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VI

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STUDIES IN FINANCIAL ORGANIZATION

BY

T. BALOGH

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PREFACE

THE present studies are a fragment of an international enquiry into the working of the Western European monetary and banking systems and capital markets undertaken in 1939. In this country the study was entrusted to the National Institute of Economic and Social Research and was placed under the direction of Mr N. F. Hall, whom the present author was to have assisted. The original plan envisaged studies of the 'public' Sector (the Treasury and extra-budgetary funds) of the Bank of England and the Exchange Equalization Account; and the present studies dealing with the Clearing Banks, the discount market and other private financial institutions. Further sections were to have dealt with the institutions, public and private, by which savings are canalized—such as the Post Office Savings Bank, Building Societies, Insurance Companies and so forth—as well as the Stock Exchanges.

At the outbreak of the war of 1939–45 the present studies were nearing completion. Mr Hall and his staff were called away to public service and the present author was engaged in other tasks, so that it has not been possible to complete the whole scheme. It has, therefore, been decided to publish the existing sections separately. They form a consistent whole and are of interest as providing an up-to-date survey of their subject before war conditions dislocated it and diverted its development. The complex interrelations between the different parts of the financial structure render an analytical description somewhat cumbrous. Repetitions are unavoidable and the fact that many important institutions have not been included in the analysis causes unavoidable gaps in the narrative. Nevertheless, the importance of the topic for the future, and the prevalence of misconceptions about the past, would seem to justify an attempt at a consistent treatment of the institutional organization of the financial system on the basis of modern economic doctrine.

The author wishes to acknowledge his deep gratitude to Professor Clay (now Warden of Nuffield College, Oxford) for his unfailing kindness and patience, to Mr Noel Hall for his advice, encouragement and help in writing, to Mr G. Crowther and Mrs F.S. Stone and to many friends in the City for their willingness to give information not hitherto available and for checking many of his

rash statements. None but himself, however, is responsible for the shortcomings of the finished product. He is much indebted to Mr J. Packman for his scholarly reading of the proofs and for his kindness in preparing the index at very short notice.

The conclusions will certainly seem too radical for those who hanker after a *status-quo* which is inevitably lost and, perhaps, too conservative to those who believe that by exorcising the monetary and banking devil, by global monetary measures or by nationalizing the banking system, all our ills can be cured. The latter are, at the moment, not only more numerous but, perhaps, more influential than the former. The dangers that misconceptions of this nature will cause a violent reaction to the formerly prevalent extremes are not negligible. If the present analysis contributes—however modestly—to some disillusionment about the all-cure effect of monetary intervention it will have served its purpose.

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August 1945

The National Institute of Economic and Social Research is glad to acknowledge the part played by the Institut Scientifique de Recherches Economiques et Sociales, of Paris, in the origination of this work. The international enquiry referred to in the author's preface was organized and sponsored by the Institut before the 1939–45 war, and the National Institute received a small grant from the Institut towards the expenses of the study that was originally planned.

F. S. STONE
Secretary
NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH

August 1947

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PART I. THE CLEARING BANKS AND THE EVOLUTION OF BANK CREDIT IN ENGLAND SINCE THE WAR OF 1914–18

SECTION ONE

THE DEVELOPMENT OF THE CLEARING BANKS

CHAPTER 1. *THE HISTORICAL BACKGROUND*

ON the eve of the last war the fundamental principles upon which both the organization and the functions of the contemporary British banking system are based had already been developed, although the crystallization of the structure in its present form took place only during the last phase and after the war of 1914–18.

The Economist Banking Number of Spring 1914, the most detailed source of statistical information, lists forty-three joint-stock banks at the end of 1913, with altogether 5,797 branches and controlling £809 millions deposits. Eight private banks published statements[1] with £27·1 millions deposits. Three of the forty-three joint-stock banks had more than 500 branches. The London City and Midland led with 867 branches and £93·8 millions deposits, Lloyds Bank was second with 679 branches and £91·5 millions deposits, Barclays had 570 branches and £60·8 millions deposits. There were fifteen other banks with over 100 branches.[2]

The great legislative milestones in the evolution of the English clearing banking system lie in the half-century between 1826 and

[1] The classification of *The Economist* is somewhat uncertain, e.g. Baring Bros. and Co., Glyn, Mills and Co. and Coutts and Co. are listed as joint-stock banks. Whilst this classification may be juridically correct, it is not correct from a functionally analytical point of view, as Barings cannot be counted among English banking firms (and even Glyn, Mills only with certain reservations), and the last two should rather be classified as private and not as joint-stock firms. These minor discrepancies do not alter the picture.

[2] It is interesting to note that the National Provincial, though it had £67 millions deposits, only maintained thirty-two branches, despite the fact that it was founded with the explicit intent of developing a widespread system of branches. The London County and Westminster, the third largest in the country as far as total assets and liabilities are concerned, had 342 branches.

1879.[1] The first date marks the removal of the prohibition[2] to establish joint-stock banking companies (with unlimited liability) with more than six members, having the right of issuing banknotes, outside a radius of 65 miles from London.[3] The Bank of England, as a compensation for this limitation of its privileges, received permission to open branches in the provinces. The financial crisis of 1825–6, which was the occasion for this banking reform, also marks the end of the use of rediscounting facilities at the Bank by the private London banks. This change in practice was to have far-reaching effects upon the future organization of the London money market.

The next step was taken in 1833. Joplin,[4] in 1823, called attention to the fact[5] that the charters of the Bank of England did not forbid the establishment of banks having more than six partners, provided the bank did not issue banknotes and restricted its operations to deposit banking. The legal position, however, remained disputed and nobody dared to oppose the Bank so long as the interpretation of the law remained doubtful.[6] The Reform ministry, however, decided to clarify the position. When the Charter came to be renewed in 1833 the Government, in spite of the protests of the Bank, inserted in the Act, which embodies the Charter, a declaratory clause (St. 1833, c. 98) whereby the establishment of non-issuing joint-stock banks was permitted even in London.[7] The London and Westminster started business in 1834, the London Joint Stock in 1836, and the Union and the London and County in 1839. Altogether eighty-seven joint-stock banks

[1] For more exhaustive treatment cf. Andreades, *The History of the Bank of England*; King, *The History of the London Discount Market* (1936); and the important histories of the great joint-stock banks: Crick and Wadsworth, *A Hundred Years of Joint Stock Banking* (1936); Gregory, *Select Statutes, Documents and Reports relating to British Banks*, 1832–1928 (1929) and *The Westminster Bank through a Century* (2 vols. 1936); Withers, *National Provincial Bank*, 1833–1933 (1933).

[2] 7 Geo. 4, c. 26.

[3] The Charters of the Bank of England (since 1709, redefined in 1742) gave to it a monopoly of banknote issuing, only private firms with less than seven members being exempted. 7 Anne, c. 7 and 15 Geo. 2, c. 15.

[4] Supplementary Observations to the third edition of an *Essay on Banking* (1823).

[5] Afterwards McLeod confirmed this opinion. See *Theory and Practice of Banking*, 3rd ed. (1906), p. 430.

[6] It seems that the Government had obtained confirmation of this view from the law officers, but that did not alter the attitude in the City. Cf. Andreades, op. cit. p. 259.

[7] Two other important reforms made banknotes legal tender and exempted the banks from the operations of the usury laws.

were formed in the first seven years after the Act.[1] The Bank of England did not give up its opposition to these new banks in which it saw dangerous competitors. On the basis of antiquated laws of the most varied character a vendetta was carried on in Parliament and in the Courts which was as acrimonious as it was unsuccessful.[2] The Bank also refused open drawing (let alone discount) accounts[3]

TABLE I. THE BANKING SYSTEM AS OPERATING IN ENGLAND AND WALES IN 1844*

(Amounts are stated in £000's)

	Number	Branches	Capital and reserve	Note circulation	Deposits
Bank of England (7 Sept.)	1	12	18,118	20,176	12,275
London banks:					
Private	63	None	?	Nil	27,000†
Joint-stock	5	45‡	2,244	Nil	7,984
Provincial banks:					
Private:					
Issuing 208					
Non-issuing 65					
	273	71	?	5,153	?
				—	?
Joint-stock:					
Issuing 72					
Non-issuing 28					
	100	441	7,244§	3,478	?
				—	?

* Crick and Wadsworth, op. cit. p. 22.
† Estimate by Joplin, *Currency Reform: not Depreciation* (1844).
‡ Of which thirty-six were accounted for by the London and County Bank.
§ Forty-eight banks did not give figures, and this amount represents capital only of the remainder.
NOTE. London branches of foreign and colonial banks are not included in this table.

for joint-stock banks.[4] The private bankers, on their part, refused to permit them to participate in the daily clearing which increased the efficiency, and reduced the cost, of dealing with the cheque payments of customers, which began to be the most important function of banking firms. The joint-stock banks countered these attacks as well as they could and secured deposits by granting attractive rates of interest. Between 1825–6 and 1841–2 the number

[1] King, op. cit.; Gilbart, *A Record of the Proceedings*, etc. (1847).
[2] Cf. Crick and Wadsworth, op. cit. and Gregory, op. cit. discussion on the Westminster Bank Act, on the difficulty of suing by joint-stock companies, the problem of stockholders, the formula of accepting bills, etc.
[3] Until 1841. Cf. Gregory, op. cit., also Gilbart, *History, Principles, and Practice of Banking* (1922).
[4] Cf. Part II, ch. 8, on the importance of this development for the structure of the money market.

of private banks diminished from 554 to 311, partly by continued failures but also by amalgamation, and 118 joint-stock banks survived at the end of the period.

The rapid increase in the provision of banking facilities and the speculative excesses with which it was accompanied led to severe crises, and numerous banking failures occurred. In 1844 the Government decided upon a thorough reorganization of the basis of banking; the result was, as far as the Bank of England was concerned, the Act of 1844,[1] the so-called Peel's Act. Its regulations need not be repeated here. Joint-stock banking was regulated in a second Act.[2] The excesses of the immediate past resulted in a strong reaction. Consequently the principles of this Act were oppressive. The establishment of new joint-stock banks was made almost impossible.[3] In fact only three joint-stock banks were established in the period 1844–54, and only ten until the law of 1857 relaxed the provisions of the 1844 law.[4] The almost complete freedom from new competition enabled the existing joint-stock banks to consolidate their position. The deposits of the London joint-stock banks increased from £8,850,774 in 1847 to £43,100,724 in 1857.[5] It is significant that the private banks could not hold their own. Of 208 private banks authorized to issue notes and existing in 1844, only 157 remained at the time when the new Act was passed.[6]

This intermediate period saw the final victory of the joint-stock banks over the London Clearing House controlled by the private bankers who refused to admit new members. Gilbart, as manager of the Westminster Bank, first applied for admission in 1834—almost immediately after he began negotiations with the Bank of

[1] 7 and 8 Vict. c. 32.

[2] 7 and 8 Vict. c. 113. In addition to the prohibition of the establishment of any new banks of issue and the limitation of the power of issue of existing banks, private and provincial joint-stock, both of which measures were already embodied in the Charter Act.

[3] They could be established only by Letters Patent for the maximum term of 20 years. This procedure necessitated the presentation of a petition to the Crown and a hearing before a Committee of the Privy Council. Minimum capital was to be £150,000. There were further stringent restrictions.

[4] Cf. Crick and Wadsworth, op. cit. pp. 27 and 293. It is interesting that two of these banks failed within a decade of their establishment (ibid.).

[5] King, op. cit. p. 184, 1858 Committee Report. It seems that this increase was due more to the spread of the banking habit than to the attraction of the clients of other banks (Minutes, Qu. 1138).

[6] Select Committee on Bank Act, 1857, App. 21. The number of private banks participating in the London Clearing House was thirty-nine in 1834 (Matthews, *Bankers' Clearing House* (1921), p. 13). By 1853 this had been reduced to twenty-five.

England—and renewed his application in 1836 and 1840. All these were refused. The joint-stock bankers thereupon elaborated plans to establish a new clearing house in which the Bank of England was to participate.[1] This plan was vetoed by the Bank of England. It was later disinterred, but the clearing house in 1854 admitted six joint-stock banks. Up to the outbreak of the last war eleven more[2] were admitted at varying intervals. A country cheque clearing was started in 1858 on the basis of plans elaborated by Lord Avebury (then Mr J. Lubbock) in order to satisfy the country bankers, who resorted to the same method of pressure as the London joint-stock bankers, and threatened the establishment of their own clearing house.[3] The cheque, which even in 1832 was only of minor importance—except perhaps in London[4]—became established as the normal method of payment. The clearest proof for this is that the Bank Charter Act of 1844 which penalized the amalgamation of joint-stock banks (both among themselves and with private banks) by the loss of the privilege of note issue did not prevent such amalgamations even in this early period. This change in the method of payment decided nearly all subsequent developments in commercial banking in the United Kingdom.

The joint-stock bank had further obstacles to surmount. The most irksome restrictions were swept away in 1857. The Act of that year[5] repealed the provisions of the Joint Stock Bank Act of 1844, retaining only the provision concerning the denomination of bank shares. The minimum of £100 was reaffirmed. The right of note issue was not restored, but the permissible number of partners in the case of private banks was raised from six to ten.

The limited liability principle which was accepted for companies other than banks in the previous year was granted to banks only in 1858.[6] All joint-stock banks had to re-register under this law. A further measure facilitating the establishment and amalgamation of joint-stock banks was the Companies Act of 1862, which unified the legal regulations of all companies. This removed

[1] Gregory, op. cit. vol. I, pp. 169 et seq.

[2] Matthews, op. cit. p. 26. The last admission prior to the 1914–18 War was that of the London and Provincial Bank (1914). Lloyds, Parrs, and the Midland were also admitted on amalgamation with members of the Clearing House. There has been only one further admission, the District Bank, on amalgamation with the non-member Manchester and County Bank.

[3] The Metropolitan Clearing (1907) was the last to be organized. The number of branches in the London area was then not less than 350. Matthews, op. cit.

[4] Cf. Crick and Wadsworth, op. cit. p. 23.

[5] 20 and 21 Vict. c. 49.

[6] 21 and 22 Vict. c. 91.

the minimum limit on bank shares. For some time the older banks did not avail themselves of the possibility of registering under the new Act as limited companies. They were deterred partly by the fear that a limitation of liability would impair confidence, partly by the obligation to publish balance sheets. But in the prosperous era prior to 1872 many new banking ventures were established.[1] At the same time the amalgamation movement was decidedly speeded up.[2] Private bankers feeling the severity of competition not merely gave up their individuality but began to amalgamate themselves. The most outstanding of these amalgamations took place under the leadership of the firm of Lloyds and Co., Birmingham Old Bank.

The consolidation of the legal basis of joint-stock banking was the direct consequence of one of the worst failures of British banking history. In October 1878 the City of Glasgow Bank closed its doors. It was one of the largest of the Scottish banks. It had 133 branches, 1,200 proprietors, over £8 millions of deposits, and a note circulation of £800,000.[3] The actual losses accumulated in a long period of speculative excesses and fraud amounted to not less than £6 millions. The unlimited liability of the proprietors involved calls amounting to £2,750 per share of £100. The effect of this failure on the value of all bank shares was ruinous, though the Acts of 1857–8 which permitted registration of banks as unlimited companies (hitherto they were legally partnerships) reduced to one year, from the previous period of three years, the liability attached to the ownership after the transfer of shares.

