause a very real disturbance of the market.

What is the reserve held against this 1,000 millions odd of liabilities? I will take first the returns made by the banks themselves, and we can afterwards consider how much these returns must be discounted if we take a strict view of what is really effective reserve. The Bank of England has for over twenty years kept considerably over 45 per cent. reserve against its banking liabilities, the note issue being otherwise provided for. The exact average rate for the years 1884-1903 was 46·6 per cent. During the last fifteen years the great joint-stock banks publishing returns show a ratio of something like 15 per cent., tending of late years to rise somewhat. The average for 1904-6 was 15·5 per cent.; last January's return stands at 17·4. For the smaller and country banks we have no complete returns; but the other day I noticed a return by one of the most important of the English country banks, one with most ancient and honourable traditions. The proportion of reserve to liabilities was 6·2 per cent. I do not think we could put the general average holding of this class of banks as more than 5 per cent. of liabilities.

Thus the banks may be divided into three orders, holding respectively about 5 per cent., 15 per cent., 45 per cent. of reserve, the proportion trebling as you pass from one order to another on your way from the country bank to the Bank of England. Remembering that reserve is dead money, and makes no contribution to dividend, these figures should be noted. Whatever value they may have as indicating the proportion of effective reserve on which we may rely, they are unimpeachable evidence of the relative sacrifices made by different elements in the banking community towards the burden of maintaining dead or unprofitable resources.

But when we come to examine these returns in the light of the exceptions we have been considering, we find that very little is left as really effective reserve, and that little is mainly confined to the holding of the Bank. I put it as twenty millions, or twenty-five millions at the outside—2½ per cent. of the total liabilities. Mr. Palgrave said, in 1902, that there was little unemployed money (other than till money) outside the Bank. We hear that some unknown amount has recently been accumulated by the joint-stock banks. On the other hand, as Mr. A. C. Cole justly remarked, in his address to the Institute of Bankers in Ireland (1905), some of the reserve at the Bank must be regarded as till money. That reserve, during the last fifteen years, has averaged about twenty-five millions. Mr. Cole

considers that we can only count two-thirds of this as true reserve. Add four millions for outside reserves, and you get about twenty millions, say, twenty-five millions as an extreme figure.

Is this reserve adequate? The arithmetical proportion is small, but no conclusion can be drawn merely on that ground. It is a question mainly of what the insurance companies call experience. It depends on the probable emergencies to be met. One can conceive a banking situation in which a reserve of one per cent. might be adequate. If we had to consider nothing but internal liabilities, and cheques were universally used, it is almost conceivable that we should want no reserves at all, especially if the process of amalgamation had been carried so far that there was only one bank. Every internal payment might be made by a cheque on that bank. In this sense the banks are perhaps justified when they urge that a large mass of their liabilities cannot fairly be regarded as involving any serious necessity for the holding of gold reserves. But we must deal with the situation as it is; and we must note that the actual liabilities are of very different kinds, some of them involving very serious possibilities.

Liabilities on current account are probably the least dangerous of all to the banking system as a whole. They represent the till money, if I may so speak, of the general public, other than their pocket money. It has often been pointed out, as by Mr. Palgrave,

that a man cannot very well withdraw his average holding on current account. He may move it to another bank, but he cannot well do without it in this form, otherwise he would invest it. When we come to what are called distinctively "deposit" accounts, we have a quite different kind of liability. The money is placed there because it is not wanted at the moment. It only lies there till a better investment offers. True, it is nominally under some condition of withdrawal subject to notice. But I gather that under the stress of competition the condition of notice tends to vanish, and I am often assured that customers can practically move their deposit moneys at will. High authorities have held that the greatest danger the Scottish banks have to provide for is a sudden withdrawal of such deposit moneys, which form a large proportion of their liabilities. We had a memorable object lesson as to this risk in the Australian bank failures of 1893. No doubt the difficulty was originally caused by an undue inflation of land values, at a time when general prices were steadily falling. But the crisis was precipitated by the fact that these banks held large amounts of money, mainly British, on deposit account. There was a rush on the part of the depositors to move their money, and the banks were wrecked, a large part of the total loss of fifty-five millions falling on this country.

Observe that these deposits, from the Australian

point of view, were foreign deposits. It is the external liabilities that constitute the really serious strain upon well-constituted banking systems like our own. In 1826 Mr. Huskisson, comparing the relative dangers of a foreign drain and an internal panic, put the latter as by far the more serious. Nobody, I think, would say so to-day. There is no country in the world, I suppose, where banking business is so thoroughly conservative, and takes so few industrial risks, as in England. Our modern banks are so well organised and so admirably managed that I can hardly imagine any panic or run setting in on the ground of distrust of a particular institution. It is, unfortunately, much easier to imagine a general collapse of the market as a whole. Our market works under very special and peculiar difficulties. We are, of course, a free gold market—not the only free gold market, for I understand that neither Amsterdam nor New York puts any obstacle on the export of gold—but still we are the most important free gold market, and the one to which resort is most generally made. There can hardly be a monetary stringency in any part of the commercial world which is not felt in London. This market is also a kind of clearing-house for international payments. It follows that we hold large deposits on foreign account as a basis for these payments. These deposits have been steadily increasing. I was astonished to find last year that

the Australian banks alone had in January twenty-five millions sterling in this country. Germany, again, has large deposits abroad, a great part of which are in this market; and it is curious that one of the effects of the passing of their Exchange Act of 1896, which considerably hampered dealings on their exchanges, was that additional German money was held in London, to facilitate dealings on German account in our speculative markets. *Per contra*, I believe that our deposits in foreign markets are relatively small, and that we have little hold on these markets, otherwise than by the general balance of trade and the interest due on our foreign investments. Mr. Hansard has often insisted upon this. He says that we hold few bills on foreign places, and that the kind of securities our banks keep, though very good, are usually not of the special class, nor in the easily negotiable form, which foreign markets prefer. There have been times, he says, when it was easier to sell Turkish bonds than Consols on foreign markets. The question for the London banker is often not how good a security is intrinsically, but how easily it can be turned into cash, or sold to check a foreign drain of gold. In 1907 the President of the Bank of the Netherlands, in his annual address, pointed out that, in consequence of the stringency in the United States in the autumn of 1906, a considerable demand for gold had been made on Amsterdam. "We met that demand,"

he said, "without the export of a single florin of metal." They simply handed over bills on London, thus transferring the pressure to this market. These bills had been a good investment for the Dutch bank, for rates were high. How many bills do we hold that we could use in a similar way ?

Of all deposits in our market, the most dangerous and disturbing are those held for purposes of international financiering. Some banks decline to hold accounts of this character, but it cannot be doubted that others are not so precise. It is matter of notoriety that the magnitude and audacity of modern finance operations have greatly increased of late, and that these operations are necessarily international in their range. Thus our liability to sudden and violent monetary disturbance, to "bolts from the blue," is greater than it ever was. This is a kind of liability which calls for a much more substantial reserve provision than we have yet made.

I come last to what seems to me the greatest danger that threatens our credit, I mean the position we should find ourselves in in case of war between two first-class Powers, especially if this country were itself actively engaged. To quote Mr. Pownall in 1899 : "It is quite possible, with our attenuated gold reserve, that a foreign government might strike its most effective blow by aiming at our financial supremacy. The power to act on our few millions of gold might be acquired by an enemy able to deplete

the Bank, and bring on a crisis." Sir Felix Schuster has also called attention to this matter on several occasions. In March, 1908, Sir Robert Giffen read a valuable paper, at the United Service Institute, on *The Necessity of a War Chest in this Country, or a Greatly-Increased Reserve.* In the course of the interesting debate which followed, Sir Felix Schuster, who was in the chair, remarked that "an efficient gold reserve in time of war, at the commencement of hostilities, is infinitely more important than food supplies"; and it was generally admitted that this was a vulnerable point in our resources for defence. We should certainly be in a very weak position to withstand an attack of this sort. When I look at the huge reserves held in some foreign countries I can hardly doubt that they are largely held in view of contingencies of this kind. What sort of provision is made here for this most dangerous of all liabilities?

The Reserve Insufficient.

If I conclude, then, that our reserve is inadequate, it is not so much on the basis of the small ratio it holds to total liabilities as on the consideration of the very dangerous character of some of these liabilities. There are other reasons for this conclusion. Much larger reserves are held in other countries, whose markets are not exposed to anything like the same strain as our own. The Bank of France the

other day held 145 millions of gold and thirty-five millions of silver—say, the equivalent, even for external purposes, of 160 millions of gold. The Bank of Russia held nearly 130 millions, the Reichsbank over fifty millions, to say nothing of the enormous holdings by the United States banks and their Treasury. Three times, too, in seventeen years we have only been saved from crisis by the friendly assistance of stronger banks. I am far from assuming that this assistance was entirely disinterested; yet I can conceive political situations in which it might have been withheld. Surely it is not wise to leave our solvency dependent upon the goodwill of our neighbours. Let me remind you of what we risked on one of those three occasions, the one known as the Baring difficulty of 1890. I give you Lord Goschen's account in his famous Leeds speech of 28th January, 1891: "No fertile imagination could exaggerate the gravity of the crisis—I doubt whether the public has thoroughly realised the extent of the danger—I tell you what was at stake, you risked the deposition of London as the banking centre of the universe, you risked the supremacy of English credit, you risked the transfer of the business of this country to other European centres, if such a catastrophe had occurred as you were on the eve of witnessing. You have escaped from a catastrophe to which the famous catastrophe of Overend & Gurney would have been child's play." How

did we escape? By borrowing three millions from France, one and a-half millions from Russia, and some smaller sums from other quarters—say, five millions altogether, or just half of 1 per cent. of our total bank liabilities. A story like this defies comment.

But we need not go to extreme cases like these to show the insufficiency of our reserves. They are insufficient in ordinary times. I think the main ground for holding that our reserves are inadequate is the extreme sensitiveness of our market and the discount rate to relatively small movements of gold. The Governor of the Bank said a few years ago that an unexpected export of two millions of gold would generally put up the rate of discount one per cent., and, perhaps, two, according to the circumstances. This means a very heavy tax on trade. I suppose there must be about 600 millions usually on loan, in the way of discounts and advances; one per cent. on that is six millions. But that is only a small part of the tax. We have also to take account of the general disturbance of trade and employment. It is hardly possible to exaggerate the losses suffered by such rises in the rate as took place in 1907. There are scores of people to-day who could move a million or many millions of gold if they chose to do so. Is it right that our trade should be exposed to a tax of this kind by reason of such casual operations? Compare the case of France and England in 1907.

Our rate was 7 per cent. in the last quarter of that year, and it was, I believe, an effective market rate. The French rate did not rise above 4 per cent. Quite apart from the question of unemployment, what an advantage is given to the French manufacturer competing with us in a neutral or in our own market! A larger reserve would make our market less sensitive, and this, in brief, is the main reason why a larger reserve must be formed.

Those on whom the expense of providing such an increased reserve would fall are naturally inclined to suggest that our difficulties may be met by other expedients. What possible courses are open in case of monetary stringency? I need not speak of a contraction of accommodation, for this is admittedly bad banking, and the very danger to be avoided. Modern banking has substituted for that the received method of raising the discount rate. This is usually effective, but it is always costly, and these rises in the rate are just what efficient banking arrangements would prevent. Moreover, this device has sometimes failed, and we are not entitled to place absolute reliance upon it. Take the Overend & Gurney crisis. I shall never forget the consternation caused by that collapse, even in a quiet Somersetshire country town. We then had a Bank rate of 10 per cent. The Paris rate was never above 4 per cent. There was a six per cent. difference between the two rates for three months. Yet this failed, for a long time, to attract

gold to London, no doubt because the crisis had caused a general distrust of all English securities. When Gurneys had gone, whose name was good? They did not think that our paper at that time was good enough to lend upon; so that the discount rate had no attractive power, and this example should warn us that we cannot always rely upon drawing or keeping money by this method.[1]

Foreign banks frequently resort to another expedient. They buy gold at a premium. Our Bank rarely does this. It is often said that the Bank is buying gold at a premium when it buys above £3 17s. 9d. an oz., the price fixed by the Act of 1844. But it is not really buying at a premium unless it pays over £3 17s. 10½d. In this latter case, of course, it incurs a loss for the public good. Foreign banks constantly resort to this method. A State bank may well be willing to incur such a loss in order to avoid penalising trade by a rise in the rate of discount. It would not be so reasonable, all things considered,

[1 Not long before the crisis of 1907, a Governor of the Bank was reported to have said that "10 per cent. would draw gold out of the earth." It may be doubted whether this panic rate has ever attracted gold. It certainly did not at the time of the War crisis. Mr. Thomson Hankey, a generation earlier, showed a sounder grasp of the real position. "The Bank knows," he said, "that there may be moments of sudden alarm, when no one is willing to part with ready money *on any terms whatever*." Mr. Hankey, who was for fifty-one years a Director of the Bank, had just steered the market through the 1866 crisis, and spoke from experience. The fact is, that it is just when a reserve is most wanted that the pull of the discount rate is least effective.]

to expect the Bank of England to make similar sacrifices. At any rate, it rarely does.

I need not allude to our power of drawing gold by the sale of bills and securities. I have said that our market is relatively weak in this respect. We are also debarred from placing an export duty, or any other obstacle, legal or moral, on the export of gold. The tradition of the City does not regard this as an open question. But most of the Continental banks can, if they wish, and do, not infrequently, protect their reserves by measures of this sort. They have also, sometimes, resorted to the expedient of gold loans. Of course, that is bad finance; but in emergency it is as open to us as to others. It would, however, only operate slowly; and to make it really effective the money so imported would have to be guaranteed against re-export, as in the very remarkable case of the United States in 1893.

Another expedient, often used in the United States, is the method of collective guarantee by associated banks and collective certification of cheques. We have no regular machinery for such operations here, and I do not think we have ever had cheques collectively certified, though the Baring case illustrates collective guarantee. We might extemporise measures of this sort, but they are open to grave objections. Moreover, they do not always provide the sort of money most needed. There are soaps, I believe,

which "will not wash clothes." These forms of bankers' money "will not pay wages."

Lastly, there is the resource of elastic or emergency note issues, of which the German system provides an excellent example. This may, in certain cases, prove of the greatest service. The peculiar virtue of a note issue, as contrasted with other forms of currency, consists in its elasticity, by which it can be safely used to relieve many periodic and other demands upon our gold resources. But I need not discuss that here, because we are completely cut off from any relief of this kind by the effect of the mechanical Act of 1844. As long as that Act is in force, our note issue is absolutely inextensible, except by the machinery of a Chancellor's letter. Nobody defends the Act now, but to discuss it would raise many issues; and the question of reserve may, at least in the first instance, be best considered apart from the very debatable question of the regulation of the bank note.[1]

On the whole, then, it is clear that our power of dealing with emergencies other than by a rise in the rate of discount is more restricted than that of our neighbours, while our market is infinitely more exposed to attack. Hence, our market is increasingly

[1] It is, of course, true that within the limits of payments made by cheque, an extension of accommodation by the Bank of England may serve the same purpose here as an elastic or emergency note issue does elsewhere. But *only* within these limits. It cannot replace gold for wages or other payments usually made in cash, or for foreign remittance.

sensitive, and the variations in the discount rate so wide in their range as to impose an unnecessary burden on trade. On economic grounds alone, on the mere basis of £ s. d., a substantial increase of the reserve seems required. The economy of cash has been overdone. "We have refined our methods of working until we are spinning a top on a needle-point," as Mr. Pownall tells us.[1] Our present system is not only too expensive, but doubtfully safe.

Practical Measures Indicated.

So far I have spoken with considerable confidence. There is high authority for the statements I have made, and I do not think they will be seriously disputed, at least by experts.

When I come to the question, What practical measures may be taken for improving the situation? I speak with more diffidence. What I will venture to say is only in the way of suggestions, general in their form, leaving details to be arranged by those whose interests are more immediately concerned.

One word may be said, in the first place, on the need of more publicity. Publicity is a great economiser of legislation. Many difficulties would arrange themselves, if the public had access to the facts. This has been recognised as regards company and railway legislation; it is probably equally true of

[1] *Econ. Jour.* Sept. 1899. It is all right as long as the top continues to spin!

banking. There are those who think that if the essential figures were published, public opinion would ensure that the necessary reserve provisions were made. Even those who are not so sanguine will agree that fuller returns are essential. Lord Goschen held, in 1891, that we have an undoubted right to this information, and this right becomes all the stronger, because it is conceivable that the larger banks might trade upon the conviction that they were "too big to be let go." This gives the public a *locus standi*, because it practically throws the burden of responsibility upon the general market.

We have no annual report from the Bank itself.[1] The returns under the Act, invaluable as they are, are more meagre than they used to be, and leave much to be desired. Since 1877 we have no information on a most vital point, the amount of, and the variations in, the bankers' balances. The joint-stock banks give no real information as to the nature of their cash holdings. Cash in hand should be distinguished from money with the Bank, and if there are any sums held in reserve, over and above till money, this might be stated. I need hardly say that the return of the reserve should be an average, not a figure for a particular day. The existing practice is a cause of disturbance in the money market, and

[1] The Bank of France publishes an admirable Report, full of instructive detail, of about 100 pp. 4to. All the great foreign national banks issue similar reports.

not a very creditable proceeding. It would be a great gain if a common form of balance sheet could be adopted, and if we could have more definite specification of the large entry under discounts, advances, and loans. Such information would be of extreme value, and we ought to have it; but, even so, I doubt if publicity alone would meet present requirements. A new departure seems necessary.

I think I may assume that any reserve, to be effective, must be publicly and centrally held, and under single or unified direction. When I say it must be public, I mean that secret hoards have no effect in steadying the market. They cannot inspire confidence in a sceptical world. Again, our main liabilities are central. They fall on the London market, and the resources to meet them must be kept there. I think the control must be in some way unified, because I do not see how you can have a definite and steady discount policy carried out by conflicting and possibly in some degree rival authorities. Hitherto the Bank of England has borne all the brunt, and therefore the question of control has hardly arisen. This is a state of things which can scarcely continue. It was perhaps reasonable when the Bank towered above all the other banking institutions of the country as a cathedral towered above the cottages of a medieval town. But now, just as the cathedrals are often walled up by the surrounding warehouses, so the Bank is almost overlooked by

the soaring joint-stock banks which surround it. Out of the 1,000 millions of liabilities nearly one-half are held by twelve of these banks, some of which hold sixty or seventy millions of deposits.[1] Now, the actual deposits in the Bank of England are not much above fifty millions. How can it be contended that in these new conditions the whole burden of holding an adequate national reserve should be thrown upon the Bank? The question becomes more pertinent when we find that the Bank only divides some 9 per cent., and that its dividend rather declines; whereas some of the joint-stock banks declare much higher dividends, rising in some cases to over 20 per cent. In the face of these figures, and remembering that the Bank does not seriously compete for the profitable country business, nor attempt to attract deposits by allowing interest on them, I think the Bank has done its share in contributing as it does to the national reserve.

On the other hand, the joint-stock banks may fairly demur to leaving more money with the Bank on present lines. Money so left in excess of clearing-house and other current exigencies will not increase the Bank reserve by the sum so left, but only by, say, 45 per cent. of that sum, and it will increase the resources of an institution which they regard as a competitor. This is an argument for constituting

[1 Five clearing banks now hold considerably more than half the total deposits of the United Kingdom.]

a second or emergency reserve out of the contributions of the joint-stock banks. There are, of course, other and very strong arguments for a reserve of this type.

What I feel, then, is that we cannot ask the Bank to do much more than it already does. We may fairly ask it to continue to do as much. But beyond the Bank reserve, our first line of defence, we want a second or emergency reserve, formed by the other banks in the United Kingdom; and I should also like to see a third reserve, against our more serious liability, formed at the expense of the nation. This might be called the war reserve, though its use need not be absolutely limited to war liabilities.