To meet this situation fresh legislation was passed in 1879. This made possible a division of the unpaid banking capital into two parts. One part was callable at the discretion of the directors. The other was 'reserved' to be called only in the event of liquidation. This provision greatly increased the credit standing of firms which availed themselves of it. To do so they had to become companies under the law and were obliged to publish their balance sheets. Many of them did so. Between 1880 and 1882 most joint-stock banks registered as limited liability companies with a simultaneous increase of their capital—in most cases the increase was not paid up, but 'reserved'. Those provincial banks which did not

[1] Especially so-called 'International Banks'. Cf. Crick and Wadsworth, op. cit. p. 33 and Baster, *The International Banks* (1929).

[2] A notable amalgamation was that of Jones, Loyd and Co. with the London and Westminster Bank in 1864, which shows the growing importance and prestige of joint-stock banks. Lord Overstone was one of the greatest opponents and harshest critics of joint-stock banking.

[3] Crick and Wadsworth, op. cit. pp. 396–8.

follow suit and continued to withhold the publication of their balance sheets, began to lose in influence and popularity. The general effect of the legislation was to cause some consolidation of the banking system. The position in 1884 appeared as shown in Table II. It is seen from this table that the majority of English banks at this period were predominantly local in character. But those which had gone beyond the limits of their own localities were already surpassing all others in size.

TABLE II. THE BANKING SYSTEM AS OPERATING IN ENGLAND AND WALES IN 1884*

(Amounts are stated in £000's)

	Number	Branches	Capital and reserve	Note circulation	Deposits
Bank of England (24 Sept.)	1	11	18,295	25,102	29,372
London banks:					
Private	35	10	?	Nil	68,000†
Joint-stock	21	52	18,147	Nil	76,654
London and provincial banks:					
Joint-stock	6	517	9,000	Nil	69,738
Provincial banks:					
Private:					
Issuing 100		330	?	1,439	78,561†
Non-issuing 72		103	?	Nil	
	172				
Joint-stock:					
Issuing 45		523	15,749	1,541	54,456
Non-issuing 46		529	18,728	Nil	80,887
	91				

* Crick and Wadsworth, op. cit. p. 34.

† Estimates: the private banks did not publish balance sheets, while eleven provincial joint-stock banks did not give full figures.

The further development, given the growing predominance of the cheque as a means of payment and the repeal of restrictive legislation, could not be in doubt.[1] The advantages of ever-wider branch banking under these circumstances were so manifest that the impetus to concentration became irresistible. These advantages are, first, the speedy and cheap clearing of cheques which is expensive for a local bank which has to maintain agents in the clearing centre. Once a bank can clear cheaply and quickly it can attract deposits by offering, instead of a cash interest payment, the service of administering a drawing account; secondly, the direct

[1] The replacement of the bill of exchange as a means of internal finance by the overdraft had the same influence.

pooling of surpluses in certain areas and their transfer to those requiring credit with consequential economies in cash reserves; thirdly, the wider (not only geographically) and therefore better distribution of individual credit risks (even the more general risks resulting from the influence of the business cycle can be better distributed, as no bank will be exclusively interested in the riskier sphere of capital goods production); fourthly, the reduction of general overhead costs (reduction in uneconomic branches, cutting the duplication of agents) and the standardization of operations; fifthly, superiority of service resulting from the possibility of utilizing the advantages of a wide division of labour by employing experts whose services, though often retained at the head office, are available to all clients. It is true that the method of employing corresponding banks in main centres and of obtaining (or sending) bills for rediscount to such centres eliminates many of the technical drawbacks of the unit system. But it cannot compete from the combined point of view of profitability and safety with the branch banking system.[1] Table III shows the development of the amalgamation movement after 1890 and demonstrates how the 1914 position was reached.

The amalgamation movement enabled successful provincial banks such as the Midland and Lloyds to establish connections in areas in which they were not represented and also to obtain a place in the clearing house[2] by absorbing a London bank which was already a member. In one instance (Barclays Bank, 1896) several private banking firms amalgamated in order to be able to compete successfully with the large joint-stock banks. Only banks in the Lancashire area resisted for a long time any attempts at amalgamation.[3] While this process of consolidation was continuing there was also a considerable amount of expansion by the opening of new branches. These increased from 1,195 in 1858 to 2,113 in 1881 and 5,797 by the end of 1913. The general character of the amalgamations can be seen in Table III.

The Amalgamations after 1914. *The Treasury Minute.* In the first years of the war the movement slackened only to gather new impetus in 1917 and 1918. The number of small local banks was already

[1] Cf. Sykes, *The Present Position of English Joint Stock Banking* (1928).

[2] The National Provincial Bank decided in 1866 to relinquish the privilege of note issue rather than lack a London office. It was admitted to the clearing.

[3] The contemplated amalgamation of the Manchester and Liverpool District with Lloyds in 1904 and of the Lancashire and Yorkshire Bank with Parrs in 1910 had to be abandoned.

TABLE III. BANK AMALGAMATIONS:* ENGLAND AND WALES

Years	Private with private	Joint-stock absorbs private	Joint-stock with joint-stock	Private absorbs joint-stock	Total
1826–1843	23	93	6	—	122
1844–1861	11	23	10	—	44
1862–1889	31	66	40	1	138
1890–1902	37	64	51	1	153
1903–1924	1	36	58	—	95
Total	103	282	165	2	552

* Sykes, *The Amalgamation Movement in English Banking*, 1825–1924 (1926).

negligible. Amalgamation now embraced large branch systems. Two reasons were given for this new type of amalgamation.[1] The first was that the amalgamation of large existing systems secured an extension of their areas with the consequent gain in safety, efficiency and economy of operations.[2] The second argument used was that the increase in the size of industrial units necessitated an increase in the banks, for otherwise they would be unable to accommodate these new large firms.[3] The most important of these amalgamations were those of Lloyds with the Capital and Counties Bank Ltd.; the London City and Midland Bank Ltd. with the London Joint Stock Bank; the London County and Westminster Bank with Parrs Bank Ltd.; and the National Provincial Bank of England (which up to that moment had not taken part in this type of

TABLE IV. BANKING AMALGAMATIONS

(Approximate figures for 1918)

	London branches	Provincial branches (excluding sub-branches and including only one branch in each place)	Foreign agencies held
(*a*) National Provincial	26	251	31
Union of London and Smith's	31	78	150
(*b*) London County and Westminster	110	180	400
Parrs	35	160	35
(*c*) London City and Midland	107	419	850
London Joint Stock	41	109	70

[1] Cf. *Report of the Treasury Committee on Bank Amalgamations*, Cd. 9052–1918.
[2] Cf. Goodenough, *M.E.* Qu. 780 and Pease, ibid. Qu. 2054–6.
[3] Cf. Goodenough, *M.E.* Qu. 780–9 and Pease, ibid. Qu. 2038–40. A third reason was, in all probability, the mere attraction of size which secures international prestige. The expansion of the German joint-stock banks stimulated the British race in amalgamations.

expansion) with the Union of London and Smith's Bank Ltd. The object and result of these transactions is best demonstrated by a table published by the Treasury Committee (Table IV). The number of banks of the first magnitude was reduced to five. They controlled nearly two-thirds of all banking resources of the country.

This spate of amalgamations caused serious perturbation,[1] and demands were voiced to curb by legislation any further concentration in banking. The Committee appointed by the Treasury concluded that the arguments raised against further amalgamations were on the whole justified, whilst the two reasons (cf. above) brought forward in favour of further concentration were losing force as the amalgamation movement proceeded. No further diversification and spreading of the banking area was possible except in the case of a few remaining banks. Amalgamations between the big institutions would rather tend to reduce competition to an undesirable extent. Nor could it be claimed that further amalgamation was necessary in order to be able to accommodate industry. The Committee mentioned (1) that the further shrinkage of the ratio of capital to liabilities was undesirable and pointed out that amalgamations tended to result in a writing down of the combined capital of the amalgamating institutions, and (2) that the dangers of reduced competition could not be considered negligible. This was especially the case with respect to the money market which depended for its existence on a free supply of short loans obtained under competitive conditions. There was, furthermore, the added risk that with the reduction of the number of first-class acceptors the limits within which both the Bank of England and foreign purchasers would be willing to take acceptances granted by the amalgamated bank would have to be restricted. (3) Finally, they pointed out that the political repercussions of the concentration of banking in the hand of a few banks would be undesirable. They therefore recommended that further amalgamations, joint directorates or any steps altering the status of banks, should be made dependent by an Act of Parliament on the joint approval of the Treasury and the Board of Trade. The departments should consider favourably schemes whose effect did not consist mainly in reducing competition. The legislation proposed has never been passed, but otherwise the conclusions of the Committee were accepted. Instead of legislative regulation 'various

[1] There was intermittent criticism before, cf. *The Economist*, 4 August 1914.

Chancellors of the Exchequer have said that they would not countenance any more bank amalgamations'.[1] The banks 'voluntarily' agreed to submit any merger or affiliation scheme to a Special Advisory Committee for approval prior to its entry into effect.

This Committee seems to have acted upon the principles laid down by the Treasury Committee. Several amalgamations took place after the report was submitted. Indeed, a new type of expansion has been extensively undertaken since it was published. Before the war great difficulty had been experienced by the Big Five in amalgamating banks in Lancashire as well as in Scotland and Ireland where the local patriotism of clients caused them to resent strongly the absorption of local banks, and consideration of note-issue rights deterred amalgamations. The Midland Bank in 1917 purchased the entire share capital of the Belfast Banking Co. This was followed by the acquisition of the Clydesdale Bank (1920) and the North of Scotland Bank (1924). Barclays acquired the British Linen Bank and the Union Bank of Manchester, Lloyds the National Bank of Scotland and the Westminster the Ulster Bank. The National Provincial acquired two English private banks, Coutts and Grindlays. There was also a reverse affiliation when the Royal Bank of Scotland bought Williams Deacon's Bank.[2]

By 1922 the number of banks in England and Wales whose cheques passed through the clearing house was twenty-six:

(*a*) The Bank of England.

(*b*) Bank of Liverpool and Martins.
Barclays.
Coutts and Co.
Glyn, Mills, Currie and Co.
Lloyds.
London, County, Westminster and Parrs.
London Joint City and Midland.
National.
National Provincial and Union Bank of England.
Williams Deacon's.

(*c*) Child and Co.
Cox and Co.
Grindlay and Co.
Hoares.
Equitable.
Gunner and Co.
Lancashire and Yorkshire.
Manchester and County.

[1] Pease, *M.E.* Qu. 2046.

[2] And, in 1939, followed it up by acquiring the share capital of Glyn, Mills. In all these cases a varying autonomy was granted by the leading unit to the affiliated bank.

Holt and Co.
King and Co.
McGrigor and Co.
Dingley and Co.
Manchester and Liverpool District Banking Co.
Union Bank of Manchester.
Yorkshire Penny Bank.

One bank (McGrigor and Co.) failed in 1922. The following amalgamations have taken place since that date:

1922: National Provincial and Union with Dingley and Co. of Launceston and Dingley, Pearse and Co. of Okehampton.
Cox and Co. with King and Co.

1923: Lloyds with Cox and Co.
Glyn, Mills, Currie and Co. with Holt and Co.

1924: Glyn, Mills, Currie, Holt and Co. with Child and Co.

1927: Bank of Liverpool and Martins with the Equitable.

1928: Bank of Liverpool and Martins with the Lancashire and Yorkshire.

1935: The District with the Manchester and County.

Except for Hoares and Gunner and Co. (Bishops Waltham) no independent private bank remains. The remaining two 'provincial' banks, the District (head office, Manchester) and Martins (Liverpool) are both members of the London Clearing House with a widespread network of branches. The Yorkshire Penny Bank is a special bank owned by eight of the clearing banks (all except National, Glyn, Mills and Coutts). There are some small and unimportant banking firms in London. The Co-operative Wholesale Society owns a bank, and there is also the Birmingham Municipal Bank. Otherwise banking resources are controlled directly or indirectly by the independent British clearing banks and the four independent Scottish banks.[1]

The absorption of local and regional banks was followed up by a systematic reorganization and extension of the branch systems. We possess an analysis of the relative importance of the two methods of expansion in the case of the Midland Bank (Table V), and Mr Sykes has made an analysis of the development of banking in England and Wales[2] which is set out in Table VI. The number of bank branch offices increased to 10,178 in 1931. In the two subsequent years it fell to 10,060,[3] to increase once more to 10,118 in

[1] *The Economist*, Banking Supplement, 20 May 1939.
[2] An exhaustive list of amalgamations will be found in Matthews, op. cit. ch. VII, pp. 87–138. Also Crick and Wadsworth, op. cit.; Gregory, op. cit.; *Lloyds Bank Annual Reports* and Sykes, op. cit.
[3] *The Economist*, Banking Supplement, 20 May 1939.

1935. After a renewed fall to 10,074 in 1936 it rose again to 10,151 in 1938. The analysis of the Midland Bank figures as well as the fluctuation around 10,100 of the total number of offices in a period of almost ten years suggest that for the moment a saturation point had been passed. Witnesses before the Macmillan Committee

TABLE V. MIDLAND BANK BRANCH SYSTEM*

	Branches opened	Branches added by amalgamation	Branches closed	Branches open at end of period
1836–79	1	2	—	3
1880–89	16	8	—	27
1890–99	111	149	8	279
1900–09	135	247	3	658
1910–19	274	517	5	1,444
1920–29	691	—	91	2,044
1930–34	126	—	60	2,110

* Crick and Wadsworth, op. cit. p. 333.

TABLE VI.* NUMBER OF INHABITANTS TO EACH BANKING OFFICE

Year	England and Wales			Scotland		
	Population†	No. of banking offices‡	No. of inhabitants to each banking office	Population†	No. of banking offices‡	No. of inhabitants to each banking office
1891	29,002,525	2,338	12,405	4,025,647	982	4,099
1901	32,527,843	3,935	8,266	4,472,103	1,092	4,095
1911	36,070,492	5,419	6,656	4,760,904	1,225	3,886
1921	37,886,699	7,611	4,978	4,882,497	1,308	3,733
1925	38,890,000	8,473	4,590	4,893,032	1,563	3,131

* H. E. Butson, 'The Banking System of the United Kingdom', in Willis and Beckhardt, *Foreign Banking Systems*, New York, 1929, p. 1242.

† The figures of population for England and Wales, and Scotland, 1891–1921, are taken from census returns. The remainder are estimated figures taken from the *Statesman's Year-Book*.

‡ Taken from the foregoing tables reproduced from *The Economist*, Banking Supplement, 29 May 1926. The numbers of banking offices for 1891 and 1901 are estimated.

denied[1] both that there had been an uneconomic extension of the branch system due to duplication of branches or that any gain would result from closing certain branches. This claim is not borne out altogether by the statistics. It is difficult to see, however, how any concerted plan to reduce the number of branches, unless accompanied by stringent State control, would be possible without

[1] Cf. Goschen (*M.E.* Qu. 1806–7, 2001), Pease (ibid. Qu. 2054–6), and Goodenough (ibid. Qu. 780).

immediately involving the charge of establishing a money trust. In contrast to the management of the assets of the clearing banks, where, as we shall presently see, some 'understanding' restricting competitive overbidding was 'arrived at',[1] no formula has yet been evolved which would provide an effective check on competition for deposits. Since 1886 the more important banks quote identical rates of interest on deposits, which is determined by bank rate.[2] Even apart from certain large funds, for which there is keen competition at times, the banks continue to try to attract small deposits through various other inducements offered to clients. These inducements now take the form of a wide and increasing variety of professional services offered free to those who maintain balances in their current accounts. Those services could not be provided without a widespread network of branches. The claim that the establishment of branch banking systems rendered competition keener because the personal and professional inhibitions disappear with the increasingly impersonal character of the business,[3] has at least, in certain directions, been substantiated by these developments.[4] This competition has, however, not taken the form of price competition.[5]

CHAPTER 2. *THE STRUCTURE OF BRITISH DEPOSIT BANKING*

The Economist Banking Supplement of 1939 lists fifteen English and eight Scottish joint-stock banks at the end of 1938. It also distinguishes three private banks. These figures are somewhat misleading. Baring Brothers and Co., the London Merchant Bank, Japhet and Blydenstein, which are included by *The Economist*, belong to the category of 'merchant banks' and the discount market respectively. The British Mutual Banking Company (established in 1857), which has no branches, is a small bank associated with the

[1] Though some of these agreements were not wholly enforced by the participants. Cf. the agreement on discounts and Treasury bills, Part II.

[2] As early as August 1875 there was a conference on reaching an agreement on deposit allowances. That effort was abortive, but by 1877 all London banks had abolished allowances in current accounts. Cf. King, op. cit. p. 290.

[3] Pease and Goodenough, before the Macmillan Committee; see p. 13, n. 1.

[4] There can be little doubt, on the other hand, that concentration tended to conventionalize and freeze the structure of the rates of interest. Cf. below.

[5] Cf. below on the level of the rate of interest.

TABLE VII. THE BRITISH BANKING SYSTEM, 31 DECEMBER 1938

(Amounts are stated in £000's)

	No. of branches	Capital and reserves	Deposits	Total
A. ENGLISH GROUPS				
Midland	2,137	27,570	462,742	490,312
Clydesdale Bank	208	3,100	35,645	38,745
North of Scotland Bank	161	2,476	29,124	31,600
Belfast Banking Co., Ltd.	51	1,700	13,519	15,219
		34,846	541,030	575,876
Barclays	2,131	26,608	433,081	459,689
British Linen Bank	215	3,750	36,471	40,221
Union Bank of Manchester	169	1,250	18,456	19,706
		31,608	488,008	519,616
Lloyds	1,912	25,310	397,674	422,984
National Bank of Scotland	192	3,400	38,282	41,682
		28,710	435,956	464,666
Westminster	1,098	18,640	346,221	364,861
Ulster Bank	115	2,000	20,711	22,711
		20,640	366,932	387,572
National Provincial	1,324	17,979	310,383	328,362
Coutts	4	2,000	21,247	23,247
		19,979	331,630	351,609
Total for Big Five	9,717	135,783	2,163,556	2,299,339
Martins	584	7,710	100,058	107,768
District	569	5,953	83,469	89,422
Glyn, Mills*	3	1,590	35,809	37,399
Hoare	1	500	3,477	3,977
TOTAL ENGLISH	10,874	151,536	2,386,369	2,537,905
B. SCOTTISH GROUP				
Bank of Scotland	263	4,500	37,852	42,352
Commercial Bank of Scotland	385	5,400	44,739	50,139
Royal Bank of Scotland	258	7,906	69,922	77,828
Williams Deacon's	209	2,775	38,335	41,110
Union Bank of Scotland	220	3,000	33,219	36,219
TOTAL SCOTTISH	1,335	23,581	224,067	247,648
C. Seven Irish banks†	1,162	14,464	136,607	151,071
GRAND TOTAL	13,371	189,581	2,747,043	2,936,624

* Intergroup deposits have not been eliminated. Glyn, Mills has since been affiliated to the Royal Bank of Scotland.

† Including sub-branches.

Prudential Insurance Company. Its balance sheet and policy are not relevant to a discussion of banking in England. The Isle of Man Bank, founded 1865,[1] is a purely local Manx bank with the right of issuing its own notes in the Isle of Man. Not listed, on the other hand, is Gunner and Co., with Hoare the only remaining private firm in England, and Grindlay and Co., established in 1828, which was converted into a private limited liability company with capital of £250,000 in 1924, after it had been acquired by the National Provincial Bank in 1923. The latter caters mainly for the Indian service, and has ten branches there. Its deposits amount to £3·4 millions. Having regard to the other amalgamations and affiliations mentioned above, the structure of British banking in 1938 appeared to be as shown in Table VII[2].

The largest of these groups is that of the Midland Bank. It controlled over £540 millions of deposits at the end of 1938 (the Midland alone rose above the £500 millions limit on several occasions in 1936–7), its total resources being above £575 millions at that date. The origins of this bank are to be found in the Midland centres[3] where it was established in 1836 as the Birmingham and Midland Bank. Its expansion dates from 1889 when its management was assumed by Mr (afterwards Sir) E. Holden. In 1891, as we saw, it transferred its head office to London upon amalgamation with the Central Bank of London and changed its title to the London and Midland Bank; it further strengthened its position in London by acquiring the City Bank. Its greatest single amalgamation came in 1918 by the merger with the London Joint Stock Bank. Its title was changed to London Joint City and Midland Bank. Sir E. Holden was succeeded by Mr McKenna as Chairman. Mr Hyde, who gave evidence before the Macmillan Committee, was for a long time its managing director. The Midland Bank has a reputation for rather greater independence in thought and action than the other joint-stock banks. It was a pioneer in foreign exchange and acceptance business as well as in the extension of

[1] The table contains an error. The liability of the bank is unlimited *only* as far as banknotes are concerned.

[2] *The Economist*, Banking Supplements, May 20 and Nov. 6, 1939.

[3] For a detailed history of the banks cf. Crick and Wadsworth, op. cit.; Gregory, op. cit.; Withers, op. cit., for the Midland, Westminster and National Provincial respectively; also Ashby, *The Story of the Banks*. Short historical summaries are published by *The Statist* yearly, 'British Banking Section', and the balance sheets and certain data on amalgamations, capital and profits are published by *The Economist*, Banking Supplement. Only a short summary of salient points can be given here.

other ancillary banking services, breaking down very strong traditions. Its voice was heard from time to time on questions of banking policy, as when it repeatedly advocated more liberal credit policies. It did not follow the other clearing banks in establishing foreign branches or affiliations, though—and perhaps partly for that reason —it probably has conducted a larger volume of overseas business than any other bank. In more than one instance, as we shall see, its policy has differed from (if it did not clash with) the policy of its competitors, often using one of its affiliates for the purpose.

The second largest combine is that of Barclays. It captured this place from Lloyds as recently as 1932. In its development it shows some similarity to this rival: it was the result of the amalgamation of twenty private banks in 1896. Its outstanding expansion was the amalgamation in 1918 with the London, Provincial and South-Western Bank. The subsequent year saw the expansion into Lancashire and Scotland described above. It has varied direct foreign affiliations.[1] Its board of directors still bears an imprint of the family origins of the bank.

Lloyds is the third bank. It reached its present form by the amalgamation of private banks in the Midlands in 1865, Lloyds and Co., the Birmingham Old Bank and Moilliet and Son. The most powerful of these was established in 1765. The London connection was established by absorbing two old private London firms in 1889. In 1918 it absorbed the Capital and Counties Bank; in subsequent years, presumably with Treasury consent, the West Yorkshire Bank (1919), Fox, Fowler and Co. (Wellington), the last of the private banks having the right of banknote issue (1921), and Cox and Co. (incorporating King and Co.), London (1923). Its board is known for its strongly orthodox views. It possesses connections with international banking. As we shall see, it is the co-partner with the National Provincial in foreign banking. It has a Scottish affiliation.

The Westminster Bank is the only one of the Big Five which is the result of an expansion of one of the original London joint-stock banks. It was established in 1833 and opened for business on 4 March 1834. Under the leadership of J. W. Gilbart it was a pioneer in London joint-stock banking. Certain of the most notable of its amalgamations have been mentioned above. Apart from the amalgamation with Parrs (1918), further recent absorptions include the Nottingham and Nottinghamshire Banking Co. (1919), Stilwell

[1] Cf. below.

and Sons (1923) and the Guernsey Commercial Banking Company (1924). It has a foreign and an Irish affiliate. Its board is aristocratic; lately, however, distinguished ex-public servants have been asked to join it. Dr Leaf, who held conservative views in banking theory, was its late chairman.

The National Provincial Bank was established in 1833, largely as a result of the propaganda of T. Joplin who afterwards quarrelled with the board and left. The National Provincial is the only bank which did not gain its foothold in London by amalgamation but by opening a branch (1866) (incidentally forfeiting the right of note issue) and being thereupon admitted to the clearing. Its amalgamations took place rather late. The most important was that with the Union of London and Smith's Bank. It pursued a policy of active expansion after 1918: Sheffield Banking Co. (1918), Northamptonshire Union Bank (1919). In 1920 Coutts and Co. was acquired, but left as a separate unit. These acquisitions were continued: 1919, Richards and Co., Llangollen; 1920, Shilson Coode and Co., St Austell; 1922, Dingley and Co., Launceston, and Dingley Pearse and Co., Okehampton; 1923, Guernsey Banking Co. and Grindlay and Co. (the latter was continued as a separate entity). It joined Lloyds in foreign banking ventures, but has no Scottish affiliate. The partners of former private companies which it has absorbed play a prominent part on its board. It had (1938) also interlinked directors with one of the public and one of the private discount companies.[1]

Martins and the District Bank now rank with the Big Five. They have their head offices in the provinces, the former in Liverpool, the latter in Manchester. The former, which prior to a recent expansion of the Royal Bank of Scotland was the sixth bank in Britain, is the result of the amalgamation in 1918 of Martins Bank, an old private bank, registered as a private company in 1890, with the Bank of Liverpool, established in 1831. It followed a fairly active policy of expansion through amalgamation and branch extension afterwards, and has succeeded in maintaining its position by attracting deposits in the last few years.

The District Bank is the amalgamation of the two last remaining provincial banks in the proper sense of the word—the District and the County Banks in 1935. After amalgamation the new bank was admitted to membership in the London Clearing, and provides the

[1] It is to be remembered, however, that interlinking directorships are mostly personal and do not originate from the direct interests of the banks.

second example of this conservative institution opening its doors to newcomers. The action of the Clearing House was, however, clearly in accordance with the spirit and tenor of the Treasury Report on amalgamations which has been quoted above. The amalgamation of two highly localized banks had undoubtedly produced a new unit able to provide valuable banking services. To have denied to it the right of membership of the Clearing House would have been extremely short-sighted.

CHAPTER 3. *THE INTERNAL ORGANIZATION OF THE BIG CLEARING BANKS*[1]

THE vast size of the Big Five has raised problems of the greatest complexity. On the one hand, a unified policy and a strict control is essential; on the other, it is necessary to safeguard the spirit of initiative and the elasticity which was provided earlier by the intimate personal contacts of smaller banks with their clients.[2]

A. THE MANAGEMENT

The five great banks have sought for a solution to these problems along different lines. Some have introduced strict concentration of the power of decision at the head office. Others have established a measure of decentralization (with or without local directors or advisory committees in the provinces—or, rather, in each or certain of the districts into which their branch systems in the country are divided).

The method of centralization seems to have been adopted by

[1] No evidence was given on organization to the Macmillan Committee by Mr Goodenough (Barclays).

[2] No account is given here of the formal legal structure of the banks, the general meetings and the regulations affecting the power of voting and the choice of directors. They may be interesting in a monograph, especially a legal monograph. From an economic-functional point of view they are wholly irrelevant. As in the case of most big joint-stock companies the board is in practice a self-perpetuating, self-appointed fellowship, which is deposed or altered only in the most exceptional circumstances. The articles of association in effect safeguard this position by limiting the individual voting power to a maximum, irrespective of further purchases. An attack on the board by the purchase of shares is therefore almost impossible. Lloyds Bank, for example, provides a maximum of votes of 5 irrespective of the number of shares held; Westminster also of 5 votes; National Provincial 4 votes; Midland 6 votes.

the Midland, the National Provincial and the Westminster Banks; while Barclays has adopted the policy of decentralization,[1] and Lloyds a system of compromise.

Under the first system an application for a loan or an advance is received by the manager of a branch. If he considers it a reasonable proposition, and if it exceeds his discretionary limit, which in many cases is quite small, he forwards it to the head office. Even this practice is varied; the Midland Bank does not give any discretionary power to its managers, all applications for accommodation must be forwarded to the head office. Other banks grant discretionary powers to branch managers; the Westminster up to £2,000, Lloyds up to £1,000. At the head office (and in the case of Lloyds at the district offices[2]) the district controllers (superintendents) consider the application. If the amount of it exceeds their limit, it will go to still higher officials, deputy general managers, chief general managers, and the like. They frequently work as a committee, and in important cases they do not decide, but—at least formally—only make recommendations to the board of directors. This is the practice in the National Provincial and Lloyds who allow their chief officers a limit of £1,500. In the case of the Midland Bank, reference is to an Executive Committee consisting of managing directors (if any) and general managers. An interesting device to assure that no business is rejected unnecessarily, is that no application can be turned down except by the highest executive organ. In the case of Lloyds the Local Advisory Committees, which seem to consist, in the main, of the retired directors of banks which have been absorbed, give their opinion on loans, but do not seem to have executive power. They are, however, helpful in establishing useful contacts and providing information.

Barclays has a different system. It possesses Local Boards which have strong executive power and, acting according to the principles and policies laid down centrally by the board, administer branches and even affiliated banks, for example, the Union Bank of Manchester which is controlled by the Liverpool and Manchester Local Board. They are obliged to refer to the head office only in exceptional cases. This system has been devised to safeguard per-

[1] Lloyds Bank: Pease, *M.E.* Qu. 2010–32, 2064. Midland: Hyde, ibid. Qu. 862–6 (also Crick and Wadsworth, op. cit. pp. 327–46). National Provincial: Goschen, ibid. Qu. 1803–8, 1919. Westminster: Rae, ibid. Qu. 2319, 2397–402.

[2] One of Lloyds District General Managers remains in Birmingham.

sonal contacts with, and knowledge of, customers, which were so valuable a feature of purely local banks.[1]

It is difficult to decide which of the two systems is more satisfactory, as they both depend on the personal element. Centralization may have its advantages even in this respect; in many cases it will be useful for a branch manager to be able to blame the unknown head office for whatever measure he would take himself in any case.

It is the problem of the personal element which presents the greatest difficulties. The career itself is not one to attract the ambitious and the venturesome. Service with one bank is the normal case and those who enter it look forward to retirement on a secure pension. The method of recruitment, moreover, of most bank clerks does not favour the most able. The age limits imposed tends to prevent adequate education. This is the remnant of the feudal days of private banks when the clerks could hardly hope to rise to become principals (except perhaps through eloping with the principal's daughter, which seems to have been a customary procedure). But now these clerks rise to be managers, general managers and even directors. Various devices have been adopted to improve matters. Scholarships are given, competitive examinations are held, and the best are helped on with their studies. For a short period university graduates were brought in—though that scheme did not prove very successful. In many cases, especially with respect to foreign business, outsiders were invited to join the banks. The banks also encourage their managers to join local clubs, to play golf, in fact to act generally as the old private bankers have acted. All these devices do not altogether solve the problem of how to train personnel, in institutions with some tens of thousand employees each, to be enterprising and at the same time cautious, to have initiative and a capacity for shouldering responsibility, when their careers may depend on their successful avoidance of bad debts. Bank employees, like civil servants, are in practice appointed for life—except in cases of dishonesty. The removal of the less able to make places for the energetic is difficult.[2]

As long as the banks could make use of the senior and experienced personnel of the small banks which they absorbed the question of recruitment was not so acute.[3] It will become increasingly so as

[1] The local directors of the Westminster are on the contrary only 'ornamental'. *M.E.* Qu. 2403.

[2] A change in the system of pension might provide some help.