The second or emergency reserve of, say, twenty millions sterling, should only be used in times of pressure. It is hardly for me to suggest the basis on which contributions to it should be assessed. Those concerned are the best judges of such a point. The question of control may well give rise to difference of opinion. It might be under the regulation of a joint committee representing the contributing banks and the Bank of England. It would be far simpler, if the banks saw no objection, to substitute an automatic arrangement. The Bank of England might be allowed to have access to the money in the second reserve on payment of a tax, the proceeds of which would go to the contributing banks. Thus for the first five millions so withdrawn the Bank

might pay a 5 per cent. tax, for the second 6 per cent., for the third 7 per cent., for the fourth 8 per cent. Thus the Bank would only draw from this reserve on condition of establishing successive rises in the rate of discount, otherwise the operation would result in loss. I have long been persuaded that some arrangement of this sort is desirable. On the single reserve system you can never be sure that you will find your reserve when you want it. You cannot prevent those who hold it from trading with it in ordinary times. A second reserve on this system would not be touched till we had a 5 per cent. rate at least, and would not be exhausted till the rate was at least 8 per cent. Opinions may differ as to when relief should begin. The scale suggested was determined by my belief that a rate above 5 per cent. begins to put serious pressure upon trade.

Coming to the Government or national contribution, which we may put, say, at ten millions, I may say that I have always resisted the contention that Government was bound to hold a reserve on savings bank account. I have gone into that question very carefully, and it seems to me that these banks are amply provided against any banking risks. Their operations might conceivably involve the nation in loss, but that is an entirely distinct question. Even in case of a run upon them, due, say, to prolonged depression of trade, the money would only run round the banks; it would not be taken out of

the market. Lord Goschen says emphatically: "The savings banks deposits are of a totally different character to banking or mercantile deposits. There has never been a case that I can remember of the least difficulty, or of having to sell any large amount of securities to meet a run or anything of that kind." [1] It would be more reasonable to tax the insurance companies for such a purpose. The San Francisco fire of 1906 caused demands on our insurance companies, all honourably met, of no less than ten millions sterling. You may search the whole annals of the world's savings bank operations before you will find a disturbance of the money markets which is to be compared with this.

But though it seems to me absurd to suggest that Government should hold a reserve of ten millions against savings bank risks, the cost of which would fall on a class of depositors who are generally of very limited means, I think that such a reserve might very fairly be held against the extraordinary risks of war. I can imagine no greater disturbance than that to which our market would be exposed in the event of war between two first-rate Powers, more especially if this country was itself involved. There would be an enormous creation of new securities, a very heavy fall in existing securities, and a general rush for money.

[1 Even in the War crisis, the net withdrawals only reached £5,000,000, an amount amply covered by Government balances; and the Government always has the resource of making Postal Orders legal tender.]

Not improbably a special attack would have been prepared upon our reserves. Success in the campaign, too, might depend largely upon the quantity of cash we had available at the outset. There would be no question of credit at such a time. Gold, cash down, would be essential. You will remember the purchase of the Chilian ironclads at the time of the Russo-Japanese war. The purchase might conceivably have affected the issue of the naval contest. Purchases of this sort will play an important part on the outbreak of a big war. For this and many other reasons adequate reserves of cash at such a time will be of the very first importance.

Is it too much to ask the nation to hold a reserve of ten millions against an emergency of this kind? The annual loss by way of interest would be £275,000. But there are very considerable offsets to be made against that. The existence of such a fund would help to steady the market, even if it were strictly reserved for war risks. But it is quite possible that in the event of a serious crisis in times of peace, the Bank might be allowed, by Chancellor's letter, to have recourse to this fund as a third reserve. The condition might be the payment of a tax of not less than 9 per cent. Such a resource would have been useful in 1866. In any case the losses caused by money market disturbances are incomparably greater than the cost of the reserves which would prevent these losses. The Government would recover more

than the cost of such a modest reserve out of increased tax revenue.

I have quoted Lord Goschen so often in support of what has been said to-night that it is only fair to say that he was opposed to both the new forms of reserve which I advocate. As regards the second reserve, he objects that there might be difficulties in apportioning the assistance to be given from this fund. Would not banks expect to be helped in proportion to their contributions? With respect, I think not. The objection cuts at the root of every form of insurance. If the assessment were equitable, the relief afforded might be left to adjust itself in the ordinary way through the rise in the discount rate. Banks, like other people, would thus obtain assistance in proportion to the urgency of their need, measured by the rate they were willing to pay. As regards the third or national reserve, Lord Goschen, of course, spoke as Chancellor of the Exchequer, and would *primâ facie* object to any further burdens on the Consolidated Fund. His objection does not take very tangible or definite shape. He says that such a suggestion is "contrary to all our ways. It would be a dangerous power to entrust to any political minister," etc. But observe that the system of relief by a Chancellor's letter exists already, and in a much more questionable form. Why should the proposed scheme be more dangerous? If the intervention of an individual is

not desired, access to the third reserve might be automatic, fixed beforehand, on the principle of a graduated tax. But as the question of war risk is eminently one for the Cabinet, it would seem more natural to leave the control of what was primarily a war reserve to the Minister.

I have merely offered suggestions, rough sketches of arrangements which I think would conduce to greater security, and, for that very reason, to greater economy. It will be said that the contemplated reserve provision is excessive. Yet, all told, the three reserves would be only about equal to that held by the Reichsbank, and no one will pretend that the liabilities of Germany are as great and as pressing as our own. I am well aware, however, that schemes of this magnitude would require very careful criticism from many different points of view, and that any kind of action in this matter is confronted by obstacles not easy to turn. But I must not presume longer on your patience. I will only repeat that the real reserve problem is not merely the bare avoidance of bankruptcy, but the minimising of financial strain. Even the simpler ideal is not always realised, as witness the United States in 1907, and our very narrow escape from a similar collapse in 1890. But our real aim should be to be prepared to meet any probable demand for cash, whether on home or foreign account, in peace or in war, without causing any undue or injurious

pressure on the money market, with the consequent disturbance to trade and employment. We are not in sight of this latter ideal at present; it is doubtful if we are even secured against insolvency. Can we afford to go on in our present happy-go-lucky way, merely on the chance that we shall somehow worry through? Is it quite certain, if we continue to allow our reserves to dwindle in proportion to those of other countries, that we shall retain our position as the international clearing-house, and preserve the high reputation of the London bill, on which so much of our financial pre-eminence depends?

VI.

THE AMERICAN CRISIS OF 1907.[1]

THE theme I have taken as my text this evening is perhaps too large for the limits of a single lecture. It will hardly be possible within these limits to deal adequately with such a colossal disturbance as the American crisis of 1907. An American professor has described this crisis as "the most extensive and prolonged breakdown of the country's credit mechanism which has occurred since the establishment of the National banking system [in 1863]"; and another writer styles it "the biggest slump in the history of the human race." The effects have resounded throughout the whole financial and commercial world, which is still suffering serious depression nearly eighteen months after the collapse, and is likely, I fear, to suffer for many months yet.

A BANKING CRISIS.

But there is one aspect from which this crisis seems specially interesting and instructive. It is a notable

[1] A second lecture to the *Institute of Secretaries*, delivered on March 31st, 1909.

illustration of the importance of the question of banking reserve, upon which I had the pleasure of addressing you last month. I propose to-night to deal with it mainly from this point of view. Speaking broadly, the crisis of 1907 stands out unique among modern crises, and especially in contrast with European crises, as mainly due, not so much to over-trading, or to general over-speculation, as to defective banking. I maintain that this crisis was emphatically a banking crisis; and I entirely agree with Professor Sprague, who, in concluding an admirable account in the *Economic Journal* for September, 1908, sums up the moral of the disaster in the words, "Above all, a more intelligent understanding of the purpose of banking reserves is required." This view has been traversed by high authorities in the City; but the objectors would probably admit that if the American system of banking had been as well organised as the ordinary European system, the crisis need not have taken place, and the liquidation required by the somewhat unsound conditions which prevailed in the eighteen months preceding October 1907, need not have involved the complete paralysis of general credit. This is my case.

To make the point more clear, we must distinguish between financial crisis and trade depression. I am afraid that periods of trade depression are at present inevitable. It used to be supposed that these periods must necessarily be connected with a collapse of

credit. Jevons, as most of you know, tried to make out that a crisis must be expected every ten years; and he attempted to find a physical connection (through the tropical harvests) between financial crises and sun-spots, which recur at about the same interval. Right or wrong, it was a brilliant example of scientific imagination; and Mr. Jevons's son maintains that his father's theory is strengthened by recent physical research.

Now, though that theory may possibly be true with regard to trade depression, it is certainly not true with regard to financial collapse. In England we still have our periods of excitement and depression in trade; but we have had no crisis, properly so-called (though we have had sufficiently narrow escapes), since 1866. Improved banking has enabled us to pass from our booms to our slumps without any general collapse of credit, in which the sound and the unsound are all necessarily involved. This has not been the case in the United States. The financial crisis proper is a regular institution there, and I am afraid it becomes more acute as time goes on. This points to the inadequacy of their banking system.

No doubt a certain strain was put upon the banking system by the abnormal activity of business and the speculative inflation of 1906-7; but there was no reason why the banks, if properly organised, should not have easily met the strain. I do not think it

can be said that the general condition of business was unsound. There had been remarkable developments of production, but they were in the main justified by the demand. Nowhere had this activity been more marked than in the railway world. But the development of the railways can hardly be called speculative. They were unable to carry the traffic that was coming forward. Hundreds of miles of sidings were blocked with cars that could not be got through. "To this day," says Mr. Leppington, "by far the greater portion of railroad mileage in the States is single track. Not long ago complaints were loud of a dearth of freight cars. The companies were devising ambitious schemes for bringing up their equipment to a level capable of coping with the requirements of an era of unprecedented prosperity.[1] Lines were to be doubled and regraded, bridges rebuilt, rolling stock renewed." In the general markets there was no pronounced accumulation of unsold goods, except in the case of coffee; and the small number of business failures arising out of the crisis shows that there was no special commercial weakness. Professor Sprague says, "It would be difficult to find an equally long period of business activity, at the close of which the relative development of different industries would seem to have been similarly satisfactory."

[1] Even in the height of the panic, November, 1907, traffic receipts were 3½ per cent. above those of the previous year.

The financial position was much weaker. This very activity of business, however genuine we may consider it, had made great demands upon the loan markets of the world. Flotations had been overdone, and it was difficult to raise capital by normal methods. Even New York City had to borrow at 4½ per cent., as against London's 3 per cent.; and the railways had resorted to an excessive extent to the doubtful resource of borrowing on short-term bonds. The weakness was most pronounced in regard to Stock Exchange operations. Certain stocks and certain shares, notably copper shares, had been carried to extreme points by means of bank loans; and those loans had been very largely financed from this and other European markets by the agency of the Finance Bill. I admit all that, and I admit the danger of it. Stock Exchange loans are specially liable to give way when banks find it necessary to contract their advances. They can be more easily called in than commercial and international loans, because they are secured by collateral that can be easily realised within the margins imposed on borrowers. If, then, there is a very large amount of Stock Exchange advances out, it is in the power of the banks to bring about a very awkward contraction. The contraction goes on increasing, too, because the first effect is that securities are thrown on the market, and prices are brought down; and then, margins running off, further blocks must be sold, and the position grows

steadily worse. But these Stock Exchange advances had been considerably reduced long before September 1907, and the prices of stocks were in many cases lower at the time when the panic set in than they are to-day. Messrs. Henry Clews & Co., in their circular for August 1907, while pointing out that the bank reserves needed strengthening in view of autumnal demands, observe that the security market had already had a severe shrinkage, and that, "beyond question, many good securities are selling below intrinsic values." The Stock Exchange position, if still artificial, ought not to have been unmanageable.

In short, I entirely accept the judgment of Professor Sprague, who writes that, "nothing in the general economic conditions of the country has been disclosed, either during the crisis or in the subsequent months of depression, which can be regarded as so hopelessly unsound as to have rendered the explosion of last autumn (1907) clearly unavoidable."

It has sometimes happened that where the conditions were otherwise satisfactory, a crisis has been caused by a sudden and unexpected withdrawal of gold from a country. This was certainly not the case with this particular crisis. There was no scarcity either of monetary or purely metallic resources. Credits had grown apace, but the monetary basis of the credit was not unduly small. In the eleven years,

1895-1906, the American banks and Treasury combined are estimated to have increased their gold holding by about two hundred millions, and just before the panic of October 1907, the stock of gold was estimated at £305,000,000. Their position, both in legal tender money and gold, was much stronger than ours. In December 1907, the National banks held legal tender to the extent of 16·7 per cent. of their deposits; the State banks, 8·28 per cent.; the Loan and Trust Companies, 5 per cent.—an average for the whole of about 11·3 per cent., of course excluding Savings Banks. On the same basis, our best showing would not be over 6 per cent.; or, if we are to exclude the Bank of England, as corresponding in some degree with the United States Treasury, not more than 5 per cent. If we take the monetary stock per head of population, the United States banks held £7½ of legal tender per head, as against our £4. Passing to the pure gold holding, the position is still better than our own. The United States banks held 6 per cent. of their deposit liabilities in gold, including certificates represented by bar gold, excluding the Treasury holding, against our 3 per cent. excluding the Bank of England, or 4 per cent. including it. Moreover, it must be remembered that there is no demand for gold as circulation in the United States, the currency being almost exclusively paper. I have only been in the United States once; but during the two months I was on that side of the Atlantic, I

only once saw a United States gold coin. It was shown me as a curiosity. Such gold as they have is, therefore, all available for banking purposes. Further, the panic and the drain being entirely for internal purposes, any form of legal tender would be as serviceable as gold. In this respect our own case is more difficult. Our difficulties are likely to arise from a foreign drain, and could only be met by gold. Then we must not pass over the holdings of the United States Treasury, though the extent to which they will be available is always uncertain. In the August preceding the crisis, the Treasury held something like £354,000,000 of gold; and, although that was largely trust money, money held against various forms of legal tender, and earmarked in fact for currency purposes, yet much of this was not absolutely necessary to be held, and might have been used in case of necessity as our own issue reserve has been drawn upon at such times. But quite apart from this, there was a free reserve in the Treasury of over sixty-six millions sterling, not trust money or earmarked in any way (except that thirty millions is held to guarantee currency parity), which the Treasury might, if it thought proper, have used to assist the banks.

It seems clear, then, that the weakness did not lie in the monetary position. Their case was the reverse of our own. We make the utmost of our little monetary store, except in so far as we are obstructed by

the Act of 1844. But it is quite inadequate in amount. They had ample monetary resources, but could not make effective use of them. The fault lay partly in their banking system, and partly in the banking habits generated by that system. These faults were matter of notoriety. They had often been pointed out, both at home and abroad; and the breakdown of the system had been predicted. For over twenty years I have been accustomed to use the American reserve law as the classical example of mistaken banking legislation. The Special Currency Committee of the New York Chamber, in October 1906, pointed out the want of elasticity in the currency, and recommended a central bank of issue, dealing exclusively with banks, and controlled by the Government. But Americans are like Englishmen. As long as they can make money, they have no time for anything else. Reforms have to wait till times are bad. Mr. Secretary Shaw, in proposing his emergency issue, September 28th, 1905, said: "He was convinced that there would be no further currency legislation until there was a panic occasioned by the want of elasticity. The country did not appreciate the danger, and until the danger was fully understood no remedy would be applied." Mr. Shaw was right. The panic came, and, immediately after the panic, you had the Aldrich-Vreeland Act of 1908. In March 1907, Mr. Rozenraad, noticing the introduction of a forerunner of this Act, the Aldrich

Currency Bill, remarked that "the measure, good as it seemed to be, would only temporarily ease the New York money market. In the long run it would be found that a complete reorganisation of the existing banking system would be necessary." Mr. Hermann Schmidt put the case more strongly. After criticising our own Bank Act, he said, "After all, England is scientific compared to the United States. There everything is topsy-turvydom, at least according to European ideas. They have no national bank, no central reserve fund, only the 15 to 25 per cent. of the deposits legally prescribed. The result is periodical crisis, when they have to go to the Treasury for assistance—the trade of the whole country dependent upon the decision of a single individual—about the worst situation possible."

But I must describe this American system, and you may form your own judgment as to the extent to which it was responsible for the crisis. Some account of it is all the more necessary, because it differs so much from our own and from most European systems.

The United States Banking System.

As a basis for a contrast between the United States banking system and our own, let me take the *Report of the Comptroller of the Currency, December* 1907, which gives the position up to the June preceding the

panic. The main figures are found in the table here reproduced:

	Currency.	Deposits.	Percentage Reserve.
	Millions.	Millions.	
6,429 National Banks - -	$722	$4,323	16·7
9,967 State Banks - -	254	3,068	8·28
794 Loan and Trust Companies - - -	102	2,062	4·93
1,415 Savings Banks - -	27	3,495	0·78
1,141 Private Banks - -	9	151	5·76
19,746 Banks - - -	$1,114	$13,099	8·5

Taking round figures, there are (including savings banks) nearly 20,000 different and independent banks in the United States, with, say, 225 millions sterling of currency, and 2,620 millions sterling of deposits. Omitting savings banks, you get 18⅓ thousand banks, with nearly 200 millions sterling of currency, and 1,920 millions sterling of deposits. The deposits in the English banks are almost exactly half this amount. But the United States population is just double our own; hence the deposits per head are the same. Against these deposits the United States banks hold 12 per cent. reserve, as against our 5 per cent. or 6 per cent. (including till-money in each, and allowing for redeposited reserves). The total resources of these banks are put at £1,600,000,000 for the National banks, £800,000,000 for the State banks, and £800,000,000 for the Trust companies—a total

of £3,200,000,000, against about £1,150,000,000 for the banks of the United Kingdom. Allowing for the difference in population, the assets are about 50 per cent. larger per head in the United States than in the United Kingdom.

The contrast in the number of banks is very remarkable. Mr.[1] Palgrave puts the total for the United Kingdom at 182; one hundred of these have no branches, and only the eighty-nine which publish accounts can be regarded as important. Even in this number are included army agents, and some institutions which are mainly discount houses. Mr. Boissevain puts the number of effective banks at seventy-four. But the total number of bank offices, including head offices, is 7,753. This works out at about fifty per cent. fewer offices per head of population than in the United States, where, of course, the population is more scattered. [The 108 foreign and colonial banks are excluded from this calculation.] The banks of the United Kingdom are now nearly all of them organised upon the Scottish or branch bank type. "There are four banks in England and Wales which alone direct more offices than all the banks in the whole of the United Kingdom possessed among them half a century since"—(Mr. Palgrave). Lloyds, the London City and Midland, Barclays, and Capital and Counties control 2,070 offices. The whole United Kingdom only had 2,008 bank offices in 1858.

[1 Now Sir Inglis Palgrave.]

Now, speaking broadly, American banks have no branches. They are forbidden in a great many States, and forbidden under the National Bank Act. I need hardly add that some of the separate banks in the United States are extremely small.

But there are many different kinds of United States banks, and I must say a word on the different types. You have, in the first place, some 6,500 National Banks. These all come under the National Bank Act, passed in 1863-4, and frequently amended. By conforming to the provisions of this Act they obtain the right of note issue, and certain other privileges. Then you have nearly ten thousand State banks, coming under the laws of the respective States, not always the same. These banks are not allowed to issue notes, and they are smaller, as a rule, than the National Banks. Then you have the important group called loan and trust companies, intimately connected, as we shall find, with the origin of the crisis of 1907. These must not be confused with the great commercial trusts we are so familiar with, such as the Standard Oil Company, the Steel Corporation, and the like. They are rather trustee companies; but they have added to their trustee business the functions of banking, just as our English banks are beginning to add the work of trustee companies to their banking business. They have been happily described by M. Arthur Raffalovitch as "financial maids-of-all-work," generals, in the civilian sense of that word. Their primary

function was to take charge of securities, and to receive deposits as savings banks; then they undertook the execution of trusts of all kinds, much as our Official Trustee does; and to this they added the examination of titles, the care of real estate, fidelity insurance, and lastly, the practice of limited banking.[1] They are not subject to the regulations imposed upon the National Banks.