[3] Cf. Pease, *M.E.* Qu. 2034.

time passes, not so much because the boards of directors increasingly admit former employees into the boards and the control of current business, but principally because the control of business in effect lies in the hands of managers and not of the directors. This is not a unique experience, nor a problem of banking alone. It is merely an aspect of the very much broader problem of the increasing centralization and therefore bureaucratization of the body politic and economic which is slowly replacing the old system of free competition between small units and which makes one wonder whether those who abhor public control because of the deadening influence of distant bureaucratic control are not longing for something which is irretrievably past.

B. The Board of Directors

'The bank's directors are not chosen for their detailed knowledge of the country's industries and trade conditions.'[1] 'Every member of the board has either been a banker in a private bank or in a joint-stock bank which we have absorbed or is the representative with expert knowledge of particular industries or districts where the bank is represented.'[2]

Recent research conducted into other directorships held by the directors of the joint-stock banks confirms both statements. According to Mr E. Davies[3] the directors of the five largest banks held altogether 1,036 directorships. These directorships were distributed as shown in Table VIII.

This is an impressive list. And it must not be forgotten that some, if not most, of these directorships carry with them managing and executive power in the greatest industrial, trading and transport enterprises of the country.[4] Especially close links are established between the boards of the banks and those of the insurance companies. Some distinguished retired civil and public servants (Viceroys, Governors, Ambassadors, etc., the holders of great names) are also invited to join boards. One must not, however, exaggerate the importance of these links. Not a few of the directors are chosen for 'decorative' purposes. If we exclude from it the full-time chairmen and managing directors, this table, as most of

[1] Memorandum from Mr Pease quoted by Lord Macmillan, *M.E.* Qu. 2010.
[2] Pease, *M.E.* Qu. 2011.
[3] *National Capitalism* (1939), p. 296.
[4] On the board of the Midland Bank, for example, the Chairmen of I.C.I. and Imperial Tobacco had seats.

TABLE VIII. DIRECTORSHIPS

	Barclays	Lloyds	Midland	National Provincial	Westminster	Total
Banks and Discount Cos.	22	24	57	19	40	162
Breweries and Distilleries	1	11	3	—	—	15
Cables and Wireless	2	7	1	7	—	17
Canals and Docks	—	2	3	1	2	8
Commercial and Industrial	23	48	53	33	23	180
Electric Lighting and Power	2	12	6	1	4	25
Financial Trust	12	10	9	1	10	42
Foreign and Dominion Rails	12	1	1	1	7	22
Gas	—	2	5	1	—	8
Home Rails	—	7	6	1	3	17
Insurance	22	19	16	14	17	88
Investment Trusts	3	17	5	8	7	40
Iron, Coal and Steel	4	21	19	16	13	73
Land and Property	3	8	8	3	7	29
Mines	—	9	5	—	3	17
Oils	—	43	3	26	3	75
Shipping	24	10	7	8	12	61
Tea, Coffee and Rubber	1	—	2	1	6	10
Telegraphs and Telephones	—	12	6	16	—	34
Tramways and Omnibuses	1	—	1	—	2	4
Waterworks	3	—	—	—	1	4
Unclassified	12	46	20	14	13	105
Totals	147	309	236	171	173	1,036

the research on the basis of Almanacs and *Who's Who*, is somewhat irrelevant. The boards do not meet more than once weekly, though some members meet more frequently on committees. It would be wholly impossible for their members to take any but the most general interest in the proceedings. It is exceptional, therefore, that they should disregard the recommendation of the management as regards any individual business. This is abundantly shown by the fact that there are clear cases of incompatibility between some of the directorships held, which do not in fact seem to have worked to the detriment of the institutions concerned. The most interesting of these seeming incompatibilities are the cases where directors of joint-stock banks are also partners or directors of acceptance and discount houses with which they compete for business. The Westminster Bank, for example, has had directors or partners of five acceptance and finance houses on its board and one director of a discount company, Lloyds four and one, the

National Provincial two and two (its own chairman was also chairman of Alexander's Discount Co.). Yet the banks, as we shall see below, made life difficult to both acceptance houses and discount companies. In many cases directors of one of the Big Five were also co-directors, on the boards of assurance companies and elsewhere, of directors of other clearing banks. This system may be objected to on formal grounds. In practice it has not had the consequences which led to such far-reaching reforms in the U.S.A. after 1933. It can be claimed against the criticism often voiced that the formal incompatibility did not result in detrimental consequences for the shareholders or the public. All directors are forced to disclose their outside connections, and they must not vote on decisions where they are legally interested on the other side. But these tables do give an interesting picture of the social stratification of the City, which contributes to the great compactness in the 'public opinion' in the City. Whilst it necessarily has great political significance, it must also be admitted that this compactness has been of some assistance to the British banking system in weathering crises so successfully.

The full-time chairmen and the managing directors of the banks have a decisive voice in matters of policy. The latter are now mostly chosen from the management staff. Among the former the family ties of the constituent banks still predominate, except in the case of the Midland Bank, which even in this respect is different from all others. It has only one private banker on its board. This fact, perhaps, explains certain features of its policy. The salaries of chairmen vary between 5,000 and 10,000 guineas or even higher, often free of income tax. The usual director's fee is between 1,000 and 2,000 guineas.

C. Interbank Organizations

From the beginning of joint-stock banking[1] efforts have been made to secure some co-operation with respect to the deposit allowances and other matters affecting banking services. These efforts almost invariably broke down at an early stage. Though this fact unquestionably contributed to the periodic spasms of excessive competition and consequent crises and failures, the absence of monopolistic regulation had beneficial consequences, for the extremely favourable conditions granted to depositors assisted in

[1] Cf. King, op. cit., especially pp. 211, 290–1.

spreading the banking habit. The first beginning of the still 'informal' co-operation dates back to the period of excessive monetary ease after the crisis of 1873, when the leading joint-stock banks co-ordinated their deposit allowances and increased the spread between the bank rate and the deposit allowances from 1 to 1½ per cent. But prior to the 1914–18 war the relations between the joint-stock banks themselves and between them and the Bank of England remained strained if not hostile.[1] This is not astonishing considering that each of the main joint-stock banks was actively engaged in expanding its own network by amalgamation and by opening new branches. The war of 1914–18, with its new problems, and the completion of the amalgamation movement, which stabilized the banking structure, resulted in fundamental changes. It was necessary to organize Committees for the relief of debtors;[2] it was also necessary to co-ordinate all banking resources for the purpose of war finance.[3] In all the Committees which were set up, joint-stock bankers took a prominent role, though there seems little doubt that the initiative and direction was in the hands of the new, temporary civil service. The problems which had to be dealt with were without precedent. The banking community did not show itself capable of dealing with questions of this character. Their *esprit de corps* was, however, as in later crises, necessary for the success of the initiative by others—in the absence of complete national control. In the immediate crisis in 1914 an ex-conservative Chancellor of the Exchequer, Lord St Aldryn, took the lead and kept the banks together. In the post-war years, although competitive conditions became more severe, reversion to the pre-war position was prevented. One of the immediate consequences was the increase of the spread between bank rate and deposit allowances to 2 per cent in 1920.

The most important of the bodies on which the clearing banks are represented is the Clearing Banks Committee. It is mainly concerned with agreements regulating business (discount market, purchase of bills, deposit allowances). It is also the body to which the authorities transmit their 'requests' concerning such 'regula-

[1] Cf. Crick and Wadsworth, op. cit., on Holden's plan for the establishment of a separate gold reserve. Also the evidence of Sir F. Schuster and Mr Gow before the U.S. Monetary Committee on the hostile competition of the Bank of England.

[2] Cf. Cd. 7684/1914, pp. 8–9.

[3] The so-called Treasury Committee which seems to have been maintained after the war (cf. Sykes, *The Present Position of English Joint Stock Banking* (1928), pp. 134–5).

tions' about forward exchange, swap, loans on gold, eligibility of the bills of Local Authorities, etc., as they may wish to enforce. Its efficiency in the latter respect is undoubted.[1] This Committee or its constituent members have representatives on the Foreign Exchange Dealers Committee and on the Foreign Loans Advisory Committee. The necessary mechanism for an efficient central control of banking in Britain[2] is in existence.

It is interesting to note, as it is little known, that the joint-stock banks had at one time a representative on the Court of the Bank of England.[3] The experiment was not successful and it was not continued. There are, however, many points of contact between members of the Court of the Bank and the board of directors of the bank in co-directorships and partnerships.[4]

[1] Cf. Mr Norman's speech, in 1935, in which he assured the then Chancellor that the City would regard the wishes of the Treasury as commands. Cf. *L. of N. Monetary Report*, 1937–8, p. 83. It should be pointed out, however, that, at that moment, there was no conflict of opinion between the Government and the financial community.

[2] There are other bodies such as the Institute of Bankers. They do not play any role in an executive sense.

[3] Harvey, *M.E.* Qu. 409.

[4] It is not known, however, whether the recommendation of the Macmillan Committee, to have frequent and regular meetings with the representatives of the Bank of England (*M.R.* §§ 371–2, pp. 160–1), has been accepted.

SECTION TWO

THE BUSINESS OF THE CLEARING BANKS

CHAPTER 4. *THE AVAILABLE STATISTICAL INFORMATION*

'I do not wish to pry into the affairs of each bank.' SIR R. PEEL, 6 May 1844.

THE financial statistics in Britain, on which analysis must necessarily be based, are not altogether satisfactory. In spite of the repeated efforts of outstanding men like Lord Goschen and Palgrave, they are still both very incomplete and, in certain important directions, uninformative if not misleading.

There was no obligation for banks established under the law of 1826 to publish any balance-sheet figures at all. The obligation to publish balance sheets monthly was introduced by the restrictive 'Act to regulate Joint Stock Banks in England' of 1844 described above, but only a few banks were established under this Act, and the rest did not publish balance sheets. The Act of 1858 substituted half-yearly balance sheets. Finally, the Act of 1879 reaffirmed the principle of publicity and, as most big banks registered under it, made that principle effective.[1] The Companies Act of 1929 demands the disclosure of balances with, and investments in, affiliated companies.

The statistical material legally demanded is extremely scanty. From an early period in joint-stock banking, there was a steady pressure on the banks to give more detailed statistics voluntarily. When Lord Goschen joined Palgrave in pressing for a reform, after the Baring crisis, the biggest joint-stock banks, who have found the publication of their balance sheets much to their interest,[2] began to publish monthly balance sheets. By 1907, twelve[3] of the major

[1] The Chairman of the Institute of Bankers, 1891, speaks of 'the desire created in the public mind for large reserves and public balance sheets'.

[2] Cf. Crick and Wadsworth, op. cit. p. 310. The public distrust of smaller banks which did not publish balance sheets directed deposits to the bigger banks and facilitated amalgamations.

[3] Later thirteen: The Capital and Counties Bank (Lloyds), Lloyds Bank, The London Joint Stock Bank (Midland), The London and County Bank (Westminster), The London City and Midland Bank, The London and South Western Bank (Barclays), London and Westminster Bank, National Bank, The National Provincial Bank, Parrs Bank (Westminster), The Union and Smith's Bank (N.P.), Williams Deacon's Bank. Cf. Crick, *The Role of Statistics in Monetary Affairs*, *The Manchester School* (1938), p. 128. Also Sayers, *Bank of England Operations*, 1890–1914 (1936); Crick and Wadsworth, op. cit. p. 39; and Palgrave, 'Bank balance sheets', *Institute of Bankers Journal*, March 1907.

banks had adopted the practice. These balance sheets were drawn up on a date freely chosen by each bank. This seriously reduced their usefulness because as these days did not coincide a wide scope was given for window dressing. Nor were the balance sheets very informative. No bank distinguished between cash and balances with other banks and cheques in the course of collection. Not many gave discounts and advances as separate items. The smaller banks continued to publish their balance sheets quarterly, others only at each half-year.

The ratio of cash to liabilities was nevertheless a subject of anxious and sometimes heated discussion. Ever since the Baring crisis of 1890 the sufficiency of the reserves of both the clearing banks and of the Bank of England had been a topic for debate. Information on the subject was not particularly adequate, but it was sufficient to make even the pre-war clearing bankers 'ratio conscious'. The more complete statistics and the growing understanding of the functioning of the banking system after the war very much increased this sensitiveness on the part of the clearing banks. The evidence given to the Macmillan Committee was unanimous that the ratios of cash and certain other less liquid assets to liabilities determine the policy of the banks.[1] In the last decade this ratio consciousness has become, as we shall see presently, even more complex than before, in so far as the second-line liquidity reserve was included in the factors determining banking policy. This has somewhat changed the considerations affecting the behaviour of bankers. The information currently available about the assets and liabilities of the different banks is, even at present, neither uniform nor comprehensive. As long ago as 1919 the Cunliffe Committee[2] drew up a detailed schedule for the monthly statements of banks (shown on p. 29).

This recommendation has been accepted among the Big Five only by Lloyds Bank, and even it publishes detailed balance sheets at the end of half-years only. The other banks adopted only the recommendation, which some had already been practising, of separating till money and balances with the Bank of England from other 'cash items'. The members of the Clearing House agreed, however, to issue, beginning January 1921, monthly statements

[1] Rae, *M.E.* Qu. 2413–20; Pease, ibid. Qu. 2090–100; Hyde, ibid. Qu. 880, etc.; Goodenough, ibid. Qu. 716–18, etc.

[2] § 34 and Appendix I. Currency and Foreign Exchanges. *First Interim Report of the Committee on Currency and Foreign Exchanges after the War*, presented to Parliament by command of His Majesty, London 1918, Cd. 9182.

Liabilities	£	Assets	£
Capital:		Cash:	
Registered		(1) Coin, Bank and Currency Notes, and Balances with the Bank of England	
Subscribed		(2) Balances with London Clearing Agents and with other Banks, Bankers and Banking Companies in the United Kingdom	
Paid up		(3) Items in transit	
Reserve Fund		Money at Call and Short Notice	
Current, Deposit, and other Accounts		British Bills of Exchange	
Acceptances		Foreign Bills, Foreign Bank Bills and Domiciled Bills	
Endorsements, Guarantees and other obligations		Balance abroad	
Notes in Circulation		Investments:	
		(1) Securities of, or guaranteed by British Government	
		(2) Indian and Colonial Government Securities, British Corporation Stocks, British Railway Debenture and Preference Stocks	
		(3) Other Investments	
		Loans and Advances	
		Other Assets	
		Bank Premises	
		Liabilities of Customers for Acceptances as per contra	
		Liabilities of Customers for Endorsements, Guarantees and other obligations, as per contra	

giving the monthly averages of their position on a selected day each week. All but two of the Big Five use different days of the week as the basis for their statement. Consequently the opportunities for 'window dressing' have not been eliminated, though they are less than under the old system of publishing the position on one day of the month chosen at random. These monthly statements give the following items:[1]

Assets

Coin, banknotes and balances with the Bank of England.
Balances with and cheques in course of collection on other banks in Great Britain and Ireland.
Items in transit.

[1] Some of the banks—regularly or for some periods—gave some additional items.

Money at call and short notice.
Bills discounted.
Investments.
Advances to customers and other accounts.
Liabilities of customers for acceptances, endorsements, etc.
Bank premises account.
Investments in affiliated banks and subsidiary companies.

LIABILITIES

Capital paid up.
Reserve fund.
Current, deposit and other accounts.
Acceptances, endorsements, etc.
Notes in circulation.
Reduction of bank premises account.

The differences between the above schedule and that recommended by the Cunliffe Committee are substantial.

In the decade after the war there was much criticism of the bank balance sheets which in some important respects [1] were less informative than the half-yearly statements issued at the end of the nineteenth century.[2] The Macmillan Committee inquired into the possibility of having more detailed statistics. Except in a few instances—such as disclosing the amount of the unused overdraft facilities,[3] and the distribution of holdings of bills between commercial paper and Treasuries[4]—the demand of Sir E. Harvey, the Vice-Governor of the Bank of England,[5] for fuller information[6] was not opposed by the bankers.[7] They objected to publishing figures for individual banks, but agreed to the publication of aggregate figures in the case of certain items, notably the distribution of the item 'cash' between till and balances at the Bank of England and the division of deposits between current and deposit accounts.[8]

The Macmillan Committee[9] recommended a more detailed form for the reform of monthly statements issued by the banks, and

[1] They did not differentiate between current and deposit accounts nor did (or do) they give any clue as to the nature of profits and expenses (except Barclays).
[2] E.g. *The Economist*, 8 October 1927.
[3] Goodenough, *M.E.* Qu. 521–36.
[4] Rae, *M.E.* Qu. 2322–8.
[5] *M.E.* Qu. 7598–603, 8848–87.
[6] Not shared by the Governor, *M.E.* Qu. 9610.
[7] Rae, *M.E.* Qu. 2338–9, 2341; Hyde, ibid, Qu. 1070; Pease, ibid. Qu. 2292–4, 2306–10; Goodenough, ibid. Qu. 659–68.
[8] E.g. Hyde, *M.E.* Qu. 1011–63; Pease, ibid. Qu. 2306–10.
[9] Apart from recommendations concerning window dressing dealt with in the section on 'Cash'. *M.R.* §§ 370 and 409.

published in its Appendices the figures which had been laid before it, covering the particular period. Its schedule was as follows:

(i) Cash in hand (true daily average for the month).
(ii) Balance at the Bank of England (true daily average).
(iii) Money at call: (*a*) in sterling.
(*b*) in foreign currencies.
(iv) Money at short notice: (*a*) to the Money Market.
(*b*) to the Stock Exchange.
(*c*) in foreign currencies.
(v) Treasury bills.
(vi) Commercial bills: (*a*) in sterling.
(*b*) in foreign currencies.
(vii) Loans and overdrafts.
(viii) Current accounts (exclusive of internal funds and accounts of the bank itself).
(ix) Deposit accounts (inclusive of internal funds and accounts of the bank itself).
(x) Investments: (*a*) in British Government securities.
(*b*) in other securities.
(xi) Acceptances outstanding (separately from engagements for forward foreign exchange, etc.).

They also published particulars about the distribution of loans and overdrafts and recommended the following classification for use in the future:

(*a*) Loans to concerns engaged in 'productive' industry (mining, manufacture, etc.).
(*b*) Loans to concerns engaged in commerce, transport and distribution.
(*c*) Loans to concerns engaged in finance, insurance, etc.
(*d*) Loans to agriculture.
(*e*) Loans to concerns and persons engaged in professions, entertainments, personal services, etc.
(*f*) Loans to private persons:
(i) for house building.
(ii) for other purposes.

Each of these general headings, and particularly (*a*), should then be subdivided further, so far as is practicable. In fact, in some cases, the banks have already proceeded to more details than the above. It would be helpful if care could be taken to subdivide class (*a*) into industrial classifications which correspond as closely as possible to the classifications used in other industrial statistics, especially those relating to employment and the census.[1]

[1] *M.R.* §§ 418, 423–5 and note to Appendix I, p. 283.

The Committee thought that statistics should be compiled on foreign balances and assets held by banks and banking firms, of the volume of acceptances and also of the aggregate value of cheques drawn on current accounts. A further recommendation concerned the position of banks other than clearing banks. This has lost its importance because of the disappearance of the banks concerned. Some point was given to the recommendations of the Committee by the necessity under which they found themselves to explain the discrepancies which appeared between the figures submitted to them and the published monthly statements of average figures.[1] The reason which they gave was the exclusion of certain branches of the National Bank. It appears that there is a further reason which has not hitherto been stated. It seems that certain banks did not give the average of their weekly figures, but for reasons of convenience followed their pre-war practice of basing their statistics on *one* monthly balance sheet drawn up near the end of each month.

Only a few of the recommendations of the Report have been adopted. We now obtain from the *Bank of England Statistical Summary* the aggregate accounts (as contrasted with individual figures which still are unavailable) of the following: (1) the average amount of till money, (2) the volume of deposit and current accounts respectively, (3) the value of cheques drawn, (4) classification of loans and overdrafts. The division of the item money at call and short notice has not been adopted for purposes of publication. We do not get sufficient information about the distribution of bills and of investment, though certain banks (Midland) give information in the monthly statements and others (Lloyds) in the half-yearly balance sheets on all or some of these items. The practice of showing acceptances and other engagements separately has not been adopted by all banks, and the method of book-keeping is different in almost every case.[2] The statistical information on total acceptances and on foreign balances and assets is available to the Bank of England but is not published.

[1] The figures published in the *Bank of England Statistical Summary*, though helpful, were not altogether adequate from this point of view. It is, moreover, questionable whether they were statistically accurate enough to form, for example, the basis of banking policy and credit control.

[2] Cf. Part II, on the Volume of Acceptances. As an example of the continuation of uncertainty—even in respect to the figure of a single bank—see the speech of the Chairman of Barclays Bank presenting the report for 1938 in which he explains the increase in the volume of acceptances at the end of December 1938 by a change in the book-keeping methods.

There are further difficulties. Certain of the banks publish their balance sheets after eliminating certain 'impersonal accounts', e.g. internal reserves against bad or doubtful debts, and, on the other side of the balance sheet, profits, unclaimed deposits, etc. Others do not 'deflate' the balance sheet in this way. Differences of procedure persist also with regard to profits, nor do we know much about the real state of the profit and loss account. We see therefore that there are more complications with respect to financial statistics than the 'window dressing' which has aroused so much comment. These complications are much more troublesome than that procedure, which, as we shall see, has at least some use in maintaining an appearance of continuity and stability that under post-crisis conditions had much to be said for it. The absence of more detailed information concerning some of the other items and of uniformity in book-keeping practice serves no evident purpose.

It is with these important qualifications that we approach the problem of analysing and interpreting, on the basis of the published statements and balance sheets, the activities of the clearing banks.

CHAPTER 5. *THE BALANCE SHEET: ASSETS*

A. General

THE principles underlying the operations of the clearing banks were discussed at length before the Macmillan Committee.[1] Their business 'lies in receiving money on deposit under various arrangements as to time for repayment and as to interest', and Mr Goodenough who, as Chairman of the Clearing House Committee, was the first among the clearing bankers to make a statement, continued: 'Then we employ the money deposited with us in a variety of ways and in such a manner as will enable us to fulfil our obligations.'[2] 'We have to consider what are the probabilities of calls upon us when we fix the amount of cash that we keep in our tills and when we fix the amount that we can call back from the market rapidly, less rapidly, slowly and so forth.' 'We must bear in mind that our deposits are in a very considerable part payable on demand, and even those deposits that are fixed for a period

[1] Cf. especially the evidence of Goodenough (*M.E.* Qu. 477–790) and Hyde (ibid. Qu. 861–1126).

[2] Goodenough, *M.E.* Qu. 478.

may be payable on demand by arrangement with depositors. After we have allowed... very much more than is sufficient to meet any demand that may be made upon us (Qu. 867)... we have (then) to consider how we shall spread our assets, bearing in mind two principles. First we must keep still a large proportion of our assets very liquid so that if there are withdrawals from our cash owing to the shrinkage in our deposits we can replenish the cash and still maintain very large liquid resources which form our second line of defence. Then the second point is that we have to earn a profit. You can quite well understand our expenses are heavy.... For that reason we distribute our assets over a variety of different forms of employment so as to secure two objects, first of all liquidity and secondly profits.'[1]

The schedule of assets in decreasing liquidity is: cash, cheques and balances, money at call at short notice, bills discounted. These four items are all usually considered liquid. The ratio of cash to deposits is called the cash ratio, the ratio of the three latter items to deposits is known as the first and second liquidity ratio.[2] Less 'liquid' are investments and advances, i.e. loans and overdrafts. Before 1932 investments were not considered to be as illiquid as loans. Since then, for reasons which will be discussed below, this distinction has largely disappeared.[3]

The ratio sensitiveness of bankers has developed, as we have already seen, only since 1890. It now dominates policy.[4] In the case of most banks these ratios are said to be 'a matter of experience and judgment according to the nature of the deposits and the class of people one is dealing with and the way they are occupied and so forth'.[5] In fact, most of these ratios—as we shall see—are more rigid than the changes in the nature of deposits justify. This fact might be an expression of a deliberate view. The bankers might wish to leave conscious action to the Central Bank which by varying the volume of the cash reserve can offset such changes in the nature of the deposits, i.e. in their velocity of circulation, as appears necessary. It might lead to complications if the bankers attempted to do this by varying their working ratios. It is prob-

[1] Hyde, *M.E.* Qu. 866–70.

[2] In recent discussions this second ratio has come to be called 'the 30 per cent ratio', because that figure is supposed to represent its minimum level.

[3] Cf. below, 'Investments'.

[4] Cf. above, p. 28, n. 1, for quotations.

[5] Goodenough, *M.E.* Qu. 485. But even he gave a precise figure for advances, 52 per cent (ibid. Qu. 413).

able that the correct decision was taken without much theoretical analysis.

The representative of the Midland Bank was alone in giving precise figures for the ratios of all items to deposits. These ratios were 11 per cent for 'cash', 3·5 per cent for 'items in transit', 7 per cent for 'money at call', 15 per cent for bills discounted, 12 per cent for 'investments' and 55 per cent for advances. The other bankers gave precise figures only for advances.[1] The actual ratios vary from bank to bank, and from time to time for each individual bank, except for cash ratio, which, though not identical, was remarkably stable for the individual cases.[2]

The cash position[3] determines the day to day policy of the banks. Each morning the cash position is reported to the executive committee[4] which then decides upon the operations which the bank is to undertake.[5] In the first instance any increase in cash seems to be treated as temporary, and only the most liquid forms of assets, money at call and bills, are increased, if this is possible.[6] This procedure commends itself because full balance sheets are not drawn up every day. Until it is known whether the increase in resources is likely to be permanent, more complicated and less easily reversible transactions cannot be undertaken.[7] Only at a later stage is the ability (and willingness) to lend or to buy longer term investments increased and the other necessary adjustments made.[8] In the case of a loss of cash the procedure is similar. Usually sufficient assets mature automatically to enable the necessary adjustment. The position is rectified by not relending the amounts repaid, and by eliminating the least desirable margin of the demand for new advances.[9] Temporary or seasonal fluctuations are dealt with rather by letting the ratios fluctuate and not by

[1] The two seem now to be linked at around 70 per cent. Cf. below on the 'Liquidity reserve'.

[2] *M.R.* para. 84, p. 38.

[3] Of course the 'true' cash position and not the position shown in the monthly statements. Cf. below.

[4] Cf. above on organization.

[5] Hyde, *M.E.* Qu. 880; Goodenough, ibid. Qu. 716–18.

[6] Cf. below on the operation of the secondary liquidity ratio which this procedure explains; if no liquid assets are available the cash ratio rises.

[7] Hyde, *M.E.* Qu. 880.

[8] Goodenough, *M.E.* Qu. 727–33; Hyde, ibid. Qu. 880.

[9] Hyde (*M.E.* Qu. 899–914), also Goodenough (ibid. Qu. 619–20); but the latter was anxious to say that his bank always accommodated all 'reasonable and sound' demand. On being further questioned he agreed that judgment of bankers varied according to general banking policy and business conditions.

TABLE IX. LONDON CLEARING BANKS. PROPORTIONS OF CERTAIN ASSETS TO DEPOSITS

	Cash (1)	Money at call and short notice (2)		Bills (3)		(2)+(3) (4)		Investments (5)		Advances (6)		(5)+(6) (7)	
	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)	(Macm. Rpt.)	(Bank of E.)
1919		8·7		17·6		26·3		23·3		38·4		61·7	
1920		5·8		15·1		20·9		21·4		48·4		69·8	
1921		5·8		20·4		26·2		19·9		45·1		65·0	
1922		6·5		18·8		25·3		24·6		41·7		66·3	
1923		6·7		16·5		23·2		23·4		45·2		68·6	
1924		6·4		14·3		20·7		22·6		47·9		70·5	
1925	11·8	7·2	7·0	13·6	13·6	20·8	20·6	19·1	17·2	51·3	51·5	70·4	68·7
1926	11·7	7·5	7·2	13·0	13·0	20·5	20·2	17·7	15·9	53·3	53·6	71·0	69·5
1927	11·5	8·4	8·0	12·7	12·8	21·1	20·8	16·4	14·8	54·2	54·2	70·6	69·0
1928	11·1	9·0	8·5	13·2	13·4	22·2	21·9	16·1	14·4	54·0	53·7	70·1	68·1
1929	10·8	8·6	8·1	12·7	12·7	21·3	20·8	15·8	14·3	55·5	55·1	71·3	69·4
1930	10·7	8·1	7·8	14·7	14·7	22·8	22·5	16·2	14·3	53·6	53·5	69·8	67·8
1931	10·4		6·9		14·6		21·5		17·1		52·2		69·3
1932	10·4		6·5		17·2		23·7		19·4		47·1		66·5
1933	10·8		5·2		18·1		23·3		27·5		38·9		66·4
1934	11·3		7·1		12·2		19·3		29·8		40·0		69·8
1935	10·8		7·1		13·3		20·4		30·8		38·5		69·3
1936	10·3		7·5		14·4		21·9		29·0		39·0		68·0
1937	10·3		7·3		12·3		19·6		28·5		41·7		70·2
1938	10·6		6·6		12·3		18·9		28·0		42·9		70·9
Dec. 1913*	16·4†		13·8		11·2		25·0		14·4		54·3		68·7
Dec. 1920	13·0		6·7		16·4		23·1		18·9		47·4		66·3
Dec. 1929	13·1		8·2		11·6		19·8		14·4		54·3		68·7
Dec. 1938	11·2		6·8		10·3		17·1		27·4		42·8		70·2

* Banks marked * in 1913 table (facing p. 114).

† Cash includes cheques in course of collection.

immediate action[1] with respect to advances, because continuity in lending policy is essential, since many customers have to plan their operations ahead and the banks are more or less committed to help them. The known future demands for cash are taken care of mainly through the bill portfolio. Money at call and short notice is used to meet unforeseen demands.[2]

The fact that the ratios (with the foregoing qualifications) are kept stable is of paramount importance from the point of view of Central Bank policy. On the rigidity of these ratios depends the speed and smoothness with which commercial banks readjust their lending and investment policies to changes in the volume of cash, which is controlled by the Central Bank. No predictions should be made, of course, for the future. It may well be that the absence of huge excess reserves in this country has been due, not to the superior organization of banking but to the confidence bankers have felt in the Government in power and in the monetary authority, and to their resulting willing co-operation. To these factors we must add the implicit trust—amounting almost to complacency—of the British public in the stability of the clearing banks which resulted, even in the most critical periods, in an absence of internal pressure on the credit structure.[3]

B. Cash Reserves

The cash reserves of the English banks consist of legal tender coin and Bank of England notes, which together constitute their 'till money', and deposits at the Bank of England. The volume and the distribution between these two items of the cash reserves are brought out in Table X.

The proportion of cash held against deposit liabilities is not, in this country, determined by legislation.[4] This proportion, as shown in the statement of the monthly average of their position on a selected day each week, has been remarkably stable (first at about 12, later

[1] Hyde, Goodenough, ibid.