As to the savings banks, I need only say that they are entitled to demand from thirty to sixty days' notice of withdrawal of deposits. That is a most valuable right at a time of panic, and not an unreasonable one when it is remembered that American panics are constantly accompanied by a premium on currency, so that it becomes a mere matter of interest for depositors, whether alarmed or not, to withdraw all the deposits they can control.

Over all these institutions, and at times in very vital relation to them, stands the Treasury of the United States. It is rather difficult to explain this in terms of European institutions. There is nothing exactly like it in Europe. But it is in the main a currency, rather than a banking institution; it is more like the Issue Department of our Bank of England than like its Banking Department, except, of course, that it holds the Government account. In this respect it exercises banking functions, and it is

[1] See Mr. Charles E. Smith, Congress of American Bankers, 24th September, 1907.

this side of its operations which is most disturbing to the money market, and most open to criticism. Its funds necessarily vary with the Government balances. At times it becomes possessed of large sums of money, drawn off the market by the collection of taxes, and, unless it can get rid of these surplus reserves, its operations cause a monetary stringency. But it has no regular and normal means of getting rid of this money, because it is not part of the general banking system. It can only be redistributed if the Secretary of the Treasury thinks fit to deposit moneys in the National banks on Government account. In doing this, the Secretary of the Treasury acts in something like the way in which our Chancellors of Exchequer have acted in times of crisis, when they have authorised the Bank to have access to the Issue Reserve. There is something arbitrary and artificial about this procedure which unfits it for normal use, and has made some persons object to resort to it in any case. No charges, so far as I know, have ever been brought against the absolute impartiality of the Secretaries of the Treasury in this action; but still it is not easy to defend a system which puts into the hands of a single individual the power of making money dear or cheap, of throwing twenty millions on the market or withholding it, as seems to him fit.

The primary business of the Treasury is to guarantee the parity of all the various forms of money in the United States. It is a first principle with the United

States, in which all parties, whatever their monetary policies, have always agreed, that a dollar shall always be a dollar. That is to say, whether payment is made in silver dollars, gold coin, gold certificates, greenbacks, or National bank notes, all are agreed that there shall be no discount or premium as between the different forms of legal payment. Even their subsidiary money can be exchanged for full legal tender money. I am bound to say that they have been most successful in carrying this out. I have never heard of any premium or discount on any special form of their money. We have not been so successful with our silver, which is often sold at a discount. This business of keeping all the moneys of the United States at parity is the duty of the Treasury. Its huge reserves are maintained chiefly for this purpose, and the redemption fund by which it is able to guarantee payment of National bank notes in case of the failure of any bank may be ranked under the same head.

Character of the Banks: The Reserve Law.

After this sketch of the United States banking system, I come to consider the character of the banks and the reserve law. Here is an account from our *Bankers' Magazine*, February, 1903: "Each of the American banks is self-centred, with its own system of administration, its own reserve of specie and legal

tender notes, and, in the case of the National banks, with its own note issue. These banks are established sometimes in very small towns, it may be said, almost in villages. It is a marvellous proof of the natural business ability of the citizens of the United States that such a number of banks can be successfully carried on." The National Bank Act of 1900, which somewhat relaxed the limits imposed by the original Act of 1864, permitted the establishment of banks in places of less than three thousand inhabitants, with a capital as small as £5,000. The Act greatly stimulated the formation of National banks; but it is clear that many of them must be very small, not large enough to be the principal business interest of those who own and manage them. Of late years there seems to have been an increasing tendency to obtain control of banks, in order to further private interests. Except as regards this latter point, the system of banking in the country districts of the United States strongly resembles the condition of English banking before the rise of the joint-stock banks, that is to say, in what we consider our worst period of banking. Of course, the large National banks in New York and the other central reserve cities are more like our great joint-stock banks in the magnitude of their operations, but they have no branches, and no connecting link in a central bank. To a European it seems obvious that it would be better if the whole system were organised, consolidated,

and unified, and if the system of branch banking was adopted. But American public opinion appears to be opposed to such a change. We are told by high authorities that the acceptance of branch banking is unlikely. Americans tell me that the small local bank is of more use to the business man. It is more ready to accommodate him. It takes business risks in a way that the great joint-stock bank, with its hard and fast rules, and its five hundred offices uniformly governed from the head office will not and could not do. Well, we are not unfamiliar with this view, even in England. We can understand and respect it. The English form of joint-stock banking is safer and more conservative, but something is lost, perhaps, in exchange for the greater stability. There are those who regret the old private banks, though I, for one, think our modern system necessary, in view of the increasing complications of the money market.

Now I come to the reserve law, which has been at the bottom of the trouble in more ways than one. For the purpose of this law the National banks are divided into three groups : country banks, city banks, and central reserve city banks. City banks are required to keep as reserve against their deposits 25 per cent. of legal tender money ; country banks, 15 per cent. I suppose this was only intended as a minimum limit, but, as so often happens in legislation, what was intended as a minimum tends to

become a maximum. As a matter of fact, the banks trade very close to the 25 per cent. limit in normal times, and when difficulty arises they are soon forced down to it, and then they suspend further accommodation, and the difficulty becomes acute. The reserve, though a good asset in case of liquidation, is no good so long as the bank is a going concern. It is useless for banking purposes. That would be bad in any case, but what makes it worse is that the banks are allowed to reinvest portions of their reserves. The country banks may deposit three-fifths of their reserves with the banks in the reserve cities; and the banks in the cities may deposit half of their reserves with the banks in the central reserve cities. There are forty reserve cities, and three central reserve cities, viz.: New York, Chicago, and St. Louis. Something very similar existed here before the great amalgamations. The country banks invested their reserves with their London agents, the London agents invested theirs with the Bank. We have got rid of one stage of this system for diminishing the ultimate reserve. It exists in full force in the United States. The following illustration, given by Mr. D. R. Forgan, of Chicago, will serve to show how it works out in practice:

"The law requires a National bank in Troy, N.Y., to carry 15 per cent. reserve. Only 6 per cent., however, need be in its own vault. The other 9 per cent. may be with its reserve agent in New York City.

If the deposits of the Troy bank are $1,000,000, it keeps $60,000 at home and $90,000 in New York. The $90,000 in New York, however, is not money. It is merely a credit on the books of the New York bank against which a reserve (allowing for legal deductions) of not more than $20,000 is kept by the New York bank.

"When the Troy bank, becoming alarmed, deems it prudent to have a larger proportion of its reserve at home, it telegraphs the New York correspondent to send it, say, $20,000. That does not seem an unreasonable request to the Troy banker—only $20,000 out of $90,000. But when the Troy bank withdraws $20,000, it withdraws all the reserve there is in the world against its deposits except what is in its own safe; and the New York bank is left with a credit on its books of $70,000, against which no reserve now exists. When that transaction is multiplied by thousands and becomes general, it is simply an impossibility for the New York bank to stand it." [1]

A single institution in New York lately carried fifteen millions sterling of interior bank reserves. In October 1907, out of the total reserves of 6,178 country banks, eighty-five millions sterling was deposited in distant banks, and only some forty millions sterling kept in hand as cash. Many American authorities

[1] Mr. D. R. Forgan, *Chicago*, quoted by Mr. Alex. D. Noyes, *Bankers' Magazine*, March, 1908.

think that these rights of redepositing reserves ought to be restricted; it is also suggested that the city banks ought not to be allowed to pay interest on bank deposits, which would check the practice. But, as things are, it is clear that the central reserve cities are liable to a very dangerous drain; and that is exactly what happened at the time of the crisis.

I have spoken of certain points in the United States system which seem to be open to criticism. But it has its good points. The statistical information is all that can be desired. The returns are very full, and apparently universally made by all the banks. Mr.[1] Holden, in a very interesting paper on the depreciation of securities, observes that the statistics of the United States and Canada are the only statistics from which we can get complete comparisons as to the relative reserve position in different years, and that the absence of such figures for English banks was a matter to be regretted. Then, the holding of cash by the United States banks is another strong point; I need not repeat the figures already given as to this. Their position is at least twice as strong as our own in this respect, even apart from the huge holdings of their Treasury.

What does this all point to? The moral has been well expressed by Mr. Boissevain, who sums up a very careful estimate in his valuable study of *Money and Banking in the United States* in words worth

[1] Now Sir Edward Holden.

quoting: "It cannot fail to strike us that the material foundations on which the banking fabric is built up in the United States need not be considered in any way inferior to those of the United Kingdom, nay, in more than one respect are even firmer. And yet it cannot be gainsaid that whilst, broadly speaking, the English banking system may be held up as an example of a strong and efficient organisation, the banking system of the United States, on the other hand, has been proved to suffer from grave defects, and in case of emergency to be entirely inadequate."

The nature of these defects will appear very clearly if we glance at the history of the recent crisis.

History of the Crisis.

Trade in 1906 had been exceptionally active, though one cannot say that the development was not warranted. But the resources of the market had certainly been strained. Private extravagance had caused a shortage in the supply of loan capital; indeed, Mr. Noyes[1] says that "a surprisingly large portion of the community had got into debt for its private expenditure." The worst feature in the general situation was the extent to which speculation had been carried by Wall Street and Chicago operators. Ex-Secretary Cortelyou declared that

[1] "A Retrospect of the American Panic," *Bankers' Magazine*, March, 1908.

"the *crux* of the situation was that the bankers of New York had been using the vast deposits from every quarter of the United States to finance operations on the Stock Exchange." The result was the so-called "Harriman boom," in which record prices had been manipulated. The severe stringency of the autumn of 1906 had brought prices nearer to normal figures, especially in the third quarter of 1907, but there had been no adequate liquidation. To quote Mr. Noyes: "This extravagant speculation, coming on top of a general strain on local capital resources, had made possible a situation where at least $400,000,000 of interior bank money was borrowed by New York, and certainly as much more of European capital, provided by the Continental bankers in a measure, but chiefly by the London banks, in their remarkable infatuation of 1906 regarding the American situation. When the Bank of England put its foot down, towards the end of 1906, and forced the London banks to abandon their policy of indefinite expansion of credit to America, the resources behind this abnormal use of credit began to disappear, but the indebtedness remained. Only, it had to be assumed by our own banks. Similarly, toward the middle of the year, the Western capital placed in New York began to go home again. The consequences of such a movement, under such circumstances, are not difficult to understand." It was in a situation thus strained, and requiring the most careful handling, that certain

special abuses became notorious, completely destroyed public confidence in the banks, and precipitated the worst crisis of our time. I cannot better describe these events than by summarising for you the graphic account given by Professor Sprague in the article to which I have already referred.

The immediate origin of the crisis may be traced to the failure of certain brokerage firms on October 16th, 1907, who had been attempting to corner the stock of a copper company. Mr. F. A. Heinze's brother was involved. Now, Mr. Heinze controlled the stock of the Mercantile National Bank, of which he was president; and the resources of this bank were used to further his copper speculations. Distrust naturally set in, and deposits were withdrawn. The Clearing House intervened, Mr. Heinze resigned, and the bank was reorganised, thereafter causing no disturbance. But another director of this bank, Mr. C. F. Morse, who was a director of seven banks, of which he completely controlled three, seems to have become suspect; and, on the 19th October, two of these banks had to appeal to the Clearing House. Assistance was granted on condition of the retirement of Mr. Morse and others. Two millions sterling were at once put up, and this difficulty was disposed of by October 21st. The total deposits of these banks were only six millions sterling.

The fundamental weakness illustrated by these early episodes of the crisis was the fact that it was

not unusual for a few capitalists, of no great standing, actively engaged in speculative industrial schemes of their own, to gain control of a group of banks, through stock-ownership on a margin. Shares sufficient to give a controlling interest in a bank were bought; they were then pawned, and another controlling interest was bought with the money raised; and so on, until a whole chain of banks was controlled by quite a moderate capital. This practice had been known to exist for more than six years past, according to a statement in *The Nation*. The possibilities of danger involved were obvious; but so far the banks had acted vigorously and promptly, and the disturbance seemed to be localised.

The real difficulties began the next week in connection with certain trust companies. These companies, as I have said, were not subject to National bank law. The Clearing House attempted to impose conditions on them; but, sooner than submit, most of them left the clearing. It was the troubles of one of those which remained, the Knickerbocker Trust, that brought on the second stage of the crisis. Its president, it may be noted, was associated with the Morse enterprises. On Monday, October 21st, the National Bank of Commerce refused to continue clearing for this trust. Next day the company had to suspend, but not before it had paid out £1,600,000, nearly one-seventh of its total deposits. It is said that this bank might have been saved; and that,

if it had been, the crisis would have been averted. It reopened in March, 1908, so that its affairs could hardly have been hopeless. But there is a general irrepressibility about American banks. It used to be said of our country banks that, like cats, they had nine lives. The same perverse and inexplicable vitality seems characteristic of their American counterparts. The whole system suspends payment for over two months, and then resumes as if nothing had happened. The suspension of this bank, however, proved to be critical. The next Wednesday, October 23rd, a run began on the Trust Company of North America, the second in size of these companies, with deposits of £13,000,000. The president of the Knickerbocker Trust was one of its directors. It paid out over four millions in two days; and in two weeks nearly seven millions, or more than half its deposits. During the first two days New York was threatened with a general panic. There were a few small bank failures, loans were almost unobtainable, and the fall in stock exchange prices was alarmingly violent. The trust was ultimately assisted, after an examination by a committee of trust presidents, and a transfer of the control; but action was unduly slow. It will be observed that in cases where assistance was given, it was considered necessary to change the control.

The strain on the New York clearing bankers was very severe. The trust and the country reserves were placed with them, and they had to find the

money, and at the same time to move the crops. Some writers have complained that New York also had to finance Canada; but this was the natural consequence of their habit of holding the call money of the Canadian banks.[1] On the other hand, they received £5,000,000 of Government deposits, with the result that their loss for the critical week ending October 26th was only £2,750,000, and they still held a reserve of £52,000,000.

The worst was over so far as New York was concerned. Savings banks insisted on the sixty days' notice, and withdrawals of deposits diminished. Clearing House loan certificates were issued. Before this, brokers could get no money at call. One bank would be afraid to lend, because it did not know whether others would assist. But as the local troubles began to subside, the panic spread to the country, and New York, as the chief reserve centre, continued to feel the strain. The failure of the Westinghouse companies seems to have been the occasion of the new development. Unable to renew floating indebtedness, they went into the hands of receivers. The Pittsburg Stock Exchange closed; there were runs on banks in Montana and Nevada; and upon a trust company in Rhode Island, with deposits of £5,000,000.

[1] The Canadian banks do not appear to draw more than £3,000,000 as a rule on their foreign bank balances and call money in the autumn. The movement of the Canadian crops is mainly financed through bills against exports. The necessary circulation is provided by an extra issue of some £3,000,000 or £4,000,000 of notes.

All of these were obliged to suspend payment. There was a general lack of confidence in the banks, such as we have not seen in England since 1826. It was not without foundation. "Seven times during the last century the banks suspended payment in some measure at least, and there has been a currency premium, the last, in 1893. There is a well-grounded belief among the people that it will be difficult to secure cash during periods of economic disturbance." Hence hoarding sets in, partly for the absolute needs of business, *partly to secure the premium*, "an ever-present source of weakness." This, by the way, shows the extreme danger of permitting these habitual suspensions, with currency premiums as their inevitable consequence.

The banks do not seem to have seriously attempted to weather the run which now set in. During the fortnight ending November 2nd, the New York banks had sent £8,500,000 to interior banks. But they had engaged £6,000,000 from Europe, with more in prospect; and their reserve was still £45,000,000, an amount which we should think very large. However, they had already ceased to pay depositors except at their own discretion. On October 31st, 3 per cent. was paid for currency in New York, and a premium of varying amount, sometimes over 4 per cent., continued till the close of the year. Not only individuals, but corporations and banks, had to buy money at the premium with certified cheques. The

New York banks reserve figures show how little help the banks gave. From November 2nd to November 23rd their reserves only diminished by some £2,000,000; after November 23rd, they increased week by week, until they had reached over £50,000,000, when the premium disappeared. In striking contrast to this, we find the reserve of the Bank of England dropping from £24,000,000 to £17,000,000 in the first fortnight of this period, and of course without a thought of suspension. Thus, in Professor Sprague's words, with which it is not easy to disagree, "the New York banks proved themselves wholly unequal to the duties of their position as the central reserve banks of the country."

It may be conceded that the general anticipation of a premium on currency made the position very difficult for them. But they seem to have found their main excuse for inaction in the Reserve Law; and, strange to say, this excuse was generally accepted by American public opinion. As soon as the reserves fell below the limits laid down by the Reserve Law, they felt justified in suspending payment. At the worst point they were £11,000,000 below the legal limit; but they had restricted payment long before this point was reached; and even at the worst they held £45,000,000 odd of reserve. Now, the only penalty provided by the law was that the Comptroller of the Currency *may* close a bank which has exceeded the legal limit. But he can only do this

after due notification, and thirty days' grace are allowed the bank, after notice, to bring its reserve up to the legal requirement. It is practically certain that at such a time the Comptroller would have ignored any breach of the law brought about by carefully considered and organised assistance on the part of the banks. Apparently, the requisite organisation did not exist, and individual banks were afraid to act on their own initiative. Suspension was really resorted to as a precautionary measure before any serious runs had been made on the system as a whole. When the reserve movements are studied in detail, it appears that as between August 22nd and December 3rd, 1907, the country banks increased their holdings by more than half the sums lost by the reserve banks; and probably the Trust companies and State banks absorbed the other half. At any rate, we have the astonishing fact that the banking system as a whole held more cash at the end of a two months' panic than at the beginning. It is an axiom in Europe that the only way to allay a panic is to pay out freely at the outset. The American banks actually hoarded.

Hoarding, indeed, was one of the most characteristic features of the crisis. The Secretary of the Treasury estimated that £60,000,000 had disappeared from the usual channels of currency into hoards; Mr. Noyes thinks £20,000,000 was hoarded in New York city alone. "This money was locked up in

the space of a very few weeks, and the greater part of it in the space of a few days." A striking incident was the demand for safe deposit boxes. Thirty-three companies in New York, from Tuesday to Friday, October 22nd-25th, let out 789 safes, or six times their usual number. Nine companies suddenly increased their lettings from 40 to 228. These companies said that most of the hoarding among their customers was done by business men and manufacturers who drew the money for immediate use for pay-roll and wage disbursements. The suspension of the banks soon put a stop to hoarding, as far as the public was concerned; and in many cities, *e.g.* San Francisco and St. Louis, the safe deposit companies agreed to rent no more boxes for any purpose. But the banks were hoarding all the time. Many of the country banks, only required by law to hold 6 per cent. of their deposits as cash in hand, were actually holding more than 15 per cent. The country reserves of cash were generally much higher on December 3rd than on August 22nd. Professor Andrew says that "a large proportion of banks outside of the three central reserve cities had accumulated excessive reserves of cash during the weeks when the panic was imminent, and then had protected their holdings from withdrawal in the course of the panic by the partial suspension of payments generally agreed upon throughout the country." The country banks increased their cash holdings from £40,000,000

to nearly £50,000,000 during the crisis; the banks in the forty reserve cities lost £5,600,000, but were still above the legal minimum; the only banks below the minimum were those of the central reserve cities. The New York national banks, however, held nearly 22 per cent. reserve. It was all very cautious, but it was not banking.

It is noteworthy that the banks were officially encouraged, even instigated, to suspend payment. The governors of many Western States actually declared legal holidays, which put a stop, of course, to all monetary claims. In the State of Oregon these holidays were proclaimed continuously from October 28th to December 14th, and in California from October 31st to December 21st. Incidentally, this suspended the operations of the courts, and until Acts were passed differentiating between a judicial and a financial holiday all judicial business was at a standstill.

The effects of all this on the public convenience can be imagined. Perhaps the Stock Exchange suffered most. "Call money reached 100 per cent. and even 125 per cent., and was difficult to obtain at those figures" [*The Times* Review of 1907]. Currency was at a premium from October 31st. Even banks were known to have paid over 4 per cent. for currency. A curious case was given by the *Daily Graphic* of November 22nd: "One of the banks at Boston has entered into a contract to pay a premium of $48 per $1,000 for the gate receipts at the football

match between Harvard and Yale, to be played there next Saturday." (If rumour is to be trusted, there are English banks who would pay a premium to be rid of some of the gate-money that came into their hands last year!) But at that time money could not always be obtained, even at the premium. A newspaper correspondent, whose bankers had suspended payment, found his gas bill due for $10. He begged for time to pay, but was met by a threat to cut off the gas. An American senator, who had occasion to go from New York to San Francisco, told me that he could only get from his bank enough to pay his railway fare. He arrived at his hotel an absolute pauper, and had to beg board, lodging, and pocket-money from his host. These things were inconvenient; the really grave side of the situation was the difficulty of paying wages and maintaining employment. The Steel Corporation paid 80 per cent. of its weekly wage bill by cheque. Cash was at 5 per cent. premium in Pittsburg; and within fifty miles of the city fifty thousand men had been discharged.

To meet the scarcity of money all manner of irregular, not to say illegal, issues of currency were made, amounting altogether, as Professor Andrew estimates, to something like £100,000,000. The United States are past masters in the art of currency extemporisation. More than £50,000,000 of Clearing House certificates were issued; £5,000,000 of small denomination, meant to go into currency. Besides

this, there were some £3,000,000 of Clearing House cheques, and large amounts of cashiers' cheques, manufacturers' pay cheques, and other forms of currency issued by individual banks. "Most of this currency," says Professor Andrew, "was illegal, but no one thought of prosecuting or interfering with its issuers. Much of it was subject to a 10 per cent. tax, but no one thought of collecting the tax. In plain language, it was an inconvertible paper money issued without the sanction of law."

Meanwhile the Federal authorities were doing their share. The Treasury made a Panama bond issue, for the express purpose of enabling the National banks to extend their note circulation, the money subscribed for the bonds being largely redeposited with the banks by the Treasury. This expedient does not seem to have been a success. Mr. Noyes says: "As for the Treasury's actual effort at relief, through note and bond issues, nothing could have been worse. Let no reader deceive himself into imagining that they helped the situation. On the contrary, they complicated it: and when it was found that the banks themselves were frightened at the prospect of paying over their reserve money for the new Government securities, when only 75 per cent. to 90 per cent. of the cash subscribed would be redeposited, the Treasury itself had to call a halt. As is now generally known, only $24,631,000 out of the $50,000,000 of 2 per cent. bonds offered on

November 17th were sold, and only $15,436,000 of the $100,000,000 offer of 3 per cent. notes. The issue was stopped by the Government chiefly because of the protest of the banks themselves against it."

Large additions, too, were made to gold resources. All the United States mints, according to a *Times* cable of November 2nd, were working day and night coining money to meet the currency demand. The Board of Trade estimated that just before Christmas 1907, when the drain ceased, £18,000,000 had been withdrawn from London on United States account; "a conservative estimate," Mr. Leppington says. Here we may note that the premium on currency had its good side. It enabled New York to import gold against an unfavourable exchange. During November 1907, the exchange on London was almost constantly above the normal gold *export* point. Yet about £13,000,000 of gold were actually *imported* into the United States in that month from England and elsewhere. It is a minor point, but it is curious to observe that these large shipments of gold raised the cost of transmitting gold, and therefore raised the gold point of exchange. According to *The Times* of November 1st, the rate rose from 1s. per cent. to 7s. 6d., and even as high as 12s. 6d. later. The explanation seems to be partly that the cost of insurance rose, owing to the large consignments of gold going out in a single vessel (the *Lusitania*).[1] This gold is

[1] Now world-historical.]

only just returning to England. The shipment of £280,000 to the London City and Midland Bank, and other shipments received about the same time, estimated to amount to nearly a million sterling, were said to be the first made direct to this country from New York since June, 1907. I see we are getting a large shipment of eagles this week, and the Bank reserve is rapidly improving.

I cannot pretend to follow out the effects of the crisis to-night. They are world-wide in their range and are far from exhausted yet. My interest is rather in the causes which provoked and aggravated it. But I may note some of the immediate results. Monsieur Théry estimates the total failures in the United States as about £90,000,000, the trading failures amounting to more than £40,000,000, and the bank failures to nearly £50,000,000. In New York State alone twelve banks failed for £20,000,000. According to the *Railway Magazine*, March 1909, "no less than twenty-three railroads went under, the aggregate mileage of the lines being over eight thousand miles. The funded debit of the defaulting roads was well over £54,000,000, whilst the stock capital exceeded £65,000,000—hence the interest on about £120,000,000 of capital was in default." Still the United States railways have seen worse times. The slump in securities was perhaps unprecedented, though much of it had taken place before the crisis of 1907 broke out. Some of the largest railway stocks

fell fifty per cent., many more from twenty to thirty per cent.; and the total fall in the securities listed on the New York Stock Exchange is estimated at £1,000,000,000. This fall bore no relation to movements in intrinsic values; it was almost entirely due to monetary causes, and the greater part of it has already been recovered. I have not time to discuss the most important consequences of the panic—I mean the enormous increase of unemployment, and the general disturbance of trade. But I should imagine that the damage sustained by the world through the general industrial dislocation was at least ten times as large as the part of it represented by actual failures in the United States. The Unions reported thirty-four per cent. of their members as out of work in December 1907, as against 12·8 per cent. in December 1906, when they were also suffering from financial stringency. Six hundred thousand steerage passengers went eastward in the winter. There are always a certain number who go eastward at that season, but this was more than double the usual number. On April 7th, 1908, it was estimated that no less than 4,750,000 mechanics and labourers (not including agricultural hands) were out of work in the United States; that is, about twenty per cent. of the total male adult population; 750,000 in New York State alone. It is difficult to realise, impossible to exaggerate, the mass of misery implied by these figures. If it is the case, as I certainly think it is the

case, that the greater part of this wreckage was preventible, it must clearly be the duty of all concerned to discover and apply the necessary remedies.

Remedial Legislation.

In considering remedial measures, the first place is due to those proposed by the American authorities. The actual life of a nation, and the practical working of its institutions, are so complicated by inheritance of past experience and tradition, and so coloured by the special genius of the people, that it is rarely possible for foreigners to form a sound judgment as to the precise forms which any necessary developments should take. As against this, the foreigner may have a certain advantage in his detachment from national customs; and he may be permitted to say how the situation strikes him from his outside point of view. The experience of his own country in dealing with problems not essentially different will inevitably provoke suggestions; and if these are made in the more general sense, leaving questions of detail for the national expert, they may not be altogether impertinent and valueless.

First, then, let me note the trend of the reforms proposed, and the legislation actually put into force, in the United States. The majority of reformers have sought in one way or another to extend the note issue, and especially to make it more elastic. It would seem

that they feel the rigidity of the reserve law, and seek to compensate it by giving elasticity to the currency. Others fix on the redepositing of the reserves as a main source of weakness, and propose various methods of checking this practice. Others, again, aim at encouraging banks to organise; and, finally, there are some who advocate a Central Bank, though they seem doubtful whether the proposal would be acceptable.

Special interest attaches to the first and only important legislation passed since the crisis, which may be taken as some index to the points on which reform was felt to be most urgently needed. As Mr. Shaw had predicted, the panic was hardly over before a temporary measure was under discussion. This took the shape of a compromise, the Aldrich-Vreeland Bill, which passed May 30th, 1908.[1] The Act contains a mass of administrative detail which cannot be here reproduced; but, broadly, it has two main objects—first to provide for an emergency note issue, and, secondly, to encourage organisation of the individual banks on the basis of locality. The first section provides for the formation of "National Currency Associations" of National Banks for the purpose of extended note issue. Other sections provide for the issue of additional notes by individual banks upon

[1] A reprint of this Act will be found in the *Quarterly Journal of Economics*, Boston, August, 1908. The essential clauses are given in Mr. Mason's paper before the Institute of Bankers: *Journal*, April, 1909.

the deposit of other than Government bonds, and by associations of banks upon the pledge of commercial paper; such issues to be taxed at the rate of 5 per cent. for the first month, with an additional tax of 1 per cent. for each later month, until 10 per cent. is reached. Such issues, if made on commercial paper, must not be in excess of 30 per cent. of the "unimpaired capital and surplus (*i.e.* reserve fund)" of the banks. Thus we get an elastic issue, somewhat on the German principle, but with what seems the improvement that the banks have, in the increasing time tax, a strong interest in reducing the issue to normal limits as soon as possible. The Act further provides that the banks shall pay not less than 1 per cent. on Government deposits; but they are exempted from reserve requirements in respect of such deposits. Lastly, the Act creates a National Monetary Commission of eighteen members—nine from the Senate, nine from the House of Representatives—to recommend further changes in the currency laws of the country during the six-year period to which the Act is limited. The Commission, I believe, is not expected to report for about three years. It has already visited Europe, and is making an exhaustive study of European banking systems.

We are told that the part of the Act that deals with national currency associations has not been well taken up. The individual banks seem to be reluctant to assume the joint liability imposed by the Act.

It is, indeed, as our own experience shows, very difficult to secure co-operation between really independent banks, even for what are admitted to be the most necessary purposes. The main result of the Act, then, apart from the appointment of the Commission, is to enable individual national banks, under certain conditions, to make emergency note issues.

If, subject to the reserves above made, one may venture to criticise this Act, conceived as a remedy for the weakness disclosed by the crisis, one would be inclined to say that too much stress is laid on the question of *currency*, when the real fault lies in the region of *banking*, and more particularly in the attitude of the banks towards their reserves. This has occurred to many foreign observers. As long ago as January 1903, Mr. Lawson wrote in the *Bankers' Magazine* that "elastic banking is required rather than elastic currency." This seemed to me exactly to hit the point. Mr. Boissevain, too, in the study to which I have referred, says that he does not think "the alleged inelasticity of the note issue is the mainspring of the evil." It may be granted that when notes are legal tender, elasticity of issues always has a certain value in cases of general internal panic, and in cases of exceptional foreign drains of gold. Yet it is not so absolutely indispensable in countries like the United States and Great Britain, where cheques are so current. But elasticity of banking accommodation is essential, whatever the system, in order to deal

with the ebb and flow of business and speculative tides. To most of us it seems that the United States reserve law prevents this elasticity by accustoming bankers to regard their reserve as bearing a nearly constant, regular proportion to their liabilities. Mr. Boissevain holds that the legal requirement should only be regarded as the absolute minimum, and that there should be ordinarily a large surplus over this minimum forming the real banking reserve. He observes that people who constantly refer to the elastic cause regulating the issue of the Reichsbank often forget that, though at times, as on December 31st, 1907, it may have an excess issue of some thirty millions sterling, its reserve is always well above the legal minimum of $33\frac{1}{3}$ per cent. But it is asking too much of ordinary human nature to expect individual private banks to interpret legislation in this large and expensive spirit. Nor does it seem to be necessary for ordinary banks always to hold as a minimum reserves on a 25 per cent. scale.

I doubt whether really elastic banking can ever be enforced by legislation. The practice has gradually been established in this country, perhaps only within the last sixty years, by a series of painful experiences which have shown that only by the liberal use of the reserves can incipient panic be allayed. Where you have a mass of twenty thousand independent banks, and no possibility of joint action, it is even doubtful whether individual banks would be

justified in adopting such a policy. It will never be really safe for them to do so until they are so far organised or consolidated as to be able to reckon on general co-operation in supporting the market. This is one of the many arguments for the association of banks which the Aldrich-Vreeland Act endeavoured to secure. Canada, with its thirty great banks, and Scotland, with its ten banks, owe much of their banking solidity to this power of co-operation. There are obvious drawbacks from the public point of view; but in banking relations security is primary, and worth paying for. It is noteworthy that the latest news from Canada is that "the tendency towards concentration of the banking business is not to be ignored." Yet we are told that just across the frontier the people of the United States are wedded to their system of small local banks, and that banks of the Scottish and Canadian type would not be possible there. It is difficult to find any difference in the general commercial conditions in the two countries which would justify this opposition of views. The greater scale of finance in the United States should point the other way.

This brings me to the great fundamental issue, upon which most European students of American banking will be agreed—I mean the supreme need of some central banking institution, to do for the United States what the great National banks do for Europe. Many minor improvements are possible in

the United States system as it stands. The reserve law might be made more elastic, the rate of interest on redeposited reserves abolished or reduced, and the whole system of redepositing modified; the Trust companies might be brought under stricter regulation. But none of these reforms would touch the root of the trouble. To put it briefly, American financiers are too big, and her financial institutions too small. The banks, which should control the big operators, are too often controlled and exploited by them. The central and authoritative control which is considered necessary in London, Paris, and Berlin is certainly not less necessary in New York. No market requires it more. It is exceptionally liable to be swept by waves of emotion, whether of panic or adventure; its financial operations are unprecedented, both for scale and audacity; nowhere is speculation carried to greater lengths. To the American financier, says M. Théry, commerce and industry appear merely as the material for his speculations. These conditions seem to indicate the necessity for powerful banks, organised under, or in some relation to, a central controlling bank.

Plans for such a bank have been put forward from time to time in the United States. Thus the Special Currency Committee of the New York Chamber, in October 1906, made this one of their alternative recommendations. Their central bank was to be jointly owned by the banks and the Government; to

have the functions of the present Treasury, and to rediscount for other banks. But in presenting the report, the chairman observed that, "while the ideal solution would be the establishment of a central bank of issue, it was not likely that Congress would adopt such a course." The difficulties are great; we can only hope it may be found possible to overcome them. There seems to be a constitutional objection to a central Federal bank. I used to think that the question of State right was decided by the Civil War. But it is clear that there is still a strong reluctance to assent to the extension of Federal powers, and to all those forms of centralisation which modern progress seems to make inevitable. A feeling of this kind destroyed the Second Bank of the United States, and it may be strong enough still to prevent the foundation of a Third Bank. Many persons consider that the destruction of the Second Bank was a great mistake, at least from the banking point of view. But whatever may have been the arguments in favour of a central bank at that time, they are incomparably stronger to-day. Now, as then, we want what Mr. Boissevain [1] calls a pivot for the whole system—a bankers' bank, dominating and leading the money market, a rallying point in times of difficulty. But since 1834 new and more urgent reasons for such a bank have become

[1] Mr. Boissevain's whole argument and plan for a central bank in the United States are well worth consideration. Mr. Boissevain writes with the twofold authority of a practical banker and an economist.

apparent. The huge scale upon which modern business is organised, to say nothing of the dangerous licence of modern speculation, calls for a corresponding development in the banking system. Moreover, modern banking, and the problems of the modern money market, are increasingly international. They cannot be adequately handled from an insular, or merely domestic point of view. It is a special function of great central banks, admirably discharged by the National Banks of Europe, to consider the international relations of the national banking and finance.

The occasion of the crisis of 1907 naturally reminded many persons of the crisis of 1893. The two greatest monetary squeezes of recent times occurred in immediate proximity to a presidential election, an election turning in each case upon issues affecting powerful interests. It is not surprising that in both cases it has been asserted that the crisis was not a pure accident. After all, these world-resounding catastrophes only repeat on a larger scale the minor market collapses to which we are so well accustomed, and which are every day and frankly attributed to an artificial origin. But however this may be, for both in 1893 and 1907 there was much in the general situation that exposed it to accidental disturbance, it is enough for us to recognise that the power exists to cause monetary stringency; and that, however caused, such a stringency may have effects, neither intended nor

convenient, which it is the business of sound banking to avert. Panic is a dangerous force to unloose; it soon gets out of hand; it is the first duty of the banker to prevent its inception. To do this, however, is beyond the power of the individual; it requires organisation. Powerful disturbing forces must be controlled by institutions of proportional strength.

The simple, ingenuous harmonies of old-fashioned political economy were built upon the assumption that the competitors in the business struggle were a crowd of individuals of something like the same order of magnitude, fighting upon terms of rough equality. I do not know whether there ever was an actual state of society of which this was true; it never was less true than in the world of to-day. The assumption has broken down all round, alike in industry, commerce, and finance. Everywhere increased inequality has led to the revival of powerful organisations, strong enough to exert control in the general interest. Trade unions, employers' associations, chambers of commerce, the great markets, trusts, and cartels—but I need not attempt to enumerate them all. It would be strange if banking were to be the only exception to the rule, and not less unsafe than strange.

But banking is not an exception. Throughout almost the whole Western world we find the banks increasing in size, becoming more closely organised, and headed by gigantic institutions representing the

national interests. The United States is not able to resist the general tendency. Though her banks are still rigidly localised, and she has recently permitted banks of smaller size than before, some of the banks in the central reserve cities are of very respectable proportions. A certain control is exercised by the Secretary of the Treasury. In normal times he enforces a somewhat minute and mechanical law on the individual banks, and keeps a fatherly eye on the whole system. When things come to the worst he appears as the *deus ex machinâ*, and empties the coffers of the State into the tills of the helpless banks. What more could be desired? The answer is that this action of the United States Treasury, though it is a testimony to the need for a central bank, does not in any degree supply the place of such a bank. The Treasury is not a bank, but a Department of State. It is only connected with the banks through its duties as controlling the currency, and the institutions which (and so far as they) issue currency. By virtue of holding the Government deposits it has a certain control over the market; but this can only be exercised by arbitrary measures of a kind which seem open to much objection. It does not, and cannot, act as a central reserve bank, nor can it control the reserve policy of the banks. In short, it cannot attempt to discharge the most important functions of the ordinary European National Bank, nor would it be expedient that such functions should

be discharged by a Department of State, even if it were possible.

Larger banks, less localised, with more organisation and a more elastic reserve policy, centring in, and under the leadership of, a great central bank—these would seem to be the sort of reforms required to deal with the existing situation in the United States. In this way she might obtain a powerful banking system, able to keep in check the huge financial forces of the present day, and to see that the public interest receives no hurt. Whether such changes are practicable or not we shall probably learn before long. Meanwhile, the crisis of 1907 has a plain lesson for us. It is clear that at present the United States is the great storm centre of the financial world. We should see to it that our own reserves are strong enough to be proof against the cyclones that may originate there.

VII.

INFLATION: IN WHAT SENSE IT EXISTS; HOW FAR IT CAN BE CONTROLLED.[1]

My *rôle* to-night, as I conceive it, is a very modest one. I am here, by the invitation of your President, on the understanding that the Institute desires to discuss the question of Inflation, and that I am to make a statement, as methodically as I can, to open the discussion. My purpose, then, is mainly to clear the issues for debate; and if I add an expression of my own opinion on some of these issues it may serve perhaps to present a target for the attacks which I am sure will follow, and thus to set the ball rolling.

There is no doubt that considerable anxiety exists, an anxiety which has been expressed in very competent quarters, upon what is called inflation. I may refer, for instance, to a very able article by Mr. Oswald Falk in the *Nineteenth Century* for July 1916, in which he not obscurely hints that the international position of London itself may possibly be involved if something is not done to check this inflation. Mr. Hartley

[1] An Address delivered to the Institute of Actuaries on 26th March, 1917.

Withers in the *Economist* has continually returned to this subject. Professor Nicholson has introduced it, although his study is not completed yet, in the *Economic Journal* for last December. We are waiting for the figures upon which his statement is based, and consequently I cannot now deal with his position.[1] I might refer also to the references which have appeared from time to time from the pen of the distinguished City Editor of the *Morning Post*, who has several times drawn our attention to the same point. Mr. Withers says in *The Economist*: "We believe that inflation has already done much harm by raising discontent in the country and increasing the cost of the war, owing to the rise of prices that it has helped to cause, and that everything should be done to check it." Well, we may admit perhaps that the rise of prices is to be deplored, though I should like to point out what is, of course, very obvious—that the rise of prices is an effective check upon consumption, and at the same time a very valuable stimulus to production, and not only to production, but, if we are thinking of the case of this country, to supply from other countries. In fact, there is a natural harmony about the action of the rise of prices when the rise of prices is due to scarcity. What precisely is meant when it is suggested, as Mr. Withers suggests, that

[1] The figures were afterwards published in a paper on *Statistical Aspects of Inflation*, read before the Royal Statistical Society, June 19th, 1917, and printed in the Society's *Journal* for July, 1917.

this rise of prices is partly due to inflation I do not know. Mr. Withers is cautious; he says "partly" due to inflation. He specifies particularly the Treasury note issue and the advances that have been made by banks in various countries, not only the advances made by State banks, but the increase in bank deposits, so far as it represents advances to the public, an increase of what we regard in this country as currency—bankers' money.