[2] Hyde, Goodenough, ibid.

[3] The volatility of bank deposits forced banks in other countries—apart from their distrust—to increase their cash reserves. Something identical seems to have occurred in England in connection with the influx of foreign deposits. The banks with which these deposits appear to have been lodged decided to keep higher cash reserves against them. This has made Central Bank policy more difficult. Cf. below, and with respect to the problem of competition of joint-stock banks for deposits also Chapter 6. Cf. also above p. 26, n. 1.

[4] It is 'very much more than sufficient to meet any demand that may be made upon us' (Hyde, *M.E.* Qu. 867).

TABLE X. DISTRIBUTION OF BANKERS' CASH BETWEEN TILL MONEY AND BALANCES AT THE BANK OF ENGLAND

(Amounts are stated in £ millions)

	Cash in hand		Balances with Bank of England		Proportion to current and deposit accounts per cent					
					Cash in hand		Balances with Bank of England		Total cash	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1919	112·4	—	103·9	—	7·4	—	6·9	—	14·3	—
1920	105·8	—	83·7	—	6·2	—	4·9	—	11·1	—
1921	110·7	—	96·1	—	6·3	—	5·5	—	11·8	—
1922	107·5	—	92·9	—	6·3	—	5·4	—	11·7	—
1923	103·8	—	87·3	—	6·4	—	5·4	—	11·8	—
1924	103·8	—	88·3	—	6·4	—	5·5	—	11·9	—
1925	103·7	104	86·2	92	6·5	6·2	5·4	5·5	11·9	11·8
1926	103·1	103	86·1	92	6·4	6·2	5·4	5·5	11·8	11·7
1927	105·1	105	85·3	92	6·3	6·1	5·1	5·4	11·4	11·5
1928	104·5	105	83·6	92	6·1	5·9	4·9	5·2	11·0	11·1
1929	104·4	104	82·9	89	6·0	5·8	4·8	5·0	10·8	10·8
1930	103·6	104	84·5	88	5·9	5·8	4·9	4·9	10·8	10·7
1931	—	96	—	86	—	5·4	—	4·9	—	10·4
1932	—	92	—	95	—	5·1	—	5·3	—	10·4
1933	—	98	—	114	—	5·0	—	5·8	—	10·9
1934	—	100	—	112	—	5·3	—	6·0	—	11·3
1935	—	103	—	112	—	5·2	—	5·6	—	10·8
1936	—	109	—	119	—	4·9	—	5·4	—	10·3
1937	—	114	—	121	—	5·0	—	5·3	—	10·3
1938	—	117	—	124	—	5·2	—	5·4	—	10·6

NOTE. The figures in columns (1), (3), (5), (7) and (9) are taken from the Macmillan Report. Column (2) is taken from the *Bank of England Statistical Summary*; column (4) is derived by subtracting column (2) from the item 'Cash and balances with the Bank of England' of the monthly average balance sheets, hence it contains the 'stage army', used for 'window dressing'. Columns (6), (8) and (10) are derived from columns (2) and (4) and figures for deposits given in the *Bank of England Statistical Summary*.

between 10 and 11 per cent)[1], even in the critical periods since the 1914–18 war. The figure for 1919 of 14·3 per cent is the result of war finance and is wholly abnormal. The reduction from just under 12 per cent prior to 1926 to below 11 per cent after 1929 is the consequence of the change in the ratio of the Midland Bank. The rise in both 1934 and 1938 (accentuated in the first months of 1939 when it rose in February to 11·2 per cent) was due to the operation of the 'secondary' ratio. It is to be wondered whether the abrupt fall in the cash reserves (and in the ratio), in spite of a further contraction of deposits, in the first period of 1939 was a consequence of the Bank of England desiring to exert a further deflationary

[1] Their year-end averages were usually higher. This, however, has recently changed.

pressure or merely 'following up' the primary pressure on the banks exerted through secondary ratio[1] and 'mopping up' cash which would not have been used in any case.

The tradition in keeping a fixed ratio for cash against deposits seems to be considered as binding.[2] The cash ratio seems to have been considered by the bankers as not only a *minimum* but also a *maximum* ratio, i.e. the banks increased as well as decreased their lending until their liabilities bore the accepted ratio to cash reserves. There have been and still remain frictions. The importance of the cash ratio was at times overshadowed by that of the second liquidity ratio, i.e. the ratio of cash, balances at other banks, money at call and short notice and discounts combined, to deposits (the so-called 30 per cent ratio). If cash were to rise above the conventional level, while the items comprised in the 'second line of defence' declined by a greater amount, the banks would be reluctant to expand the volume of credit until their normal cash ratio was reached.

The Macmillan Committee[3] felt justified in following the Cunliffe Committee in recognizing the substantial advantages in this traditional procedure and refrained from recommending legislative regulation of the level or altering the basis of calculation of the cash ratio.[4] It did, however, recommend that agreement should be established between the banks and the Bank of England on the subject of the cash ratios which should be rigidly adhered to by the banks. 'For the power of the Bank of England to control the aggregate volume of credit in the country by means of open market operations and other measures essentially depends on the rigidity of this ratio.' It is not known whether any conversations did take place or agreement was reached between the Bank of England and the joint-stock banks. Nor is it known whether the further recommendation of the Committee that the ratio should be varied by agreement has ever been put into force. We can only conclude

[1] Cf. below.

[2] Cf. *M.E.* Qu. 3776 and following. Sir Josiah Stamp suggested that the flexibility of the cash ratio provided a possibility of counteracting the Bank of England policy by the clearing banks varying their cash ratio. Mr McKenna answered that such a policy would be disastrous to confidence and gave the impression that a ratio of between 10 and 11 per cent must be considered as a 'bedrock'. The Midland Bank had reduced its former higher ratio to that figure by 1929.

[3] *M.R.* §§ 79–81, pp. 36–37; §§ 358–370, pp. 153–161, esp. § 370 (7).

[4] E.g. on the basis of the turnover, rather than on the absolute volume, of deposits. Cf. *The Report of the Committee appointed by the Federal Reserve Board*, Washington (1935).

from the actual evolution of these ratios that, with minor exceptions, the bankers refrained from all policy and left the Bank of England in complete control of the management of credit.[1]

The cash ratios of individual banks are less uniform and show greater variations than the combined figure. Thus Barclays Bank, for example, showed the largest cash ratio at 12·3 per cent, Lloyds Bank the lowest at 10·2 per cent, at the end of 1938.[2] The year-end

[1] The frictions resulting from the operations of the 'secondary' ratio could have been foreseen—and prevented—by the Bank had it so desired. Cf. Mr Keynes's speech at the General Meeting of the National Mutual Insurance Society for the year 1936.

[2] It seems that some of the fluctuations of, and discrepancies between, the published cash ratios of individual banks have in the last few years been primarily due to the movements of foreign deposits into and out of London. These deposits, the significance of which will be discussed elsewhere, seem to have been attracted by certain banks. These banks appear to have regarded the deposits thus acquired as somewhat more volatile than their average inland deposits and they seem to have increased their cash held against them. Thus their overall cash ratio has been above that of the other banks. The following table shows the result of such variations in March and April 1938 (given in £ millions):

	All clearing banks	Midland Bank	Barclays Bank
March 1937:			
Cash	225·7	47·8	42·4
Deposits	2,244·2	470·7	415·3
Cash ratio	10·1	10·2	10·2
Investments	667·4	129·4	109·4
March 1938:			
Cash	244·2	60·5	48·6
Deposits	2,253·7	496·4	413·2
Cash ratio	10·8	12·2	11·8
Investments	630·0	122·4	99·3
April 1938:			
Cash	246·4	54·9	52·7
Deposits	2,268·0	497·8	420·4
Cash ratio	10·9	11·8	12·5
Investments	637·7	125·1	98·2

These figures show that though total cash in March and April 1938 was respectively £18·5 and £20·7 millions greater than in March 1937, the increase in the cash reserves of the Midland and Barclays alone was not less than £18·9 and £17·4 millions. Their cash ratios rose sharply. The rest of the banking system actually suffered a diminution of its cash reserve in March and showed an increase of barely more than £3 millions in April of the latter year as compared with March 1937. As a result total deposits of all clearing banks were not more than £10 millions in March and £13·8 millions higher in April 1938 than in March 1937. Investments were down by some £30 millions, advances rose by about £60 millions; the differences were accounted for by a contraction of discounts and money at call and short notice. The reverse movement seems to have taken place on the last three occasions when French money was being repatriated and capital was exported to America. This example shows that the monetary position cannot be analysed in all circumstances by working on average banking figures for the system as a whole.

differences in that year were greater than the differences in the monthly statements which are more representative of the policy and position of the banks.

Certain temporary variations in the cash reserves of individual banks can be explained by large special maturities of assets. They demonstrate that banks use their cash ratios as a residual item whenever they have difficulties in finding remunerative other employment of satisfactory liquidity. Temporary changes in cash ratios may therefore occur whenever they experience a shortage of the liquid assets necessary to build up the desired combination of assets. These fluctuations and discrepancies between individual bank figures also demonstrate that the time lag, necessary for a general permeation throughout the banking system of the effects of a change in the monetary policy of the Central Bank, though less in London than elsewhere, is not negligible.[1] These difficulties facing the Central Bank in monetary management have not received the attention which they deserve.

According to the evidence of Mr J. W. B. Pease,[2] the proportion in which cash is divided up between till money and balances at the Bank of England is governed by practical experience. Closer analysis of the figures suggests, however, that the banks usually keep more till money in their vaults than is strictly necessary for the conduct of business. After the abandonment of the gold standard in 1931, the banks co-operated with the Bank of England to preserve the apparent strength of the central reserves for psychological reasons, and reduced their till money from just over £100 millions in January 1931 to £85·3 millions in December 1931, and kept it throughout the year 1932 at an average level of more than £10 millions lower than in 1930.[3]

The proportion of till money to total cash reserves seems to have varied between 46·2 and 49·3 per cent in the last six years, and between 4·9 and 5·3 per cent of deposit liabilities. It has remained lower than balances with the Bank of England, whereas prior to 1931 it was substantially higher. Fluctuations in the ratio of till money to total cash reserves have in the past rendered monetary management very difficult. Until 1931 the banks did not report

[1] This is demonstrated by Mr A. J. Brown ('The Liquidity Preference Schedules of the London Clearing Banks', *Oxford Economic Papers*, no. 1, 1938, p. 56), who found that the coefficient of variation even of the 'window-dressed' cash is 4·39 per cent as against only 1·08 per cent of investments plus advances.

[2] *M.E.* Qu. 2292–310.

[3] Cf. *Bank of England Statistical Summary*, January 1939, p. 4.

these changes at frequent intervals.[1] The Bank of England therefore had no knowledge of the true state of the total cash reserves of the banking system, but only of the state of bankers' deposits on its books, and this, as will be shown below, was often misleading.[2]

The Macmillan Committee recommended the lowering of the proportion of till money from about 6 per cent of deposits to some 4 per cent whilst maintaining the total cash ratio at about 10 per cent, involving therefore a concurrent increase of bankers' deposits with the Bank of England.[3] They also wished to prevent the banks from influencing the reserve of the banking department by varying the ratio of their till money holdings to total reserves. This possibility arose out of the principle of the Charter Act of 1844 (accepted in subsequent legislation) that banknotes in excess of the fiduciary issue had to be fully covered by gold, though no gold cover was required for bankers' balances at the Bank of England. By changing bankers' deposits into till money or vice versa, the clearing banks were able to decrease or increase the banknote reserve of the banking department of the Bank of England, and, in the days before the 1928 and 1939 Acts, they could—at least in theory—force the Bank to change its policy or to apply to the Government for a suspension of the Bank Act. In practice such a conflict and such tactics would have been unthinkable, particularly in the post-war period. But in the old days of feud between the joint-stock banks and the Bank of England one eminent banker did, in fact, advocate the increase of till money in order to force the Bank to stiffen the money rates which had fallen to unremunerative levels.[4] The Macmillan Committee contented itself with recommending that the ratio be kept constant, and it refused to recommend the exclusion of till money from the cash ratio, as is done in the United States.[5]

The clearing banks after 1931 adopted the recommendation of Sir E. Harvey[6] and currently notify the Bank of England of the

[1] The Bank of England could calculate the true state of their till-money holdings only once every half-year. Cf. below.

[2] Cf. the testimony of Sir E. Harvey, *M.E.* Qu. 7598, and also *M.R.* § 344, p. 147.

[3] *M.R.* §§ 341–6, pp. 146–7; also § 368, pp. 156–7, and also with respect to window dressing, §§ 347 and 370. The latter recommendation was partly due to their desire to increase the resources and thus the open-market power of the Bank of England. The establishment of the Exchange Equalization Account has provided a solution in this respect.

[4] Cf. Crick and Wadsworth, op. cit. p. 430, on the correspondence of Rae.

[5] *M.R.* § 370 (7).

[6] *M.E.* Qu. 7599.

state of their till-money holdings.[1] They also adopted, as we have seen, the recommendation to lower the till-money ratio. The last Currency and Banknotes Act, 1939, moreover, provides such flexibility in the management of the volume of note issue,[2] that the problem of the volume of till money and the fluctuation of its proportion to total cash, like other tactical difficulties, can hardly assume importance. It is conceivable, however, that at some future time the expansion of the note circulation may once more give rise to apprehensions, however misconceived. In the absence of stringent controls the problem may then regain some of its significance.

A general impression seems to prevail[3] that the war and post-war inflations and the monetary reforms which were necessary to enable that expansion, have resulted in a fall of the cash ratio from the levels maintained in the pre-1914 period. The final wave of amalgamations in banking during the war, which tended to diminish the difference in seasonal and cyclical drains on individual banks, would have justified such a reduction. Yet—apart from the change in the ratio policy of the Midland Bank—no such reduction has taken place. And it must be borne in mind that the English banking system in the years immediately preceding 1914 was very much more liquid than in former periods, as a result of the continuous campaigns which had been initiated by Lord Goschen and Palgrave.[4] This misapprehension is no doubt due to the disregard of an important change in banking statistics[5] after the 1914–18 war. Before 1920 even those banks which differentiated between their cash holdings and balances at the Bank of England on the one hand, and money at call and short notice on the other, did not segregate the item now shown separately as 'balances with other British banks and cheques in course of collection'. This item, according to Mr Hyde,[6] was estimated to be roughly 3·5 per cent of their liabilities, at the time of the Macmillan Committee. In

[1] It is, however, not known whether the statistics on the currency holdings of the clearing banks now published in the *Bank of England Statistical Summary* are 'true daily averages' or not. The explanatory note (*B. of E. S. S.* January 1939, p. 4) merely states that they represent 'average figures'.

[2] Cf. D. H. Robertson, *Lloyds Bank Review*, May 1939.

[3] Cf. Prof. Gregory, *M.E.* Qu. 713.

[4] Cf. Sykes, *The Present Position of English Joint Stock Banking* (1928), p. 16. The ratio of cash and call money to total liabilities had increased from 18 per cent in 1890 to 23 per cent in 1910. It further increased between 1910 and 1913.

[5] If this is disregarded, the ratios are as follows (year-end figures): 1913, 16·4 per cent; 1920, 13·4 per cent; 1929, 13 per cent; and 1938, 11·2 per cent.