I think it will be convenient before going further to make a more or less formal distinction between the different senses in which the word "inflation" has been used. I make no apology for introducing what some people would call an academic discussion to an audience of this kind. First, I think we have what may be called legal or internal depreciation, depreciation as known to law; that is, loss of parity of either coins or notes or other legal tender currency in comparison with the standard unit, the standard unit in this country being the gold sovereign (not bar gold). If there were an inflation and a consequent depreciation of this kind, it would be measured at once by the depreciation of the particular element of currency in terms of the standard unit. Supposing, for instance, that element were Treasury notes, we should find them at a discount in terms of the sovereign. Further, it might, if it went far enough, result in what William Cobbett used to call two prices: we should have a double price quotation

for everything—a gold price, and a currency price representing the element of the currency which was inflated and depreciated. I am not aware that there has been any depreciation of this kind in Great Britain. I have been on the look-out for it incessantly, but I have not come across even an isolated case, although it is difficult to prove negatives, and it is conceivable that somebody may have offered a premium on the sovereign. I cannot speak so positively for France; I have been told that in France there is a premium on gold, but I do not think there is any quotation. That may again be owing to an act of State. We do not know how far the markets are free. In Germany we know there cannot be two prices. Germany enacted a law on the 23rd November, 1914, which exactly corresponds to our Lord Stanhope's Act, which was passed during the Napoleonic Wars in 1811, an Act which made it penal to buy or sell gold coin at a higher price than its face value. That law was passed to put a stop to a bullion agitation promoted by Lord King, who had ordered his tenants to pay him either in gold or in paper to the value of the gold. The Act was absolutely effective. We do not know that two prices ever existed after the passing of Lord Stanhope's Act. The Americans tried a gold Act of the same kind in 1864, and were absolutely unsuccessful, the only result being that their paper at once jumped 40 points higher discount. Lord Stanhope's Act was

effective, and the German Act apparently is effective. We find no quotations of gold in Germany, and we do not find double prices; prices there are presumably paper prices.

Let me now pass to a second sense in which a currency may be said to be depreciated. It may be depreciated in an external sense as a whole. It may lose its parity in terms of some foreign currency. In that case this international depreciation would be shown by the exchange rate, but for my part I do not admit that the exchange rate is a proof of the depreciation of the currency. I do not think it holds, *vice versa*, that we can infer depreciation of currency from the exchange rate. For instance, the American exchange was depreciated in the most extraordinary manner in the first week of August 1914. I was told that exchange on London was actually sold at 7 dollars instead of 4·86 dollars. Nobody ever suggested that that argued a depreciation of the American currency in that ratio. There certainly was no inflation of the American currency. At any rate, nobody I suppose imagines that the American currency was in any way depreciated. The high exchange rate arose from circumstances mainly accidental—the refusal on our part of accommodation which we had been usually ready to extend to America at that time. Many other examples of the same sort might be given. I could never agree with the Bullion Report of 1810 in holding that the premium on

exchange was a necessary proof of the depreciation of our currency; and it is worth observing that most of the very eminent Cambists who gave evidence before that Bullion Committee were opposed to the Report of the Committee on that point. They were, perhaps, in the best position to know what accidental circumstances will sometimes disturb the exchange, and they held that the discount on exchange could not be taken as proof of the depreciation of our paper.

It is worth while, however, to see what the rates are at the present time. There are no exchange dealings with enemy countries. I will divide the remaining exchanges into three groups: first, the more important Neutral exchanges, secondly the exchanges with our chief Allies, and thirdly the Scandinavian exchanges. Our most important Neutral exchange is with the United States, and we know that that exchange dropped rather unfortunately in September 1915; but for the last fifteen months or so it has remained remarkably steady at 4·76½ instead of 4·866, a discount of a little more than 2 per cent. It is difficult to know for certain whether it is a discount at all, because we do not know what the gold point is. We do know that owing to the high freights and the high insurance rate the range of the gold points has been very greatly widened during the war. I have tried many times to get a statement in regard to the actual gold point, but it

is not forthcoming. Perhaps there is no very definite market. But I am told that practically the 2 per cent. does not represent much more than the distance between the gold point and the par; at any rate the United States exchange is fairly steady. With Amsterdam, another important exchange, at the present moment the position is fairly favourable, $2\frac{1}{2}$ per cent. discount. I do not lay much stress upon the discount on the Amsterdam exchange, because it is conceivable that there are objections to settling that exchange by the export of gold, as Amsterdam is dangerously near to the Enemy; so that even if it were a discount of 10 per cent. I do not think that would prove any depreciation in our currency. It might be interesting as a sign that we were restricting the export of gold to Holland, and nothing more. When we come to South American countries there is a rather unpleasant discount in those exchanges. Roughly, averaging the countries, the discount is about $7\frac{1}{2}$ per cent. With Spain the discount is nearly $11\frac{1}{2}$ per cent., and with Switzerland nearly 5 per cent. The Spanish and the Swiss exchanges are, perhaps, not very important to us, but the South American is more important. It may be held, of course, that the freight and insurance are extremely high on the South American exchange, and that that explains the slump, as it were, in the rate.

When we come to the exchanges with our Allies our position is most favourable. However depre-

ciated our own currency may be, it is clear that, if the rate of exchange is a test, their currencies are in a worse position. The exchange on Paris is 10 per cent. premium, Petrograd 76½ per cent., and Italy nearly 48 per cent. I do not want to lay stress on that position; we should be glad to see these exchanges at par.

Passing to Scandinavia we find that all the Scandinavian exchanges, taking them as a whole, are 7½ per cent. against us, but that is very easily explained. Scandinavia, at the present moment, is not on a gold basis; it is true she is using gold, but she has appreciated gold deliberately, and 7½ discount there largely represents the extent to which gold in Scandinavia is appreciated beyond the value which it has in other parts of the world. They have done that after deliberate reflection, with a view to stopping the rise of prices in their own countries; because they conceive that after the war there will be a fall in prices, and they want to cut off the upper peak of the movement, to stop the rise and so to lessen the distance from which they can see there will be a fall afterwards. It may be good policy. Of course there are a great many complicated reactions in the operation of exchange rates, and it must be rather difficult to sum up the net result of this exchange policy on the whole.[1]

[1 The policy seems to have been abandoned, at least so far as remittances from the Netherlands Bank are concerned. Cf. the Report of this Bank, for the year ending March 31st, 1918.]

However that may be, it is obvious that is a remedy we never could apply here. We do not wish to keep gold out of the country—far from it. We have to make such enormous payments to New York, to say nothing of any other centre, that we want all the gold we can get. We cannot make a formal and deliberate appreciation of gold here as compared with other countries.

As to the German exchange, about the only test of it—the most important test at any rate—is the New York exchange, a discount of 30·7 per cent. as compared with our 2 per cent. on New York. But it must be observed in regard to all this matter of exchanges that the exchanges are not working freely; first, because trade itself is restricted, both exports and imports, and secondly, because the ordinary arrangement by which the balance of trade is adjusted by gold movements is almost completely paralysed by the action of the belligerent Governments. Gold cannot move freely. As Mr. Withers very neatly put it some time ago: "The world is now divided into two classes of countries: those which refuse gold and those which refuse to part with it." I think it is clear from the rates of exchange that even Great Britain does not go out of its way to facilitate the export of gold. I will leave it at that. I do not agree with Professor Cassel,[1] that we can argue from discount on exchange that the

[1] Cf. his articles in the *Economic Journal*, March and September, 1916.

currency of the country whose foreign exchange is at a discount is depreciated. Present circumstances are too exceptional for us to draw any inference of that kind. Even in peace time, the inference would be doubtful, and open to such exceptions as in the case of the American exchange, already noticed. Upon the whole, then, I do not admit that a depreciation of our currency is proved by the present state of the foreign exchanges.

Now I come to what I think is probably at the bottom of people's minds when they speak of inflation. They are not thinking so much of the parity between our currency and some other, or the parity between one element in our currency and our standard. They are really thinking of the rise of prices. It is that in their minds that argues inflation; at any rate, it is the rise of prices that they wish to correct. This, of course, is entirely to change the point of view. Here we are considering, not the depreciation of something in terms of gold, but the depreciation of gold itself; and that is extremely important, because it is clear that the depreciation of gold itself is not a local question, but a world-wide question; it is not a question that we can control here, even if we wish to. Gold is depreciated nearly as much in the United States as it is in Great Britain. It would be quite as much if trade were absolutely free between Great Britain and the United States, and every kind of article was in exchange between the two countries.

I have been unable to get a formal index number from the United States, although I ordered it more than five months ago. As far as I can judge from isolated quotations and remarks, the level of prices in the United States is about as high as here. Two days ago I had a letter from Dr. Irving Fisher, who is the greatest authority on this point, and according to a chart which he sent me I make out that prices in the United States have risen 60 per cent. since the war began. It must be remembered that they were very much higher than our prices before the war—I cannot say how much at the moment, as we have no precise measure of the difference—but everyone knows that prices in the United States were, on the whole, much higher than our prices. Therefore a 60 per cent. rise would probably bring them somewhere near the level of our prices now, which have risen 100 per cent. There is probably no important difference between the average levels in the two countries. We have no doubt what the rise has been in this country. We have accurate index numbers, more particularly the number established by Mr. Sauerbeck and now published by the *Statist* newspaper, which I think would be correct within a limit of error of about 5 per cent. According to that number, prices have exactly doubled since war broke out. I ought to say, however, that when the war broke out in July prices were rather lower than they had been; they had fallen from 85 in the

previous three years to 81, and in the opinion of many experts we were then on the eve of a crisis, or rather a depression of trade—one of the ordinary periodic depressions of trade—there being a general depreciation not only in the prices of commodities but in the prices of securities. Possibly in the case of securities the war was casting its shadows before, to some extent. There had been a drop in prices in any case, so that it is perhaps hardly fair to take the figure for July as a base when we are calculating the rise due to the war. It would make a difference of some 4 points. But, broadly speaking, prices have not risen more in this country than in other countries, certainly other European and western countries. I have been trying to make out accurate figures, but they have no index numbers in most countries, and one can only judge from estimates made from time to time; but it is quite clear that prices are higher in Germany, that they are about half as high again in Austria, and about three times as high in Hungary. The prices there are prodigious, according to the only returns I have been able to see. In the case of meat the prices are seven times as high as they were before the war. I do not know very accurately what the prices are in Scandinavia; they have been deliberately lowered now. Complaints come from all countries of the rise of prices. It must be so, because it is gold itself that has depreciated, and as all these countries are on a gold basis, or else on the

basis of currency which is at a discount on gold, prices in all countries will be similarly affected, though in different degrees.

It may be asked what would have been the course of prices but for the war? Prices have been rising on the average ever since 1896, at about the rate of 2 per cent. per annum. That rise is explained by the large increase in the gold supplies; but I do not suppose that the gold supplies alone would account for much more than this 2 per cent. rise on the average. Perhaps I ought to say a word here about the theory of prices. Price is a function of two variables: it varies directly in proportion to the supply of money of all kinds and inversely in proportion to the quantity of goods or transactions requiring to be handled by money. The more you increase the quantity of goods handled by money, money remaining the same, the more prices fall; the more you increase money, the goods remaining the same, the more prices rise. The general relation admits of simple statement, although in working it out we are often faced with complications of detail. For instance, what is money? You have to take account of bank deposits, cheques, and the various forms of purchasing power, and that is not a particularly simple thing. But in fundamental principle nothing could be clearer or plainer. Dr. Johnson put it very well. He was told that in the Island of Skye twenty eggs might be bought for a penny, whereupon he observed: "Sir, I do not

gather from this that eggs are plenty in your miserable island, but that pence are few."

To what, then, is due this rise of prices that has undoubtedly taken place since the war? In the first place, to the large production of gold which is the basis of all our credit, but mainly to the enormous increase of purchasing power which has been created by the various belligerent Governments, quite apart from the form which that purchasing power has taken. Our own expenditure is about £6,000,000 a day, and I think the total expenditure may be estimated at about £20,000,000 a day for all belligerents. The war expenditure of the five principal belligerents is known to be 18½ millions a day, so that it can hardly be under 20 millions for the whole of the belligerent Powers; say, 7,300 millions a year, or if we allow for double entry in connection with loans, roughly 7,000 millions a year. In our case the additional expenditure of Government is more than as large as the total expenditure of the nation in peace time. No one proposes to restrict that expenditure of Government, I suppose. The various belligerent Governments are struggling to obtain the military material and other necessaries for carrying on the war, and it would be absurd to attempt to restrict their power of obtaining that material. I do not think it makes very much difference by what precise machinery they exercise that power. For instance, if the belligerent Governments were able to buy merely in exchange

for their own scrip, their own credit, without using currency at all, I do not think we should have a much smaller rise of prices. They would be still in the market for the same amount, and would be competing with the same intensity. Is there any reason for supposing, therefore, that the level of prices would be much lower? My own belief is that there is not. The level of prices is really the result of the enormous expenditure of the Governments, and as long as that expenditure is maintained and exerted the level of price will roughly be maintained. This is the root fact, I maintain, at the bottom of the rise of prices.

But I do think it makes *some* difference by what machinery the purchases are made. In the act of purchase the effect will be the same, but if you make the purchase by means of an increase of currency you leave behind after the purchase the purchasing power you have created, and I think that constitutes a real difference in the position. You are left with a mass of purchasing power in the hands of the general public which would not have been in their hands in that form but for the particular way in which the Government made its purchases. It would be better, for instance, as far as that is concerned, if the Government could make all its purchases by forced loans without using currency at all. By what means have the purchases been actually made? They have been made, in the first place, taking the

world broadly, by enormously increased issues of notes. The French note issue was trebled and the Russian note issue increased four times. Our own note issue has only increased slightly, and the issue of bank notes hardly at all. The new currency note issue has altogether reached the amount of more than £140,000,000; but against that must be set the value of the gold whose place has been taken by the currency note, most of which gold has been exported to the United States. I think it will be found that the excess issue of currency notes over the gold displaced by the currency notes is, after all, a very small matter, not in any way comparable with the rise of prices, nor an increase that would have contributed very much to that rise of prices. Then in certain countries enormous advances have been made by the State Banks. The Bank of France advanced £400,000,000 to the Government, most of it gratuitously and none of it at more than 1 per cent. It behaved in the way it always does behave in times of crisis, admirably. The State is under very great obligation to that bank, so much so that meetings have been held in France of merchants and financiers calling on the Government to extend the bank monopoly for thirty years without asking for any concessions from the bank. The extension of the monopoly is usually made an occasion for asking for concessions, but on this occasion the feeling is that the State owes so much to the Bank of France that

the bank has earned its monopoly for another thirty years without further consideration.

Then in all countries there has been a very great increase of divisional money, silver and other forms of small change. Perhaps that does not count for very much, but I think it has some effect. In this country in normal times the circulation of silver is about one-fourth in value of the circulation of gold, so that it really is a considerable element in our price basis. What is most important for this country—but not so important I think for many others—is the increase in bank deposits. We are accustomed to consider the draft upon a bank as the very best form of money, cash in the highest sense of the word, especially if that bank happens to be the Bank of England. A draft on the Bank of England would be considered cash, perhaps, in any part of the civilised world. In this country we make a very large use of Bank of England advances when we are in difficulties for want of currency. I have found very great difficulty in estimating what has been the precise increase of bank deposits in this country. Our banking returns are always miserably inadequate and unworthy of the country; but during the war, ever since the large loan of 1915, they have been suspended altogether, so that we only have the annual account made up for a particular day, and everyone knows what that means as a basis for an estimate. We have, in fact, no scientific basis at all. I think it is

a matter to be very much deplored. You will remember what was said about Austria when the Austrian Bank suspended its returns. I am sorry that we should have in any degree followed an example of that kind, because I think myself there was no reason whatever for it. I cannot see that the banks have anything to be ashamed of. It is a sort of morbid timidity that seems to cause the withholding of these returns without which there can be no proper basis for scientific action. However, as far as I can make out, the bank deposits have not increased more than some £250,000,000 during the war, to which may be added about £120,000,000 for the Bank of England, or under £400,000,000 altogether for the whole banking system.

Compare that with the total of deposits before the war of something like £1,200,000,000. There is a 33 per cent. increase of bank deposits, and that is the most serious figure relating to inflation that can be found in our accounts—the expansion of bank deposits by something like 33 per cent. But that will not account for 100 per cent. rise in prices; nor is it anything like so large as the correlative forms of expansion in other countries, the expansion of notes and State bank advances and so forth. The State bank advances have been very small here as far as one knows. I do not know what the advances may be at any given time, but supposing them to be £70,000,000 or £80,000,000, we have no figure that

can be classed as a figure of expansion here that at all corresponds to the great movement of prices. It must be observed that in some foreign countries they have been increasing the use of cheques, and that has been another cause of rise of prices. In France, Russia and Germany the greatest efforts have been made to extend the use of the cheque, and that has had just the same effect as the expansion of the note issue. Generally speaking, I am inclined to think there has been an economy in the use of metallic money and in the use of notes all over the world—that there has been a more rapid circulation of money. During the Napoleonic wars it was proved that the rapidity of circulation of the bank note doubled during some ten years. I admit the case is not quite parallel. The fact was that we were just beginning to understand banking economy at that time; our clearing house had been established only twenty years before, and we had just begun new experiments in the machinery of cheque banking; and it is possible, therefore, that the increased velocity was not due to the war but to the natural development of our banking system. But I am inclined to think that the pressure caused by war does make the sixpence a little more nimble than it otherwise would be. Then there is the question of the emptying of hoards. Large amounts have been brought from hoards in France and in Germany. I do not know if we shall get any in India from the new Indian Loan, from

the great hoards there, or through ornaments being melted down. This has been an addition to the amount of gold available for currency, and just as important, in its effect on prices, as if new gold had come from the mines. These are the general causes, on the money side, of the rise of prices.

Passing to the side of commodities, there has been a shortage in productive power tending so far to make commodities scarce, but of course this has been compensated very largely by increased effort and by women's labour, and by the labour of other persons not usually employed in normal times. I am bound to say there has been in this country a great margin for an increase in productivity. When you hear that women coming fresh to an industry were able to turn out five times the previous output of a skilled workman, it is impossible not to feel that we were working well within our power when the war broke out. I would also refer to the decrease of available tonnage, and the rise of freights. High freight rates do not, strictly speaking, I think, restrict the supply of commodities generally, but they may restrict it locally. They may prevent us, for instance, from bringing goods from the United States which we might otherwise have had, and they may bring about a local scarcity here and therefore cause local high prices. There has been a certain failure in the harvest, partly due to the shortage of fertilisers. Those, I think, are the principal causes on the side of commodities.

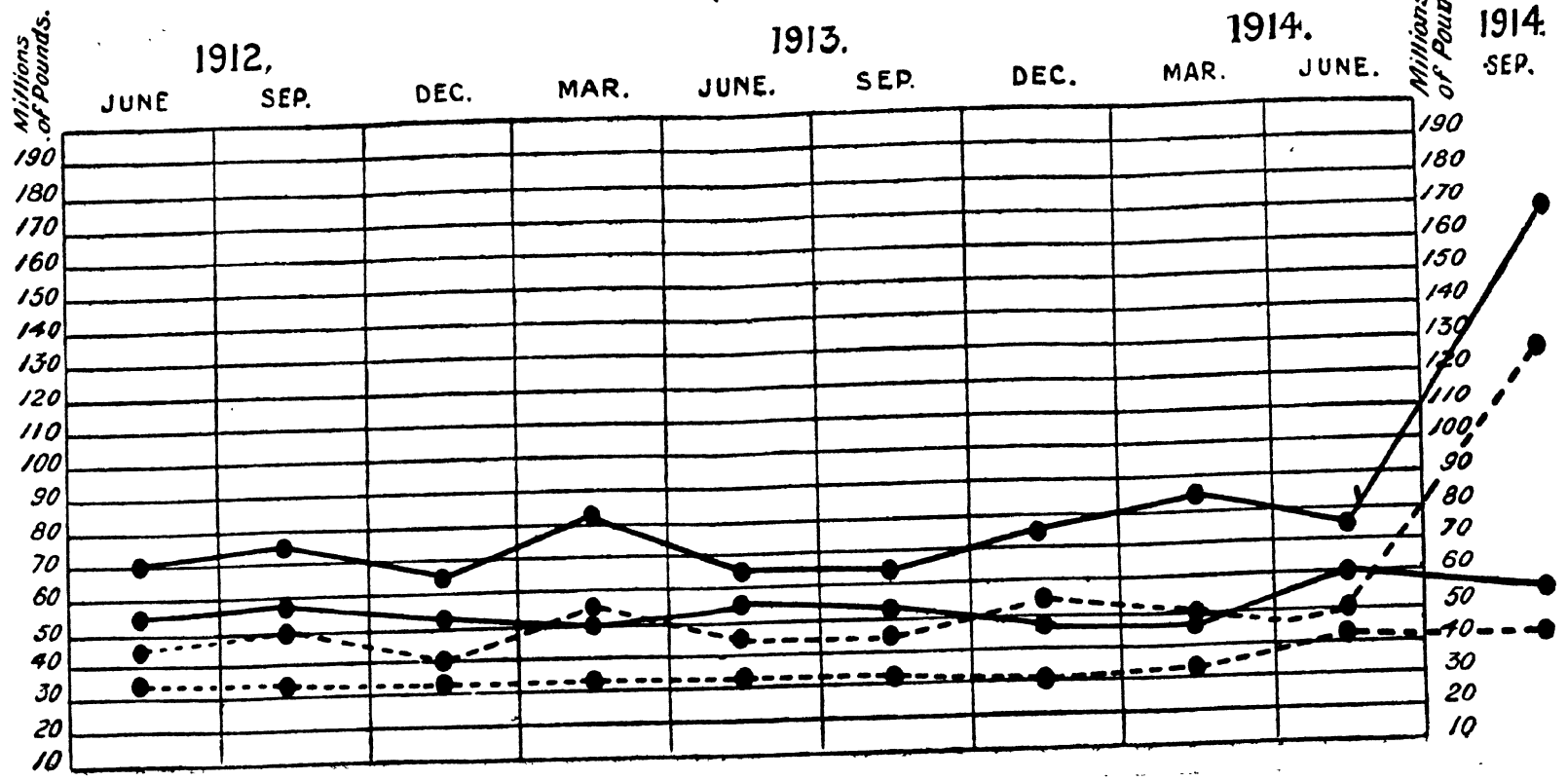
Then there are certain matters connected with dealing and distribution which have tended to raise prices. There has been too much of the amateur in the market. He generally pays very dear for his operations. Military purchases, for instance, have not been of the most economical type. On the other hand, there has been a certain tendency on the part of the expert to hold up goods and to exact the full advantage of his position and his knowledge, and there has also been a certain amount of hoarding by consumers. These are small matters, and not so important as the others I have noticed.

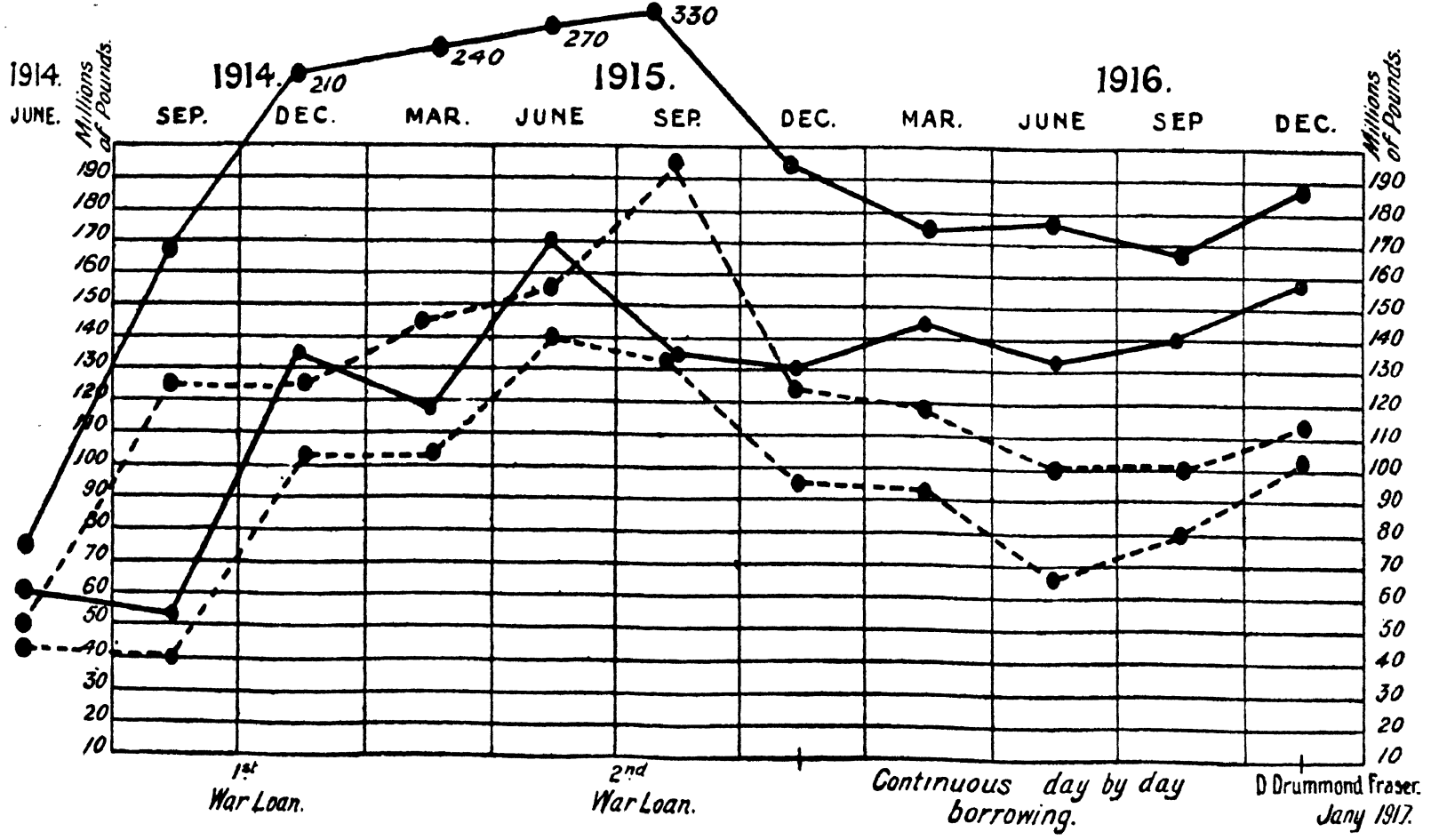
I ought, perhaps, to say a word about the question of bank deposits in addition to what I have already said. I said that the way in which Government borrowed did make some difference, and it was advisable, as far as possible, to avoid borrowing by the creation of currency. We have done very little to create currency in this country in the shape of notes, practically nothing if you make allowance for the substitution of notes for sovereigns; but we have done a great deal—say to the amount of £400,000,000—to create bank currency by bank advances. The question is whether that could in any way be avoided, and I am inclined to think that it can be avoided, that it is very largely connected with the issue of big loans. These big loans require large operations to finance them. We talk about raising a loan of £1,000,000,000, but it is quite certain that there does not exist in

the country at any one time even £400,000,000 of spare cash, and it is an impossibility to raise a loan of £1,000,000,000 in the strict sense of the word. What we do is to finance it by bank advances. Every big loan means a large expansion of bank deposits. We cannot tell how much because we cannot get the returns, but we know very well there must be that expansion, because we know there is no spare money in the country to the extent of anything like the sum raised by a big loan. No country in the world could raise a loan, I think, of £500,000,000 without recourse to some method of financing, and that method of financing practically creates currency. It is for that reason that I confess myself entirely a partisan of Mr. Drummond Fraser, the apostle of continuous borrowing in this country, who argues that the proper way to borrow is to take up money when the public have it to spare, by always being open to receive loans, to receive the spare cash as it comes into the current accounts. That is practically what we were doing all through 1916. I admit that there were reasons for one large regularising loan. We have got into difficulties with previous loans and previous rights conveyed by those loans, and it was desirable to unify the public credit on a single basis as far as possible, creating a large marketable stock on sound principles. That was admirably done by the recent loan. It is likely to be what Consols used to be, a fine banking security in the future, or at least I hope

BANK OF ENGLAND WEEKLY STATEMENT.

Quarterly Maximum & Minimum { Deposits Public & Other. ——— / Other Securities. - - - - - -




1914.
JUNE.
Millions of Pounds.
1914.
SEP.
DEC.
MAR.
JUNE
1915.
SEP.
DEC.
MAR.
JUNE
SEP
DEC.
1916.
210
240
270
330
190
180
170
160
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120
110
100
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70
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10
1st War Loan.
2nd War Loan.
Continuous day by day borrowing.
D Drummond Fraser.
Jany 1917.

so ; and I was very glad to see that it was so admirably insured by the large contributions made first by War Savings Certificates, and secondly by the Prudential Insurance Company and other bodies of that particular type. I regard this as a very important point, a bull point for the new stock. In the future and in general it seems to me that Government can raise the money it requires with a minimum of disturbance and with a minimum of inflation if it will avoid placing these large loans at long intervals and revert to the system of continuous borrowing to the full extent as money becomes available. That borrowing should give a freedom of option to the public ; there should be bonds of various dates and bills of various dates. The chart on pp. 242-3 constructed by Mr. Drummond Fraser shows the effect upon the deposits of the Bank of England of two kinds of borrowing during the war. The upper part of the chart shows the pre-war period, the normal position of the Bank of England deposits as shown by the Returns. When you get into the war period the deposits rise very rapidly, partly owing to the panic at the outset of the war and afterwards owing to the War Loan ; but when in 1916 you come down upon this method of continuous borrowing, you see how remarkably even the curve of Bank deposits is, almost at a level from December to December. I have no doubt that if we could get the figures for the new Loan we should see a corresponding rise in the bank deposits, if not of the Bank

of England yet of the country as a whole, in consequence of the big loan of 1917. It is well to avoid these disturbances, and also to avoid the creation of currency which they cause.

The root of the whole matter it seems to me is this: whether by inflation or otherwise, gold itself has depreciated, and it is this depreciation of gold which is expressed in the high level of prices. The depreciation of gold is the result of the enormous increase of purchasing power in the hands of Governments. In some cases the new purchasing power has been created by methods which have depreciated currencies in relation to gold. That does not seem to have been the case here. Our prices are very high. But we see these high prices in America and other countries where there is no question of inflation in any ordinary sense of the term. Thus the problem is international, and that is a matter of the first importance, because it shows that, unless we are prepared to revert to what I may call Scandinavian methods to bring about a local appreciation of gold in our own country—and that is obviously impossible and undesirable—the rise of prices is beyond the control of any one country. We can only check it by cutting ourselves off from a gold standard, which is what we do not want to do, either by appreciation or depreciation. Secondly, I think it is important because it meets an objection raised by Mr. Falk which I confess rather impressed me at the time I read it—that

a rise of prices, by creating exchange difficulties, threatened our international position after the war. It might if it were peculiar to this country, or even if it were peculiar to belligerent countries; but if it is really universal, if it affects the United States, for instance, I cannot see how it threatens our international position. At any rate that consideration reduces the danger to which Mr. Falk referred. That is broadly the position that I wish to submit.

ABSTRACT OF THE DISCUSSION.

Mr. O. T. Falk asked members to listen to him for a few minutes, mainly because he hoped that by taking part in the discussion he might extract a little more truth from Professor Foxwell. Professor Foxwell had said that the objectors to inflation were mainly concerned with the third form of inflation in his category, the depreciation of gold. That might be so, but it was not his own experience, possibly because his life was spent in the City, and he thought it would be admitted that, so far as those who lived in the City were concerned, inflation of the first two kinds was the most important. It might be because he had not a due allowance of that morbid timidity which Professor Foxwell ascribed to bankers that he disagreed with him with regard to the position in so far as the first two forms of inflation were concerned. There was a difficulty about the question and he frankly admitted that, so far as he knew, those who believed that depreciation—or what he would rather call potential depreciation—of the currency in terms of gold existed, were at present unable to offer any satisfactory proof of that depreciation. So far as he was concerned, he suspected it. He did not admit that the rise of prices in every country was a measure of the depreciation

of gold, simply because he did not admit that the prices in all those countries were gold prices. He believed they were admittedly not so in Russia, to take a single example, and he thought they were not so in other countries also.

He appreciated Professor Foxwell's point when he said that there was no cause for alarm with regard to the position of this country if the rise in gold prices was international and if the rise in this country was not greater than the rise in other countries; but his own idea was that the rise in prices in most countries was a rise in currency prices and the rise was measured in currencies which were admittedly depreciated in terms of gold. In the case of this country, the currency was supposed to be on a par with gold. If, therefore, our prices had risen to as great an extent as the prices of other countries, it was possible that our currency was depreciated in terms of gold; in other words, it was a question as to whether there was not what might be strictly called relative redundancy of the currency. It was not possible for him to give any proof of that relative redundancy, but he would ask the members for a moment to assume that it existed. He wanted them to assume it because he wanted them to allow him to criticise the point of view of those who said that redundancy simply could not exist, who said that the absence of that redundancy was proved by certain current conditions. Professor Foxwell had compared the position in 1810 with that of 1917, and it would appear that that was a very good starting point for the criticism he himself wished to make. In 1810 the Bullion Committee and Ricardo and a few others pointed out that the high price of bullion and the state of the foreign exchanges was a proof of the depreciation of bank paper, and a proof also of the over-issue of that paper. He would agree with Professor Foxwell that the depreciation of the exchanges was not a conclusive proof in all circumstances of the depreciation of the currency in terms of gold, but for his purposes that qualification was not important, because the point he wished to make was that, whether those tests were conclusive or not,

it was fair to say that it was not possible to state with confidence that, because there was no high price of bullion and because there was no depreciation of the exchanges, therefore redundancy was absent.

Comparing the position in 1810 and the position to-day, in 1810 there was a high price of bullion and there was a Restriction Act. The objectors to the hypothesis which he put forward said that to-day there was no Restriction Act and no high price of bullion. He admitted there was no Restriction Act, but there was restriction by consent. It was also said that there was no high price of bullion, but he did not see how there could be a high price of bullion; it was not possible to melt down gold coin or to import bullion or to export it—as a matter of fact bullion could not really be bought. There was no Lord Stanhope Act, but it was not legal to pay a premium for British gold coin, and certain men had been convicted of that offence. So far as he knew, there was only one case in which a gold premium within the country could be made evident, and it so happened—although he laid no stress upon the point—that in that case a premium existed. It was legal to purchase foreign coins, not current coins, and melt them down, and jewellers, because they badly needed gold, were buying foreign coins and paying a high premium for them, from 10 to 15 per cent., but it was not a highly regularised trade, so that the premium probably varied considerably in different localities. He did not in any way wish to suggest that the premium paid by those jewellers was any evidence of a gold premium within the country, but he did think that it was fair to say that the absence of a gold premium was not a proof that there was not a premium on gold, because by consent and by legal restriction there was no real dealing in bullion or gold coin. Fortunately this country had been free during the war from individuals of the type of Lord King, so that we had not really had the point tested as it might have been.

The second main test of the days of the Bullion Committee

was the state of the foreign exchanges. The American exchange was now at the low gold point, or approximately so, and he was perfectly prepared to admit that the state of every other Neutral exchange could be explained away. He did not want to go in detail into the matter, because he thought it must be obvious that if this country had been able to maintain the American exchange at the low gold point it could have maintained all the other Neutral exchanges at that point by the same methods, if there had not been special difficulties. Assuming that all the foreign exchanges were at the low gold point, could it therefore be argued that the currency was not potentially depreciated? He thought not. The state of the exchanges in the present case proved absolutely nothing. He would ask the members to look for a moment at the method by which this country was maintaining the American exchange; we were not paying for goods with goods; we were paying for the adverse balance of trade with gold, with foreign securities that were acceptable and with promises to pay gold. Promises to pay gold were not gold, but promises to pay gold, and that was a point that it was impossible to escape from. He thought it was fair to say—to borrow a phrase from Professor Jevons—that this country was engaged in selling a gigantic bear of gold. Anyone who knew what the selling of a bear might result in, especially when it was on a very large scale, would appreciate what he felt about the situation. If his hypothesis was correct, this country was selling gold for future delivery at a price which might be far below the world's market price, if, as he supposed, our currency was relatively redundant. He did not say we were selling below the market price, but he thought it was possible. It was evident in any case that we could, so long as we had credit and acceptable foreign securities, go on maintaining the exchanges independently of the state of our currency. It might be redundant and yet things might for a time be kept right.

Personally, therefore, he thought there was some reason

for careful enquiry into the situation and possibly for more prevision than had as yet been exercised. That necessity became obvious if one looked ahead and saw what would happen on his hypothesis, namely, if this country was selling a bear of gold with a redundant currency. Some day we should have to stop settling an adverse balance of trade by promises to pay gold, and we should then have to buy goods with goods, and if we wished to buy goods with goods we should be at an extraordinary disadvantage if we offered gold at a lower price than the rest of the world. Gold would then be the cheapest commodity that we had to offer, and the foreigners would take our gold first and our commodities second. He did not mean to say that gold would be the only thing they would take from us, but gold would be very nearly the first, if not the first, they would take from us. The question was—How was the problem to be solved ? It could only be done in one of three ways, unless we wished our last ounce of gold to be drained from the country. We could lower our prices by contracting the currency, which would be a highly objectionable course—one had only to read Professor Foxwell's admirable preface to the translation of Andreades' *History of the Bank of England* to see what his view about that method would be—or we could suspend specie payments, and, as the financial centre of the world, that was a solution we did not want to have to face. These two solutions were within our control. The third was not within our control, and personally he thought it would be madness to count upon it. If one could suppose that after the war some of the main commodities which this country produced and exported would rise in value relatively to the other main commodities of the world our position would be maintained, because relative prices must be adjusted to relative values, and we should, by the appreciation in value of our main commodities, be able to support a higher level of prices. There might be a fallacy there, but he thought there was not.

He did not think there was any disadvantage in discussing the position, because there was very little harm that could be done under present circumstances and he was not sure there was not a great deal of good, but he did wish to emphasise very strongly that he by no means maintained that a relative redundancy existed; he admitted he only suspected it. The remarks he had made were mainly a plea for a very careful enquiry, the nature of which there was not time to develop, but which had really been indicated by Professor Foxwell. He was hoping that those who had the capacity for undertaking that work might combine and test the position, so far as it was possible to do so, by obtaining the necessary information from other countries. He understood, from the article to which Professor Foxwell referred, written by Professor Nicholson in the last number of the *Economic Journal*, that Professor Nicholson was engaged on such an enquiry, and he trusted that he would get all the support that was necessary. Also he hoped that it would be possible to induce the City to take the matter rather more seriously than they appeared to do at the moment. The City referred the question back to the tests of the Bullion Committee days and appeared to have satisfied itself that there was nothing to be alarmed about.

Mr. W. A. Kiddy (Financial Editor of the *Morning Post* and Editor of the *Bankers' Magazine*), speaking on the invitation of the President, said that one thing that must have struck everybody that evening was that the subject under consideration was one where proof seemed to be well-nigh impossible; that had come out in what Professor Foxwell had said and also in the remarks of Mr. Falk. The question of inflation had to be considered from three standpoints: First, whether there was a premium on gold; secondly, the position of the exchanges; and, thirdly, the rise in the price of commodities. In all those three cases it was easy to find simple explanations of the phenomena, without including inflation. In considering the question of a premium on gold, Mr. Falk had pointed out

quite properly that, while it could not be proved there was a premium on gold, it would be equally difficult under the artificial conditions which existed to say that there was *not* a premium. With regard to foreign exchanges, as was well known, there was a great trade balance against all the belligerent countries which were buying from the neutral countries, at a time when their own productive power was reduced. Under those circumstances, how was it possible to have anything but adverse exchanges ? Therefore there was an ample explanation of the position of the exchanges without going into the question of inflation.