[6] *M.E.* Qu. 866.

fact, it varies with the state of business and financial activity and is in the main a consequence of the general practice of the banks of crediting their customers on the same day as a cheque drawn on another bank is received. These cheques are then presented through the clearing house. They are, therefore, from the point of view of each bank, superficially equivalent to 'cash'. But other banks, presumably, also have cheques in course of collection. For the banking system as a whole these cheques, therefore, cancel out. They might, eventually, represent a shift of cash from one bank to another, but not a change in *total* cash and therefore do not constitute part of the 'true' cash reserve. They merely inflate the balance sheets of the banking system as a whole.[1] In the year-end balance sheets of the clearing banks this item amounted in 1920 to 3·1 per cent,[2] in 1929 to 3·8 per cent, and in 1938 to 3·9 per cent of liabilities. The percentage varies as between individual banks. On 31 December 1938 it was as high as 4·3 per cent in the case of Lloyds and as low as 3·4 per cent in the case of Barclays.

The first and rather modest appearance of this item as a separate entity took place in the 1918 balance sheet of the Midland Bank (London Joint City and Midland Bank as it then was). It was stated to be £2,001,846. 12*s.* 7*d.*[3] Sir E. Holden then stated that the Midland never considered this item as part of its cash reserve. It was probably carried under 'money at call' before the change was introduced. Next year it was already over £8 millions.[4] The great upheavals in banking figures prevent a conclusive answer to the question as to whether that part of this item which was 'not considered as part of the cash reserve' comprised all the items shown separately in later years, or only part of them. Presumably under this heading all banks show a part of what was considered to be cash reserve prior to 1919, for it is practically certain[5] that the majority of the banks previously included most, if not all of it, under cash. We shall, therefore, not err much if we compare the

[1] This was not seen by some of the bankers. Cf. *M.E.* Qu. 560.

[2] Partly on the basis of December 'average' figures. No uniform practice was evolved as to what to include in this item.

[3] Sir E. Holden's speech to shareholders, p. 12. Also *The Economist*, 1 February 1919, p. 139.

[4] *The Economist*, 1920, vol. 1, p. 165. Barclays in that year published its own figure at £13 millions, which was an increase of £5·7 millions over the previous year. But there is no such item in the published balance sheet for the end of 1918.

[5] By comparing the year-end balance sheets with the first of the monthly average balance sheets published in January 1921. Cf. also Gregory, op. cit. vol. II, Appendix.

cash ratios of pre-1914 days with the post-war ratio of cash and balances and cheques to total liabilities. This comparison shows that (apart again from the consequence of the change in the Midland Bank ratio policy) the (apparent) cash ratio thus interpreted hardly declined at all:

End of the year	1913:[1]	16·4
,, ,,	1920:	16·3
,, ,,	1929:	16·8
,, ,,	1938:	15·1

It must be remembered that the number of independent banks before the last war was substantially greater than at present. It is reasonable to infer that the volume of cheques in transit must have been relatively greater. It is not known whether the true balances with other banks were carried under the item 'cash' or not. There is some uncertainty how they are now carried except in the case of banks which show them separately.[2]

Window Dressing. Hitherto we have considered the cash ratios as they are derived by adding together the figures for the separate banks published in their monthly statements and half-yearly balance sheets. None of the items summed in this way represents accurately the daily position of each bank throughout the month. They are not the figures on the basis of which the policy of the clearing banks is determined by the managements. They are the average of figures attained on one selected day of each week. These days are called 'making up days'. They are not identical for all banks.[3] Three of the Big Five have separate 'making up days'. Barclays publishes its average figures for each Monday of every month, Lloyds for each Tuesday, the Midland and the National Provincial for each Wednesday, and the Westminster for each Thursday.[4] This fact gives rise to the possibility of indulging in

[1] For twenty banks differentiating between cash and money at call and short notice.

[2] Balances with solvent banks abroad could of course be regarded as parts of the true cash reserve under a gold standard or even under managed currency standard (in so far as the Central Bank or the institution charged with monetary management was preventing an appreciation of the currency through gold or foreign exchange purchases). It could not properly be so regarded under a pure paper standard.

[3] For the pre-1914 position cf. previous section.

[4] The National Provincial seems to have 'made up' on Thursday (cf. Truptil, *British Banks and the London Money Market*, p. 93). On the same day this bank also had to pay over weekly tax collections which accumulated in the account which one of the main tax collectors maintained at that bank. The

operations called 'window dressing' which further reduce the accuracy of English banking statistics and particularly of the figures for cash reserves. All that is necessary is that each bank in turn shall arrange to call in from the market rather more cash than usual on the day on which it makes up, and that the other banks should let their ratio drop below that level. The fact that they make up on different days makes this a simple and cheap operation. Mr McKenna asserted that his bank did not indulge in this practice.[1] This still seems to be the accepted view in the market. This does not, of course, mean that certain incidental variations occurring on Wednesdays in the cash positions of the Midland Bank are never smoothed over by 'calling'. A further distortion of banking statistics was due to the custom of transferring Exchequer balances accumulating at the individual banks on Thursdays. Thus the Bank of England statement, made out on Wednesdays, included funds which remained with the banks only overnight.[2] Sir Richard Hopkins[3] admitted that the introduction of thirteen weeks' Treasury bills might smooth the flow of funds into the Exchequer. The diminution in the outward manifestation on the money market of tax collections suggests that the required

'call' on the market was, therefore, extremely heavy on Thursdays. Both causes of disturbance seem to have been removed recently. On certain occasions (e.g. Easter holiday) a week might be missed; and each June or December average would include the figure for the last day of the month even if the last day was not the day of the week for the usual 'make-up'. During the recent war the banks reverted to the pre-1914 practice.

[1] *M.E.* Qu. 7562.

[2] Sayers, *Modern Banking*, p. 39.

[3] *M.E.* Qu. 5426: 'You think it desirable that fluctuation (in bankers' balances) should be avoided as far as possible?—Undoubtedly.—There was another point which was mentioned to the Deputy Governor, and that is whether the question of paying over taxation to a large extent on Thursdays has an unsettling effect upon the bankers' balances in the ensuing week? You might like me to say a word upon that matter. The amount that comes in on Thursday is by no means so large a proportion of the whole as it used to be. The supertax comes in day by day and that part of the income tax which is collected by deduction from Municipal loans, Government loans, and the like, comes in on the actual date when the deduction is made. In addition to that, the collection of income tax in the City of London now comes in on Tuesdays and Fridays, and the collection from a good number of provincial towns comes in day by day. There is, however, a larger payment upon Thursday than upon the other days of the week, and according to the figures I have taken out it looks as if the excess of the Thursday payment over the daily average payment for the first thirteen weeks of the year is in the region of £3,000,000. It is not a large figure. Sir Ernest Harvey tells me he took some figures out; they did not provide any indication that Government deposits were during this time higher on Thursday and that they then sunk till Wednesday. At the same time, if the Committee thought it worth while to have an altered arrangement in regard to the day of payment in of that part of the collection which now comes in on Thursday, it could no doubt be arranged.'

administrative changes have been made. The Bank of England statements are no longer unrepresentative of the average size of balances held by the clearing banks, though they still tend to be on the high side. Further methods of smoothing fluctuations seem also to have been introduced. The Bank seems to have opened 'suspense' accounts which remain part of the reserve of the banks collecting the tax monies, from which the tax money, collected and paid into the Bank, is transferred only gradually into public deposits.

But it is not likely that the extent of fluctuations in bankers' deposits from Wednesdays to Thursdays varies much in time. Thus the trend of the true level of bankers' deposits is faithfully reflected. In any case it would no doubt be desirable if Sir Ernest Harvey's advice[1] were followed and that both banks and the Bank of England published figures not relating to specific days but daily averages. These would no doubt be much more representative and significant than our present statistics.

If all banks 'made up' their weekly balance sheets on the same day they could not increase temporarily their individual cash reserves for the purpose of showing a higher cash ratio than they usually carry. Their efforts to do so would mutually cancel out. If they 'make up' on different days, however, each individual bank can arrange to attract part of the cash of the other banks. If it releases this cash again immediately afterwards, it need not fear a retaliatory action on the part of the others, an action which would lead to deflation. It merely has to let part of its assets mature and postpone its normal lending and investment activities for the day so as to show increased cash reserves. Hence the increased cash reserves are obtained by shifting temporarily assets of one to the other banks. This procedure is obviously impracticable in the case of advances and difficult in the case of long-term investments. In practice, money at call and short notice is used for this purpose, though discounts are also utilized at half-year ends to contribute to the higher published cash reserves. Persons with practical experience of the City have estimated that the proportion is as to 1/3 discounts and 2/3 money at call on the latter occasions. The differences in the cash position between average and half-yearly balance sheets has been diminishing in the case of the clearing banks.

The bank which is making up its weekly balance sheet reduces

[1] *M.E.* Qu. 8859–60.

its loans to the money market by calling part of the amounts lent at short notice. The bill brokers have to repay this bank by borrowing from the other banks. The 'making up' institution, therefore, increases its cash in the published balance sheet and depresses the volume of its short loans. The next day another bank calls. The bank which has already made up its weekly balance sheet, and those which will make it up later, will furnish part of the cash reserve by increasing or maintaining their loans to the market.

Thus part of the cash reserve as shown in the balance sheets of the banks really travels round and serves in its turn to swell the cash ratios of each bank. As the report of the Macmillan Committee[1] points out, the monthly figures 'published by the clearing banks are not true daily averages, but are averages of one selected day in each week of the month. It seems that, in order to present a better appearance, most of the banks concerned are at pains to manipulate their balances with the Bank of England on the selected day of the week so that they stand at a higher figure than usual. Moreover, each of the four biggest institutions pursuing these practices selects a different day of the week for the purpose, calling in loans from the money market on its own selected day, but returning them next morning in time for the next big bank to call them for its making-up day. Thus a certain part of the published reserves of the clearing banks in the shape of deposits with the Bank of England is like a stage army, the same liquid resources doing duty four times over in the course of each week.' The cash ratio shown by the monthly statements is, therefore, a fictitious ratio. The average size of this 'stage army' was estimated by the Committee at something over £17–19 millions for the years 1929–30.[2] They found, therefore, that the 'true' cash reserve of

[1] *M.R.* p. 156.

[2] *M.R.* § 79, p. 36: 'The Bank of England figure covers a wider group of banks than the ten clearing banks whose figures are shown above. Nevertheless, if we exclude the larger balances maintained at the end of each half-year, it shows that for 1929 the bankers' balances averaged on each Wednesday about £62 millions and for 1930 about £63 millions. If we take the clearing banks' figures (excluding the half-yearly figures), the average balance at the Bank of England works out at about £77 millions for 1929 and £78 millions for 1930. It is evident, therefore, that the clearing banks do not maintain from day to day so high a proportion of cash as is shown by the monthly statements, and although we have not available all the data required to make an exact calculation, it seems probable that the balance maintained by those banks (excluding the half-yearly periods) is appreciably below £60 millions or less than 3½ per cent of deposits.'

the banking system is only about 9½ per cent of liabilities against the published figure of nearly 11 per cent.

At half-year ends, when the banks simultaneously publish their balance sheets, the 'stage army' cannot fulfil its duties; all the banks desire to show a high ratio on the same day. In the past this ratio was even higher than the average, swollen as it was through the 'normal' window dressing.

TABLE XI. FLUCTUATION OF CASH RATIOS

Midland Bank	Aver. cash ratio 1938	= 11·1
	Year end ,, ,,	= 11·6
Barclays	Aver. cash ,, ,,	= 10·7
	Year end ,, ,,	= 12·3
Westminster	Aver. cash ,, ,,	= 10·2
	Year end ,, ,,	= 10·7
National Provincial	Aver. cash ,, ,,	= 10·3
	Year end ,, ,,	= 11·1
Lloyds	Aver. cash ,, ,,	= 10·8
	Year end ,, ,,	= 10·2
Big Five	Average ,, ,,	= 10·6
	Year end ,, ,,	= 11·2

Table XI shows the difference between the annual average of the cash ratio of the banks, calculated from their monthly statement, and the ratio shown in the year-end statement. The figures bear out Mr McKenna's remarks on the divergence among the policies of individual banks.[1] 'My banks published on 30th of June our cash ratio as 9·7 per cent. Our average for the month was over 11 per cent. I have observed that some banks published ratios at the 30th June almost double ours although their cash ratio throughout the month and through the year has been considerably below ours.' Thus the 'stage army' had to be transformed into real cash. The method traditionally followed was to force the money market into the Bank of England. At the same time other measures must also be taken lest the conversion of 'money at call and short notice' and of 'discounts' into cash, should distort the usual pattern of their balance sheets. This seems to be accomplished by letting the discount market carry a higher proportion of bills in the month preceding the half-year end by decreasing their bill portfolio at the critical date. Thus, generally, money at call increases in these months[2] above the average of other months, so that even after the calling of a certain proportion of these short-term loans to the market, in order to strengthen their cash reserves, the banks still

[1] *M.E.* Qu. 8859.

[2] Cf. next section.

show an adequate proportion of this item. The half-yearly in contrast to the monthly average balance sheets therefore usually tend to show lower discounts, somewhat more call money and considerably more cash. The Bank of England statement at half-year ends shows increased 'bankers' deposits' on the one hand and increased discounts and advances on the other.[1]

During the period when Treasury bills could be obtained through an unlimited tap the banks could usually arrange their purchases so as to have a large volume of bills falling due at the end of each half-year. By not replacing these bills immediately, but only after the year end, they provided themselves with the amount of cash they desired. The Treasury, being short of cash over the year end, had to borrow from the Bank of England. Thus the banks, instead of 'calling from the market', put the Treasury[2] into the Bank. With the gradual closing of the tap, except for Government departments, the technique of window dressing by way of Treasury bills had to be suitably adapted. The rules of the weekly tenders permit the lenders to specify the dates from which they wish to date Treasury bills. They are therefore able to acquire bills suitable for window-dressing purposes in exactly the same fashion as through the 'tap', though the shortage of bills may prevent the full use of this method. Since 1934 the banks have not tendered directly for bills; but the market, knowing the desires of the banks for bills appropriately dated, obtain such bills and resell them to the banks at the appropriate moment. This expedient has some influence on the balance sheets both of the Bank of England and of the joint-stock banks. In the case of the former the weekly statement coinciding with the half-year would show an increase of 'Government securities' instead of 'securities and discounts' in the banking department. In the case of the joint-stock banks this method simplifies 'preparation' of the yearly balance sheet. If the banks can arrange to obtain the additional cash from the Treasury, they need not go to the trouble of making the arrangements discussed above and, therefore, the period of dislocation before and after the half-yearly balance sheet is shorter.

This procedure is not practicable, however, when the year end happens to fall on a Saturday or Sunday or on such occasions when

[1] The existence since the end of the war of a large volume of Treasury bills has provided the banking system with another method of achieving the same end. Cf. Appendix II, Part II.

[2] This incidentally diminishes the utility of the discount market from the point of view of the banks; cf. Sayers, op. cit. p. 142.

the fact that three months' bills are issued renders it impossible to obtain bills maturing on that day.[1]

The fact that the Bank of England statement does not usually fall on half-year ends tends to obscure the extent of the fluctuations. Nevertheless, the picture is clear. Government securities and bankers' deposits at the Bank of England both show increases almost equal to the increases in Ways and Means advances shown

[1] Sir Richard Hopkins, *M.E.* Qu. 5426: 'Another thing that has occurred to me quite recently, on which I have no definite suggestion to make, but which may be worth looking into, is the fact that we are in the habit of issuing a three months' Treasury bill. In seven months of the year the three months amounts to 92 days, and the result of that is that bills taken out on Friday are payable on Saturday, bills taken out on Saturday are payable on Saturday, because they cannot be paid on Sunday, and bills taken out on Sunday are payable on Monday, or in other words, none are paid on Monday. You get two days' payment of Treasury bills on Saturday and none on Monday, and that must have a certain disturbing element in the Government balances. It may be worth while looking into that point to see whether that needs correction.'