With regard to the rise in commodities, he had been rather struck in looking over the record of prices to see how a rise commenced about the year 1906. When the war period began there was of course a tremendous bound, but there was quite a substantial rise between 1906 and 1912, and he suggested that one reason for that rise was probably to be found in the greater equalisation of wealth, the manner in which taxation was changed during those years having caused wealth to be spread over a greater number of the community : in other words, he believed that in those years there was a tremendous increase in the purchasing power of the people, and that fact was important in connection with the more recent events, because the rise in wages, the expenditure of belligerents, and the high wages paid to munition workers, played a great part in the rise that had taken place in commodities. Wages had been high all over the world and the purchasing power of the people had increased, and under those conditions there was bound to be a great rise in commodities, quite apart from such circumstances as the cutting off of productive power and the great demands on the part of the belligerent Governments. Moreover, in the years from 1906 to the period of the war there was reason to suppose that in many of the food-producing countries there had been a tendency to go into manufactures rather than to increase the area of food stuffs ; in other words, the cultivation of food stuffs had not kept pace with the growth

in population. He only pointed that out because it seemed that from 1906 to 1912 there was a great rise in the price of commodities when nobody talked about inflation at all, and when there were other causes to account for it. All the same he thought there was inflation to-day, that there *must* be inflation. It seemed to him that there was no need to look further for proof than the fact that, as Professor Foxwell had pointed out, the Continental banks of Russia and France had increased their note circulation enormously. How could anything but inflation result from that? The point was that it could not be measured because it was so mixed up with the other and more easily discernible causes, and no measure could probably be found until after the war, when some of the other causes had ceased to operate.

With regard to the currency notes of this country, he was inclined to think there was perhaps rather more concealed inflation than Professor Foxwell acknowledged. It was well known that against the 140 millions of Treasury notes there was 28½ millions of gold earmarked, and to that extent there was of course no inflation. He understood Professor Foxwell to suggest that the great mass of the remaining Treasury notes might not be inflation because of the gold it displaced, but he went on to say that a great deal of that gold had now been exported to the United States. If that were so, was not that gold forming a basis for fresh credits which, in considering the rise of prices of commodities all over the world, must lead to a still further creation of credit and therefore to inflation? He thought that the extent of the Treasury note issue was undoubtedly another sign of inflation. Was there anything in all this that could be controlled during the war? When it was remembered that the greatest cause of all was the great enlargement of credit, it would be seen that the problem was a delicate and difficult one, because we knew very well the whole war had been carried on by a great expansion of credit. If that credit were to contract suddenly, a totally different condition of things might be brought about, and yet in the

enlargement of trade in various forms, Government loans, banking deposits and so forth (inasmuch as increased purchasing power was involved) was to be found one of the chief explanations of such a phenomenon as the rise in the price of commodities. With regard to the question of control, one method concerned the Government and the other ourselves. It was admitted that the belligerent Governments were now the largest buyers of commodities of every kind, and the question was whether those purchases were being conducted on the best lines, even after making all allowances for the fact that things had to be done in a hurry. If they were not, but were being done in an amateurish fashion, then the evil was unnecessarily exaggerated. With regard to the public, their duty consisted in economising in the matter of consumption. Although the war had been going on for two-and-a-half years, it was only within the last few months that the question of personal economy had been really forced home upon the people by the Government. If the people had not economised it was not altogether their own fault, the word not having been clearly given by the Government itself until within quite recent months.

When the question of controlling the position was really considered, however, it must be felt how difficult was the task. It was, perhaps, as regards the form of borrowing and the manner of regulating the expenditure that opportunities were chiefly afforded. With regard to borrowing, Professor Foxwell advocated very strongly Mr. Drummond Fraser's plan for continuous borrowing by Treasury bills, Exchequer bonds, etc., rather than a big loan operation, but had the Professor considered whether that form of borrowing could sufficiently draw money from the investor himself? Because, unless the money was obtained from the investor, and not simply from banking credits, Professor Foxwell would be the first to say that there would be undue credit expansion. It was easy, of course, to "job backwards," as was sometimes said in the City, but looking at the great success of the new Loan

it seemed almost a pity that there could not have been some scheme devised whereby the Loan could have been made very much larger with payments made by fortnightly instalments over a period, say, of two years, the Government having the right at any time to stop the subscriptions if the war were suddenly to cease. Spreading the payments over a more lengthy period would have given the Government probably two or three times the amount they actually got, and the public, having been committed to supplying the Government with funds for perhaps two years, would have felt all the greater need for economy in the matter of personal expenditure.

Mr. E. W. TOWNLEY wished to make a few remarks on Professor Foxwell's third interpretation of inflation, namely, the depreciation of gold in terms of commodities as measured by the rise in prices. The real and ultimate cause of the rise, as had been said that evening, had been the enormous additional expenditure of the belligerent Governments, which had affected neutrals as well as themselves, but the difficulties began when an attempt was made to ascertain to what extent any one of the more immediate causes was responsible for the rise. Professor Foxwell had remarked that even assuming that British prices depended solely on British currency policy, the expansion in our currency was quite inadequate to explain the rise, and he thought everyone would agree with that. But while our currency expansion was obviously insufficient in itself to account for the rise, and allowances must be made for other factors, such as the lack of tonnage and the withdrawal of millions of men from productive employment, it still seemed to him that the increase in our currency issues had had a material effect on the rise in prices. He would like in that connection to refer to the statistical enquiry which Professor Shield Nicholson was conducting. Although that enquiry was not yet finished, Professor Nicholson had already indicated some of the first approximate results in the following terms: "There has been a general conformity between the increases of our note issues and the rise in prices in the United Kingdom.

The increase in prices as shown by the index numbers has *followed* the increases of notes, and in general, the movement in prices is of the character associated with over-issues of inconvertible paper, such as has occurred in the other belligerent countries." As a matter of curiosity he was led by Professor Nicholson's remarks to compare the growth of our currency note issue with the rise in prices as shown by the index numbers of the *Statist* and *Economist*, and for that purpose he divided the period since the commencement of the war into intervals of three months. He did not overlook the fact that our banking deposits were so much potential currency, but, as Professor Foxwell had pointed out, the miserable monthly returns formerly published by the Clearing Banks were discontinued in June, 1915, and it was not, therefore, possible to trace the growth of their deposits at short intervals. His rough analysis, on which too much should not, of course, be built, indicated two rather interesting features. First, each of the two quarters in which the emission of Treasury notes was the largest was followed by a quarter in which the rise in prices also was specially marked. Secondly, and conversely, each of the three quarters in which the notes issued remained more or less stationary was followed by a quarter in which prices also were practically stationary, or even receded. In other words, there seemed to be a curious correspondence between the movement of currency notes in one quarter and the course of commodity prices in the next. Allowing for the time which it took currency notes to get into active circulation, that did seem to support Professor Nicholson's statement that the rise in prices had been due to a considerable extent to currency issues. If that view was correct, there was at all events one factor which it was within the power of the Government to control, and as so many other factors which were contributing to the rise in prices were beyond control, he thought everyone would agree that the Government ought as a matter of duty to restrict currency issues as far and as quickly as possible.

The PRESIDENT, in proposing a vote of thanks to the lecturer, observed that on the question itself he preferred, for reasons which he gave, to say nothing. His very kind remarks are therefore not reprinted in this account of the debate. A complete report of the proceedings will be found in the *Journal* of the Institute for October, 1917.

The LECTURER, in reply, said that in the first place he would like to thank the members of the Institute for the very kind way in which they had spoken of the few remarks he had made. The President had rather hinted that although he had brought forward very little statistical evidence in regard to the statements he had submitted to them, the statements were not made at random but really represented the result of a very considerable amount of inquiry. He could assure them that he had spent two or three weeks in trying to get some more definite evidence, but had to abandon the attempt, as he found he had no figures worthy to present to a body like the Institute of Actuaries that would really stand the test of close examination. There were no adequate returns. That must be his apology for what he was sure must have been noticed to be a rather obvious defect in a statement of such a kind—the lack of a definite statistical basis. It was not for want of taking pains.

With regard to the admirable criticisms that had been made, he might say at the outset that in questioning the existence of any serious inflation he had had in his mind all through such inflation as it was within the power of this country to control. What Mr. Falk had said mainly related to the rise of prices, due to general inflation all over the world, very little of which this country could control; and he did not indicate any particular measure of control which in his opinion it would have been wise for the Government to adopt. In speaking of the exchanges, Mr. Falk said very truly that many of the other currencies whose exchange rates were quoted were not currencies at par with gold. That he believed was true of Germany and Austria and Russia, but it was not true

of Scandinavia, which had even a super-gold currency, if he might so term it. It would not be true of the United States, which was the principal currency with which we had relations and with which our relations were on a very fair basis. As to the case of a premium on gold in this country, Mr. Falk did not press the point, indeed he appeared to admit that the position of the goldsmith was very peculiar. The goldsmith was not buying gold as currency, but as a metal which he happened to be able just now to sell at exceptionally advantageous rates, and therefore he did not care what he paid for it. On the other hand, the Government was interested in stopping the consumption of gold by the goldsmith, and had imposed certain restrictions on his usual source of supply, and that made him all the more anxious to obtain it and tended to cause the premium. Personally, therefore, he did not attach any importance to a premium if only paid by goldsmiths; the very same thing happened in the Napoleonic wars; one of the few definite purchases at a premium he had seen mentioned was a purchase by a goldsmith; and there was one conviction, quashed on appeal, for a sale of guineas at a premium for export.[1] Then Mr. Falk said there was no real dealing in bullion now. Probably that was so. In any case, even in time of peace, the bullion market was very limited, confined, he believed, to about four firms. He did not understand that those firms had absolutely nothing to do at the present moment, but he could easily believe that the dealing might be very restricted. The rate quoted for bar gold was the lowest possible, namely, £3 17s. 9d., the Bank price.

Mr. Falk rather deplored the method by which we were maintaining the exchange. It was in fact unfortunate that the

[1] [It is noteworthy that even in Holland, where there is no question of an inflated currency, and the Bank is glutted with gold, its reserve having risen from 12 mlns. to 54 mlns. during the war, the Netherlands Bank is selling gold at a premium of 38 per cent. to goldsmiths. August, 1918.]

exchange had to be maintained by exporting securities, but the export of securities was just as legitimate as the export of goods. There was nothing wrong about the method; we were giving value and were extinguishing debt and were not putting ourselves in a false position; we were simply sacrificing a certain amount of our property and selling to a rival country. We might be in an inferior position as a creditor nation after peace to some extent, but he did not think that involved anything of a hollow or unsatisfactory kind in relation to the currency; it did not argue a depreciated currency, for instance. It had nothing to do directly with the question of inflation. What we were suffering from was the failure to balance trade. Our exports had naturally diminished and our demand for imports was abnormally high, and that necessarily brought about a failure to balance, and we were meeting that failure by the export of securities. He saw nothing in any way wrong in that; it was the only course open to us. He thought, on the whole, Mr. Falk did not say that he was satisfied that there was inflation so far as this country was concerned, but that he simply desired an enquiry. There could be no objection to that, and it would be very desirable to know under what conditions the currency notes were issued. He had never come across anyone who could tell him precisely what those conditions were. That was a very unsatisfactory state of things, and there was no precedent for it in our history—an issue of currency the conditions of which were not declared or understood. Even in the Napoleonic war the Bank had a very clear rule; they never issued their notes except on the discount of "good mercantile bills, not exceeding 61 days' date, at the rate of 5 per cent." [1]

Passing to Mr. Kiddy's remarks, he had pointed out very well that there were plenty of explanations of the adverse exchange and of the high prices, without being driven to resort to the explanation by inflation. That there had been inflation internationally no one could doubt, enormous inflation

[1] The Usury Law prevented the charge of a higher rate.

of currency, especially by notes, and in this country there had been a certain amount of inflation by bank credits. But the inflation was mainly an international matter. We, in this country, must hold our own; we must provide for Government in some way or other a mass of purchasing power equivalent to their needs, relative to the purchasing power enjoyed by the countries which were our rivals. He did not see that we could control or diminish in any way the purchasing power at the disposal of our Government. It was our duty to make it as large as possible. Mr. Kiddy also suggested that our currency notes, although they might not have caused inflation here, had contributed to inflation because they had been the means of enabling us to export gold to the United States, and that export of gold to the United States had been one of the principal causes of the rise of prices. That, of course, was so. On the other hand, we were driven to export gold to the United States because we had to maintain the exchange; it would be deplorable if we ceased to keep up the tradition of gold payment in this country, and he did not see how else we could have acted.

Then there was the question whether the Governments were buying well. That was a point on which he had no special knowledge, but his impression was that they had not bought as well as they might have done, and it was a matter to which attention ought to be paid. He agreed with Mr. Kiddy that at bottom the remedy for the rise of prices and any consequential evils lay rather with the public than the Government. The public must produce more and must consume less. Those were the radical facts of the position, and they were not entirely within the control of the Government, although he thought the Government should give a very distinct lead. The people were never in a more docile mood than they were to-day; they felt they were in the presence of a very difficult situation, and they believed the Government was better informed than they were, and they were willing to take the word from the Government. As to continuous borrowing and the big loan,

Mr. Kiddy had suggested that continuous borrowing did not appeal directly to the investor. That was so, as it was conducted in this country, but it was not as it was conducted in France. This country had not given the ordinary investor any chance; we offered Treasury bills of £1,000 minimum, which was very nice for financial people but did not appeal in any way to the ordinary investor. In France one could buy a bill for as low a value as 100 francs, or say £4. In that country they thought it politic to open all their loans in all their different forms to the very smallest subscriber, and he believed that that was a sound policy, and he would like to see it done here.

Mr. Townley had spoken of Professor Nicholson's results and had quoted a sentence which he very well remembered, but which did not seem to him to be supported by any figures that Professor Nicholson had hitherto given. Mr. Townley's own enquiries seemed to have shown a curious correspondence between currency issues and subsequent prices, but he did not think Mr. Townley had mentioned quantities, but had merely referred to the direction of variation, so that that did not come to very much. It only showed a general sympathy, but unless the movements were proportional in magnitude he did not think it could be held to show causal relation. It was suggested Government could control the currency issue, but he did not very well see how it could, though he spoke—as most people spoke—in the dark. If he thought that Government was financing the war by the issue of currency notes he should deprecate it most strongly, because he held that that was the worst possible way of financing the war; but he did not believe that the note issue represented borrowing by Government. He did not know whether the suggestion that the notes ought to be withdrawn was seriously put forward, or that it was really argued that we should return to gold circulation. If it was, we should require about another £120,000,000 of gold, and how would it be possible to finance the American exchange? The thing seemed to him absolutely

impracticable. The great merit of the currency notes was that, if properly managed, we substituted for the expensive circulation of gold an inexpensive circulation of Treasury notes, and as a result were in possession of £100,000,000 to £120,000,000 of gold which we could use to settle the American exchange. The whole operation was absolutely defensible if it stopped there. He was not sure that the issue had not gone £20,000,000 beyond that limit, *i.e.* beyond the amount necessary to make the substitution of paper for gold in circulation.

Note.—It should have been stated on p. 223 of this paper that, by an Order in Council dated May 18, 1918, a new regulation, 30EE, has been made, which substantially re-enacts Lord Stanhope's Act.

APPENDIX.

I.

THE GROWTH OF MONOPOLY, AND ITS BEARING ON THE FUNCTIONS OF THE STATE.[1]

After a century of the keenest and most unbridled competition the industrial world has ever known, economists find some of their gravest problems in the consideration of the growth and future of monopolies.

It is difficult to picture the astonishment with which the contemporaries of Adam Smith would regard this outcome of the reforms they did so much to set on foot. They imagined that we were passing out of an age of monopoly into an age of competition, the distinguishing mark of which would be equal opportunity and equal remuneration. Abolish artificial restrictions, they urged, and natural equality will prevail. By nature, said Adam Smith, there is little difference between a philosopher and a coalheaver. Let the careers be free to all without favour, and competition will prevent inequality. Liberty granted, in short, equality was a necessary consequence.

It is easy now to see how great was the mistake they made, and how they came to make it. The obvious, conspicuous

[1] A Paper read at the British Association, Bath Meeting, September 7th, 1888. Reprinted from the *Municipal Review*, October 13th, 1888. Afterwards translated by Professor Gide, and published in the *Revue d'Économie Politique*, September, 1889.

causes of inequality and monopoly in their day were privilege, corporate and private, and governmental activity by military, fiscal, and industrial measures. These causes of monopoly, which they called artificial, were largely swept away in the first half of this century. But more permanent, and as they would have said, natural, causes remained. The reforms of that age were very destructive, but they could not destroy monopoly. What they actually did was to shift its basis, and give it freer play. The industrial advantage which formerly rested largely on privilege, and was limited to localities, now rests on abilities, opportunities, and possessions, and has the world for its sphere of action.

It is in fact a mistake to suppose that a state of competition can be a final permanent state—a state of stable equilibrium. Where one man is as good as another, competition ensures that men shall be indifferently and equally remunerated. But this is not its main office. The points in which a man is on a level with his fellows are of small importance to society in comparison with those in which he has a superiority, however small. The main function of competition is that of selection. It is an industrial war, more or less honourably carried on, leading to the more or less disguised supremacy, the commercial monopoly, of the victorious firm, whose initial advantage is strengthened by every victory. From this point of view it is competition which is transitional; and monopoly presents itself, not as something accidental, a stage through which we pass in a backward age, but as something more permanent, more fundamental, than competition itself. We begin and end with it. We start with private property, the monopoly every individual has of his abilities, opportunities, and possessions; and we end with the impregnable commercial position which is the result of a fortunate (or possibly a fraudulent) use of these advantages.

What is more, the more perfect the competition the more certain and strong is the resulting monopoly. Where competition is very keen, and the markets of the world are open

to the competitors, an initial difference of one or two per cent. in efficiency might be sufficient to give the control of the market. This control once gained, the expansion of the business rapidly increases the advantage, until a practical monopoly is secured. Though this tendency to monopolies of ability is nothing new, it is clear that it has assumed a new importance since the great advances in communication. In past times artists have furnished the most conspicuous examples of it, because great artists have always had the civilised world for their market. But such has been the advance of transport, that the heaviest manufactures now enjoy the same advantage. The products of Armstrong and Krupp command the markets of the Antipodes as easily as those of their own capitals, and the facility with which this control is exercised increases every day. In the case of articles of general consumption the tendency is greatly strengthened by the development of the parcel post, money order, and cash on delivery systems. A similar effect is produced by the system of discounts and of uniform retail prices. These devices, by placing all localities on the same footing, extend the market of the monopolist, depriving local competitors of the advantage of their geographical position. The development of banking and joint-stock enterprise has removed all difficulty in obtaining capital, once so severely felt by private employers. So abundant is the supply of capital, that it forms a temptation to monopolise instead of a check upon it. Thus the expansion of undertakings passes all previous bounds, stimulated by the well-known advantages of division of labour and large scale of production.

Of course there are practical limits to the extent to which an industrial monopoly can be thus developed. There is a limit to the size of an enterprise in the difficulty the master finds either in supervising it himself or in obtaining efficient responsible assistance. Personal friendships, too, and local considerations, though weaker than formerly, still count for something in dividing custom which would otherwise be

concentrated. Then there is a constant change in the economic situation, giving new men a chance. The rapid progress of science, the incalculable caprices of fashion, the altered habits of the public, all disturb the routine of business, and help to dislodge the monopolist. The imperfection of heredity, too, places a term on the most successful enterprises. A father may leave his property to his son; it is a very different matter to leave him his business.

But in the main it is true that everything which is most characteristic of our age, from the consolidation of Empires down to the quackeries of advertisement, is favourable to the growth of these monopolies of efficiency.

Nor is there anything, as has been sometimes assumed, in the progress of education, or of political equality, to arrest this tendency. Education does not level natural advantages; it merely enables their possessors to use them with greater effect. The slow progress of co-operative production, and the gradual extinction of the small employer, force us to accept the conclusion of President Walker. "Whatever," he says, "may be true in politics, the industry of the world is not tending towards democracy, but in the opposite direction." The significant fact of modern industry is the increasing value and importance of business ability.

When, therefore, we are considering the principles that should determine the future dealings of the State with industry, I think that monopolies of efficiency deserve our closest attention. They are not, however, the first to catch the public eye; and it might be objected that, strictly speaking, they are not monopolies at all. I should, therefore, explain that by a monopoly I understand an enterprise which, no matter for what reason, is so established as to be practically unassailable by competition: and the only monopolies we need specially consider here are such as by virtue of this secured advantage become undertakings of exceptional size and power. Now, if we disregard such minor monopolies of patent and copyright as are now secured by law, and which are really

forms of property in the product of labour, the principal varieties of monopoly may be classed under three heads. These are monopolies by efficiency, monopolies by combination, and monopolies of local service. Of the first class, which I regard as the monopolies of the future, I have already spoken. It remains to say a word on the other two, and more familiar kinds.

Robert Stephenson, in his evidence before the Railway Committee of 1853, laid down that "where combination is possible competition is impossible."[1] And it would certainly seem that where competition has been unrestrained, there is a strong tendency for it to end in agreement of a more or less comprehensive kind. But the difficulties in the way of making and maintaining such agreements are so formidable that they are not likely to make much headway in general industry, until industry is much more highly organised. Most of the great trading corners have been failures. The few industrial combinations, such as the steel-rail ring, seem to have been unable to hold together long. The greatest successes are to be found in the history of railway enterprise. But this really falls more properly under the third head. It is the force of considerations of locality which accounts for the persistence of railway combinations. Otherwise we may say generally that combination, as distinguished from amalgamation of interests, is not a fruitful source of enduring monopolies.

The third class of monopolies may be said to hold an accepted and recognised position in the economic world. It has long been admitted that competition in the ordinary sense of the word is out of the question when we have to deal with certain cases of local supply and of communication or transport. The geographical facts are too strong for the theorists of free competition. Mr. Chadwick, in one of his admirable reports, gives a drawing of a section of a London street under the old

[1] Report Select Committee Railway and Canal Bills, 1853. Qns. 885-6.

régime of competing gas and water companies. No one could forget the lesson given by that simple picture. The waste, danger, and inefficiency of that preposterous maze of pipes was too obvious to be tolerated. For such purposes unity of administration is essential.

The case is similar, though not so strong, with the services of transport and communication. There is enormous waste, sometimes physical impossibility, in so multiplying these services as to admit of competition; and even then there is no means of preventing the termination of competition by agreement, which local conditions make it easy to enforce.

Mr. C. F. Adams, in his very able book, *Railroads: Their Origin and Problems* (New York, 1878), tells us that "railroad competition has been tried all over the world, and everywhere, consciously or unconsciously, but with one consent, it is slowly but surely being abandoned. In its place the principle of responsibility and regulated monopoly is asserting itself" (pp. 204, 205). His general conclusion seems to be that in this, and presumably in similar cases, the best policy is to allow amalgamation, not so much on account of its obvious economies, as because the larger the concern the more easily responsibility is fixed, and the more easily the pressure of public opinion is brought to bear upon and control it.

About these monopolies of service, indeed, the common sense of the business world seems to have at last arrived at a settled opinion. In America, sometimes supposed to be pre-eminently the land of competition, the most thoughtful writers agree with our own in accepting monopoly as inevitable and economical, and in occupying themselves with the legislation necessary to prevent that monopoly from becoming mischievous.

It must be added that monopolies, once established, have a tendency to beget other monopolies. It is convenient for a railway company that its traffic should be in the hands of the smallest possible number of shippers. By giving special rates, it creates big traders, economises its yards and sidings,

and simplifies its book-keeping. At its heart, it creates huge works for the construction of its plant; along its arteries, news and refreshment monopolies; at its extremities, great delivery systems and monster hotels. The same thing goes on, less obviously, over the whole face of industry, greatly stimulated by the growth of municipal and joint-stock enterprise.

It must be apparent, then, that really effective competition is a much rarer phenomenon in the greater forms of enterprise than people sometimes suppose. It is very commonly assumed that competition exists wherever the State does not interfere. This is a very loose and misleading abuse of words. The mere absence of State interference has never given us competition in any real sense of the term. On the contrary, nothing has been more favourable to the growth of practical monopolies than the *régime* of *laissez faire*. A century's experience of even a partial application of this *régime* finds us everywhere confronted with growing monopoly. Monopoly, in short, seems to be nearly as significant a feature of our time as competition was of the time of Adam Smith. It is possible, therefore, that the political economy and industrial legislation which suited the earlier period may require some adjustment or development in view of the new force. At any rate, the new force deserves our careful and unprejudiced study.

What is the reasonable position to adopt towards industrial monopoly? The very name monopoly is, by long usage, dyslogistic; it seems to carry censure with it. Lord Coke said that "Monopolies were ever without law, but never without friends." Certainly it is only of late they have had any friends in the camp of the economists. The old monopolies of which he spoke were granted by favour, at the public expense, and against the common law presumption of free dealing. Those who sold them, and the individuals or corporations who fattened on them, were their friends; but they had no others. They were execrated by the public whom they plundered, and the jealousy aroused by their privileges

blinded the people to the real services they sometimes rendered. The cry was for competition, for competition presented itself as the abolition of privilege.

The monopoly we have to deal with is of a different origin, and the temper of the public towards monopoly is sensibly changing. Modern monopoly does not spring from privilege or legislation, but from competition itself. It is competition which now comes in for popular odium ; even monopoly, with its order and permanence, seems a welcome relief from the iron rule and terrible uncertainties of so-called free competition. Besides, monopoly is gaining ground, and Darwin has taught us to be respectful in presence of success. Perhaps most of us feel towards monopoly much as we do towards popular government. Its evils are obvious enough, but we have to reckon with it. Our wise course is to make the most of its possibilities for good, and to exert ourselves to minimise its powers of mischief.

It cannot be denied that whatever evils may be attendant on monopoly, it has enormous advantages ; advantages which suffice to explain its success, and to induce us to view that success with a certain degree of sympathy. There are the enormous economies in administration and division of labour, the concentration of knowledge and skill, the unbroken tradition of trade mysteries and crafts, the *esprit de corps*, which go with great firms. The monopolist, says Proudhon, centralises, capitalises, and consolidates the victories of industry. We save, too, the wasteful rivalries of competitive firms, the costly litigation of rival schemes, the utterly useless expenditure on advertisement. The consumer profits by the guarantee of quality, by the uniform, easily ascertainable price, by the absence of temptations to adulteration, by the greater variety of choice. Within limits, too, monopoly gives low prices. This is the American experience in the matter of railway freights. The amalgamations of 1869 to 1882 resulted in a reduction of freightage charge of 60 per cent., according to Mr. Ed. Atkinson. " Modern industry," says Mr. Seligman,

another American authority, "is a period of industrial anarchy. Combinations are designed to put an end to this anarchy. They do away with the excessive fluctuations of prices, performing much the same functions as legitimate speculation."

Probably no class gains more by the rise of these huge firms than the *employés*. The larger the firm, the more effective is the public opinion of the employed. Their loyalty is of greater consequence to the employer. The administration is on regular and generally better principles. The master lives in face of the public. He pays the penalty of greatness in his exposure to criticism. The name of his firm is a household word, and its reputation must be above suspicion. It is hardly necessary to point out the very important bearing of this upon the problem of State control. It is in the smaller, fiercely competing workshops that State control is most required, and by common consent it is almost an entire failure. In the larger concerns inspection is extremely easy, and nearly superfluous. It is replaced by the public opinion of the employed, and the honour of the employer.

It is, of course, equally true that monopolies have their special dangers, and are peculiarly open to abuse in certain directions. In some cases the monopolists may take advantage of their monopoly to enforce excessive rates or prices. But a due regard to their own interest will generally check this to a greater extent than is always supposed. There is more probability that though charges may be reasonable enough, the net profits may be indefensibly large, and the public may ask that in some way or other they should share in a gain partly due to an exceptional position.

There are worse evils too than high rates, flowing from the enormous power wielded by a great industrial organisation. The Americans have found discrimination or personal preferences, whether or not for value received, to be a more formidable evil than high rates. Great corporations boast that they can make or ruin not only individuals but whole towns. They

may tyrannise over their *employés*, socially and politically. There is an English Railway Company [the West Lancashire] which will not allow alcoholic liquors to be sold on its premises, and will employ no one who has not been for some years a total abstainer. Only teetotallers will be allowed to travel next.

Nor is it to be supposed that such powers will always be used in the interest of the Corporation itself. Corruption is rife throughout the length and breadth of modern business. Privileges are sold by subordinates. Commissions are freely given: double tenders submitted. In fact, corruption is emphatically the curse of the age. Measured by every one of Bentham's tests, it is the most serious of modern offences. The temptations are strong; the direct public injury very grave; the indirect effects are all-pervading; the whole tone of business life is lowered, and the respect for success and for property, as in general the reward of merit, is palpably weakened.

These defects are brought out strongly in proportion as an undertaking approaches the character of a monopoly; but it is a mistake to suppose that competition is any remedy for them. The competition of brewers does not prevent their control over the licensed houses, with all its mischievous restriction of the consumer's choice, and attendant abuses. Mr. Seligman tells us that on American railways "personal discriminations are most glaring where competition is most active—during the railway wars." He adds that "the surest method of preventing them is—universal combination or monopoly, in other words State ownership." "This," he says, "was one great reason why the railways were bought up by the Prussian Government."

Time will not permit me to make a special reference to monopolies of raw material and to trading corners, which have often been worked so as to inflict grave injury on the public. It is unnecessary to dwell on the evil thus caused; but it is only fair to notice that it is not solely due to the fact of mono-

poly. It is largely due to the speculative mania which infests all forms of modern business. Moreover, the power of such monopolies to injure the public is very limited, if the monopolists study their own interest, and have no indirect means of profiting by their operations.

What, then, should be the policy of the State in view of this new tendency of industry to assume more or less completely the character of monopoly? I have tried to show that monopoly is inevitable, and in many respects of public advantage. It is a natural outgrowth of industrial freedom. It would be idle, therefore, for the State to attempt to repress it. For some time it was thought, especially in the typical case of the railways, that the State could keep it in check by promoting competition. The best authorities on State railway policy have everywhere abandoned this idea. It is recognised that competition will be both ineffective and wasteful; and the tendency everywhere is towards what I may call the English policy of regulation. In fact, as soon as it is clearly seen that effective competition is impossible, the only alternatives are State control or State administration. The experience of Anglo-Saxon countries is, in my opinion, strongly against the policy of extending State administration. Industry can never be efficiently organised by popular suffrage. But the Anglo-Saxon race would tolerate no other principle, if the organisation is to be governmental. The greatest danger of modern industry is corruption. State administration is no remedy for this. It may itself become a new source of corruption in politics. I believe that the economical efficiency of State administration has been greatly overrated. We have not always clearly distinguished between the advantages due to monopoly, and those due to State direction. I see no reason to believe that the Post Office would be less efficient, if it were farmed by a private corporation, and merely controlled by the State. It is almost certain that this system could be applied with great profit to the work of the dockyards. Nor does the position of labour seem to be better in State

than in private service, except, perhaps, in the one important matter of regularity of employment. The State is sometimes urged to acquire the railways. Jevons, in my opinion, has shown that there are very few economies to be secured by further railway concentration. And whatever the grievances of railway servants, their position will compare favourably with that of the men in the dockyards or the Post Office. The possible gains in the change to State enterprise are small; the indirect injuries by the stifling of private enterprise are enormous.

If, then, the State is not to administer industry directly, what are to be its relations towards the individuals or corporations who do administer it? If competition is to land us in monopolies, *laissez faire* is out of the question. A few writers have been found, of whom only Bastiat and Mr. Herbert Spencer deserve mention, to pretend that, by some preordained magic, competition will give us universal harmony of interests and greatest possible happiness to the body politic. No one has ever yet viewed the action of monopoly with this happy-go-lucky complacency. Though it may be granted that the monopolist and the public have some common interests, it is absurd to pretend that monopoly is self-regulating, whatever may be said of competition. Those, therefore, who oppose some kind of public control for the great industrial monopolies are simply playing into the hands of the collectivists. They are the true apostles of socialism.

Most of us will desire to see public control applied in such a way as to minimise the amount required, to avoid unnecessary detail, to leave the maximum of freedom to enterprise, and to secure the utmost intelligence and knowledge where limitations must be imposed. A large consensus of opinion among practical men seems to point to two principles of policy as best calculated to secure these ends.

First, there should be every possible form of publicity in regard to all transactions affecting public interests, that is to say, in regard to nearly all economic transactions. With

due publicity, self-help would be far easier, and public opinion would come in to aid the right, and would largely dispense with the necessity for direct legal control.

Secondly, where control is found to be called for, it should be as far as possible delegated to local or trade bodies familiar with the practical details of the case, and subject only to a mild revision from the central authority. Precise and rigid legislation should be avoided as far as possible. Most practical questions are questions of degree. These cannot well be dealt with by law. They are best referred to commissions or other bodies with a large lay element, and partaking of the character of a jury.

In this way we might get over the main difficulties which arise in the administration of industry. But the knotty question of the distribution of wealth would remain to be attacked. The competition of the various monopolies for labour would ensure a certain proportionality of remuneration as between different employments. But what is to prevent the governing corporations or individuals from making excessive profits by means of their exceptional position? First, I think, the potential competition of rival monopolists; for a monopoly is seldom absolute. Secondly, it is by no means certain that the profits must be large. The railway companies, for instance, though they compete very little with one another, cannot charge more than the traffic will bear, and have to compete with other modes of carriage. Hence, on the average, they only make a modest 4½ per cent. Thirdly, when excessive profits could and would be made, it is open to the State to insist on profit-sharing, either with the nation, the consumers, or the *employés*. The former modes have been followed in dealing with the London gas companies and some Indian railways; the latter mode has been adopted by the Paris Municipality in all contracts under its control. Either plan would seem to be preferable to a severely progressive income tax, or other impost on property; for such taxes act as a direct discouragement to saving and premium on improvi-

dence. It is conceivable, too, that public opinion may develop until it is considered as shameful for a man to make 30 per cent. in business as by usury, unless his gains are liberally shared with those he employs.

Whatever is done, we must be careful not unduly to hamper the operations of self-interest, a motive power of enormous force, which we cannot at present replace by any equally effective impulse. We must also beware of stereotyping industrial methods. The best market must be provided for inventors, and the fullest opportunity afforded to that tendency to variation upon which the selection of the fittest, and consequently progress itself, really depends.

In order to present a general view of the subject, I have been obliged to treat very broadly of questions each of them presenting grave difficulties, and deserving very detailed examination.

What I have sought to show is, that in the growth of monopoly we have an economic fact of the first importance, which must modify views as to State control founded on the assumption that perfect competition prevails. I agree with Mr. John Rae that the action of the State thus rendered necessary need not proceed on different principles nor with wider objects than those prescribed by Adam Smith. But it will necessarily take somewhat different forms. Hitherto the tendency has been to an increase in the complexity of the State control; and Mr. Rae thinks we must expect this complexity to continue increasing. I see many features in modern industrial progress, however, which tend to lighten the burdens of the central government; and among them I think we may reckon this tendency to monopoly. For if it renders control more necessary, it also renders it more easy; and it is possible that such control as is required may be very largely secured by the simple expedient of publicity.

In any case, and whatever be the amount of control required, whether to prevent oppression by monopoly, or waste and degradation by competition, it behoves us to see that that

control is provided. It is no longer a question between *laisser faire* and regulation, but between wise and unwise regulation, or worse, between regulation and collectivism. Supreme power has been placed in the hands of a class not too much given to reflect, and especially familiar with the seamy side of the present *régime*. If the shoe pinches them too painfully they will be apt to fling it off, without asking whether a new one would be more comfortable, or even forthcoming at all.

"The State may become social reformer without becoming Socialist," says Mr. Rae, one of our ablest writers on this question. I entirely agree with him. I will only add, in conclusion, that if the State does not become social reformer, it inevitably will become Socialist.

II.

FIXED EXCHANGE WITHIN THE EMPIRE.

To the Editor of the "Bankers' Magazine."

SIR,—The proposal to establish fixed rates of exchange within the British Empire, made by the chairman of Barclays Bank in his address on January 24, seems to me to have received less public attention than it deserves. So far as I have noticed, it does not appear to have been formally considered except in a letter from Mr. Frank Morris to the *Morning Post*, where that gentleman, with less than his accustomed acuteness, makes it the subject of an uncompromising attack. But what Mr. Goodenough proposes would really be a great advance in the development of our banking system, as I have tried to show for many years past; and it is encouraging to hear that so high an authority regards the question as one of practical business.

Mr. Morris says that to fix exchange within the Empire (it is already fixed within the United Kingdom) is "to make water run up-hill." The illustration is unfortunate. If the water companies did not make water run up-hill, our domestic life in large cities would be impossible. The editorial comment on Mr. Morris's letter, though it expresses sympathy with Mr. Goodenough's proposal, makes the reserve that the fixed exchange would be clearly artificial. No doubt; but could not every step which civilisation makes in controlling to our convenience the irregularities of nature be condemned on the same ground?

Mr. Goodenough is really only asking us to go a little further on well-proved lines. He proposes to extend to the whole Empire the service of free remittance which the later development of our banking system has made so perfect within the United Kingdom. Why should I be able to make a payment to Edinburgh without any question of exchange rate, while that question at once arises in the case of a payment to Montreal or Melbourne? Some will say because the first case is one of internal, the second of foreign exchange. Even so, this explains nothing; but in neither case is there a "foreign" exchange. If for "foreign" we substitute the term "overseas," we are no nearer an explanation. The question of exchange arises whenever the cost of remittance has to be paid for by individuals, on the basis of a particular set of conditions. It is not necessarily a question of payments over-seas, or even of payments to foreign countries; in fact it is a misfortune that the term foreign has become associated with exchange. The real distinction is found in the fact that in the last century our banks developed a machinery of free remittance within the limits of their system; but that as soon as we cross the frontiers of that system we have to make special exchange arrangements for remittance.

In the eighteenth century such arrangements had to be made in every case of inland remittance. How heavy these inland exchange rates were may be seen by a reference to Boase's *Century of Banking in Dundee* (pp. 53, 274, etc.). Inland exchange rates, though small, still remain in the United States. The Federal Reserve Board are now trying to abolish internal exchange there. Would Mr. Morris think that their action also is due to "an unconscious phase of socialistic leaven"? If not, at what precise point does the provision of parity of exchange incur his censure?

There is no magic connected with remittance over-seas. At present it usually involves crossing the frontier of a banking system. This need not necessarily be the case. Our banks are extending their frontiers. In the last fifteen years they

have established direct banking connections over-seas to a remarkable extent; one of the latest examples being the arrangement between Barclays Bank and the Colonial Bank. We have had a striking object-lesson, too, in the Ottawa Deposit system of the methods by which over-seas remittance may be economised.

It is really a question for the banks whether they should or should not add to the many services they render the public the further service of free remittance at fixed parity between the various parts of the British Empire. This service need not, on balance, be very costly; nothing like so costly, if one may guess, as the cashing and crediting of coupons which they now undertake. Such a development would be most timely. Our position as the international clearing-house will be subject to competition from more quarters than one after the war. New York and Amsterdam have both developed an acceptance business, and the Central Powers are not likely to be less active in their rivalry.

Would not our long-standing financial supremacy be distinctly fortified against the new attacks if we were able to say that exchange on London meant exchange on any part of the British Empire? Exchange on London, since 1820 or thereabouts, has meant exchange on any part of Great Britain. Why not, after 1920, exchange on any part of Greater Britain?

H. S. FOXWELL.

1 Harvey Road, Cambridge,
February 15, 1918.

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