In all these cases the Treasury can be compelled to borrow from the Bank of England to provide the banks with cash only if the market misses the week's tender altogether. This it seems definitely reluctant to do (for reasons see under Bill Market), and, therefore, on these occasions, the traditional method of calling from the market is reverted to. Table XII is taken from a paper by Mr Paish and illustrates the differences (amounts in £ millions).

TABLE XII. YEAR-END BORROWING AT THE BANK OF ENGLAND

	Total Treasury bills	Ways and Means (Govt. depts.)	Advances bank	Bank of England (banking dept.)		
				Bankers' deposits	Govt. securities	Discounts and advances
			End of half-year falls at week end			
1938:						
21 Dec.	—	—	—	98	72	15
24 Dec.	988	42	—	—	—	—
28 Dec.	—	—	—	101	69	29
31 Dec. (Sat.)	986	46	5	—	—	—
1939:						
4 Jan.	—	—	—	136	71	49
7 Jan.	998	41	1	—	—	—
			End of half-year falls during week			
1937:						
18 Dec.	939	42	—	—	—	—
22 Dec.	—	—	—	98	96	7
25 Dec.	942	41	—	—	—	—
29 Dec.	—	—	—	121	115	9
31 Dec. (Fri.)	890	39	56	—	—	—
1938:						
5 Jan.	—	—	—	129	108	15
8 Jan.	934	42	7	—	—	—

in the appropriate bank return. The extent to which the banks force the market to have recourse to the Bank of England is much more difficult to ascertain. Mr Paish states 'on June 30th of both 1934 and 1935, which fell on a Saturday and Sunday respectively, the year-end figures for the cash holdings of the nine clearing banks were actually appreciably below the averages for both June and July. The same tendency can be observed in December, though no actual fall is recorded in recent years'.[1] It is interesting to observe that the extent of window dressing is smaller when the banks are not able to put the onus of window dressing on the Treasury. Mr Paish does not suggest an explanation for this phenomenon. It is very probably due to the fact that money remains easy if the Treasury is the source of the supplement of the banks' cash. It tends to be tight, however, and the banks must be tempted to limit their calling, if the market is forced to borrow from the Bank as the Bank (except on special occasions) charges penal rates. It is interesting to observe, too, that the disturbances in the balance sheets last a longer time if the banks are compelled to use the market for window-dressing purposes. The reason for this is that the Treasury is able to borrow from the Bank far more smoothly than the market which, as we shall see below, is forced to borrow for relatively long periods. The Ways and Means advances are granted to the Treasury on special terms[2] and do not come under the rules which govern the minimum period for loans to the market.

If the extent of window dressing were constant, its effect would be irrelevant from the point of view of banking policy.[3] The

[1] *Economica*, 1939, p. 459.

[2] Cf. Sir Richard Hopkins (*M.E.* Qu. 5317): 'The arrangement as regards interest on overdrafts is varied from time to time as the bank rate is changed. The ordinary arrangement is that on the first £5,000,000—which, except for the special days of the year that I have mentioned, is the maximum that we should require—the rate is 1 per cent; there is usually an intermediate step to 2½ per cent; or 3 per cent on the next £5,000,000; the maximum rate we pay, and that only on the excess of the overdraft over £10,000,000, would usually be ½ per cent or 1 per cent below bank rate. That is simply a matter of adjustment between ourselves and the Bank of England. I ought perhaps to add that the precise rates are of very little importance, as the total interest payment involved is quite a small sum year by year.'

[3] Since the publication of the average till-money holdings—assuming that the published figures are true averages and not manipulated figures—window dressing is no longer an obstacle to monetary analysis. Nor is it an obstacle to central banking policy, for the practice, once its extent is known, cannot stop the Bank of England from *eventually* imposing its will on the banking system. It may, however, be an obstacle in the sense that it prevents the Bank from imposing its will *speedily*, as it permits the banks to lower their ratios successively after each dose of deflation by the Bank *without* incurring publicly the odium of being increasingly 'illiquid'. This elasticity of the banking system has, of course, some substantial advantages.

problem of whether, and to what extent, it varies is, therefore, important. Prior to the publication by the Macmillan Committee of the statistics for average till-money holdings and the continuation of this series in the Bank of England Statistical Summary (cf. Table X), there was only one method of calculating weekly window dressing. It was based upon the half-yearly statements, because on these occasions all banks 'make up' *simultaneously*. The *average* extent of the weekly window dressing could then be calculated by subtracting the increase of the banks' cash holdings shown in the half-yearly balance sheets from the increase in bankers' deposits at the Bank of England.[1] This calculation, apart from being feasible only at infrequent intervals, is not always wholly accurate for certain technical reasons. The method, for what it is worth, gives the following results (amounts in £ millions):

	1913*	1920†	1929‡	1938§
1. Cash as shown and balances at the Bank of England	115·5	241·5	233·0	250·3
2. Cheques in course of collection and balances with other banks	Mostly contained in above	55·0	70·1	86·5
3. Total	115·5	296·5	303·1	336·8
4. Allowance for window dressing	25‖	45	52	36
5. Net total	90·5	251·5	251·1	300·8
6. Deposits	706·1	1,798·2	1,799·3	2,228·9
Ratio of (1) to deposits	16·4	13·4	12·9	11·2
Ratio of (4) to deposits	3·5	2·5	2·9	1·6
Ratio of (1)–(4) to deposits	12·8	10·9	10·1	9·6
Ratio of (3)–(4) to deposits	12·8	14·0	14·0	13·5

* 20 banks. † 11 banks. ‡ 10 banks. § 10 banks.

‖ Lavington, *The English Capital Market*, p. 288, estimates the expansion at £23 millions. This sum is on the low side as deposits increased from £45·492 millions on 17 December 1913 to £71·344 millions on 31 December 1913.

Since the publication of statistics on 'till money' another method of estimating the extent of window dressing has become feasible. This is superior to the former, both because it is more accurate and because calculations can be made at monthly intervals. It is based on a comparison between the level of bankers' deposits at the Bank of England as shown in its weekly balance sheets and the amount of till money held by the clearing banks on the one hand and the monthly average of the cash reserves (i.e. till money and balances with the Bank of England) of the clearing banks as pub-

[1] It must not be forgotten, however, that the Bank of England does not publish special statements as year-ends or *average* weekly balances. If, therefore, the year end does not fall on a Wednesday, part of the half-yearly inflation resulting from the simultaneous window dressing may be already 'deflated' by repayments, hence the whole extent of window dressing may not be known.

lished in their monthly statements on the other. Even this estimate of window dressing is merely an approximation. As Mr J. F. Cahan has pointed out,[1] the item 'bankers' deposits' as published in the Bank of England statements includes the balances of banks other than the London clearing banks.[2] Variations of the extent of window dressing have been substantial. From a maximum of over £40 millions in June 1929 the size of the 'stage army' decreased to a minimum of £1 million in 1934. In the late thirties it amounted to about £20 millions. Except for the months of June and December, when window dressing used to be higher than in other months, no seasonal movement is apparent. Considerable variations are shown within one year, e.g. in 1936 from £2 millions in January to £29 millions in December.

It has been suggested[3] that the variations in the amount of window dressing move in inverse ratio to the level of the true cash ratios. This has been denied during the Macmillan Committee evidence both by Mr McKenna[4] and by Mr Goodenough.[5] The latter has tended to deny altogether that the window dressing of banks had any effect on their cash ratio and, through it, on their policy. He later admitted that it might cause some slight differences. Sir Ernest Harvey, however, disagreed with this conclusion.[6] Statistical evidence which is available seems to justify Sir Ernest Harvey's view. It does not, however, bear out altogether the suggestion that the banks tend to counteract the policy of the Bank of England by an appropriate variation in the extent of their window dressing. Much more detailed work would have to be undertaken in order to justify any hard and fast conclusions in this respect. *Prima facie* it seems that the banks tended to increase window-dressing periods when it was profitable for them to do so, i.e. when they had suitable investment opportunities, and decreased the practice in reverse circumstances. It is obvious that in boom periods when there are profitable outlets for bank credit the Bank

[1] Letter to *The Economist*, 17 June 1938.

[2] The objection that 'bankers' deposits' also include the figure of the 'stage army' which is not used by those banks which make up their accounts on the Wednesday is not valid. The volume of the bankers' deposits at the Bank of England is wholly independent of the size of the 'stage army'. A somewhat different larger figure is obtained by this calculation from that suggested by the Macmillan Committee. A smaller window dressing appears in ten months in each year. In June and December it results in a larger figure.

[3] Mr R. M. Goodwin of St John's College, Oxford, in his thesis on banking statistics, as mentioned by Sayers in *Modern Banking* (1938), p. 39.

[4] *M.E.* Qu. 7562–6.

[5] *M.E.* Qu. 657–9.

[6] *M.E.* Qu. 8857–60.

of England will try to restrain speculation; but the coincidence is not complete. Further factors, such as a shortage of suitable liquid investments, may render it inadvisable or impossible to extend it to the maximum limit while the banks are unable to maintain the liquidity schedule which they desire.[1]

Except for the possibility of being able to counteract for some time the policy of the Bank of England, the condemnation of the custom of window dressing as an altogether mischievous practice by the Macmillan Committee was too harsh. It permitted the banks to overcome temporary maladjustments in the money markets, such as sudden temporary fluctuations in their deposits at the Bank of England, due to the role which the Bank of England plays as the Government banker, a function which, especially in the period after 1931 of Exchange Equalization Funds and violent international short-term capital movements, was not altogether favourable to its functions as the central monetary authority. It has been shown repeatedly that the Bank of England was unable at times to offset instantaneously sudden changes in the volume and quality of its assets, hence in the volume of bankers' cash. Window dressing in these cases helps the banks to avoid unnecessary disturbances in their credit policy and at the same time to maintain stability in their published cash ratios. This certainly is a desirable aspect of window dressing, for the public cannot always know the correct interpretation to be given to short-period changes in bank balance sheets. The evil aspects of window dressing, moreover, have been substantially reduced by the communication to the Bank of England and the publication of the till-money holdings of the clearing banks.

As long as Britain is not on the gold standard or is not committed to defend a given rate of exchange and international capital movements are controlled, the Central Bank can always impose its policy on the banking system. Deflation can be enforced by open market sales of securities. In the unlikely event that the Bank has no securities to sell, i.e. if the whole of its reserves consisted of

[1] It would not be feasible to do so without disturbing 'call money' which has to be reduced if cash is to expand. This item cannot be reduced to zero. There was an occasion when one of the clearing banks, the Midland Bank, deliberately lowered its cash ratio in order to follow an expansionist policy which its management held to be justified. On that occasion the Bank of England apparently disagreed with that diagnosis of the position. The effects of the change of the cash ratio which 'liberated' cash were therefore offset by appropriate deflationary open-market operations on the part of the Bank of England.

gold, the Exchange Equalization Account technique could be used, the Government could sell Treasury Bills and hold the proceeds at the Central Bank, thus reducing the cash basis of the banking system. Conversely, if the banks refused to expand credit when the Central Bank increased their cash reserves (i.e. let their cash ratios rise, e.g. because they had no confidence in the Government) the Central Bank could—without fear of inflation—increase its own holdings of Government securities.

As long as the Central Bank is either in accord with Government policy or can be forced to accept it and, secondly, the export of capital is controlled, the clearing banks will be unable to influence economic policy by their refusal to co-operate. The sole result of their resistance will be a change in the balance sheets of the banking system. Instead of their holding Government securities the Central Bank will hold them and the cash ratios of the clearing banks will be rather higher than they would otherwise have been (or the reverse).[1]

C. The Secondary Liquidity Reserve[2]

The secondary liquidity reserve consists of *money* lent at call or short notice—fortnightly (exceptionally three weeks if the Stock Exchange account is longer) or weekly—to the money market, to the Stock Exchange and exceptionally to other financial and trading firms[3] and of *sterling bills*,[4] both commercial and Treasury bills.

Information concerning these items, as we have already mentioned, is not satisfactory. Some of the banks lumped together—especially prior to the war of 1914–18—bills and advances. Treasury bills or short-maturing Government debt are often included in securities. Short loans to the market, on the other hand, are sometimes carried under 'cash and other items of a cash nature', sometimes part was included in advances. Book-keeping methods have become more uniform of late, but all discrepancies in treating assets for balance-sheet purposes have not been eliminated.

In 1913 the item[5] 'money at call and short notice' amounted to £97 millions or 13·8 per cent of total deposit liabilities.

[1] Cf. also p. 26, n. 1.

[2] Cf. p. 35 on the day-to-day methods of adjusting the cash position.

[3] Goodenough, *M.E.* Qu. 488; Hyde, ibid, Qu. 910.

[4] Only very small quantities of bills labelled in foreign currencies are bought, *M.E.* Qu. 490.

[5] The banks which separated cash from call money accounted for £963 millions of bank assets.

Lavington[1] states, however, that loans to Stock Exchanges were not less than £80 millions at the outbreak of the war. The bill portfolio of the banks which listed bills separately amounted to £79 millions or some 11·2 per cent of total deposits. Cash and these two items (at that time, however, also including cheques in course of collection) representing the first and second line liquidity reserve were some 40·4 per cent of the liabilities—against 36·1 per cent in 1920, 32·9 per cent in 1929 and 28·3 per cent in 1938. The biggest relative fall (from 13·8 to 6·2 per cent) occurred in the loans to the market. The relative share of bills had hardly declined (10·3 per cent in 1938 as against 11·2 per cent in 1913—but not less than 16·7 per cent in 1920).[2] The difference between the ratio policy of individual banks was and remains very marked, though each of the banks adhered rather faithfully to a given pattern in their distribution of assets for long periods.

TABLE XIII. LIQUID ASSETS OF THE BRITISH BANKING SYSTEM

Year	Money at call	Money at short notice		Treasury bills discounted	Commercial bills discounted	Proportions to current and deposit accounts		
		To the money market	To the Stock Exchange			Money at call	Money at short notice	Bills
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1919	22·9	90·9	17·7	159·2	106·8	1·5	7·2	17·6
1920	23·8	54·3	22·0	115·6	144·2	1·4	4·4	15·1
1921	27·2	54·8	18·0	224·6	134·1	1·6	4·2	20·4
1922	29·7	58·8	23·4	208·0	113·3	1·7	4·8	18·8
1923	24·8	60·2	24·5	146·1	119·8	1·5	5·2	16·5
1924	24·6	57·2	22·8	104·8	125·5	1·5	4·9	14·3
1925	24·8	61·1	30·6	91·0	127·6	1·5	5·7	13·6
1926	25·0	63·1	32·1	100·9	107·8	1·6	5·9	13·0
1927	25·2	75·4	39·5	112·6	98·4	1·5	6·9	12·7
1928	28·4	77·7	48·0	107·7	118·2	1·7	7·3	13·2
1929	28·9	76·0	43·4	98·3	122·9	1·7	6·9	12·7
1930	33·1	80·1	28·5	128·6	127·2	1·9	6·2	14·7

The Macmillan Committee published detailed data of the constituent parts of the secondary liquidity reserve for the period 1919–30 and their proportion to deposits (Table XIII).

[1] Op. cit. p. 142 and nn. 43 and 44, p. 289. Altogether the London Stock Exchange owed £81 millions to financial houses and the provincial exchanges £11 millions. Yet he states that though the great bulk of this was borrowed from the banks the 'greater part' of the call loans went to the discount market (p. 142). This shows the uncertainty of statistical treatment.

[2] And 20·4 per cent in 1921.

These statistics must be, nevertheless, taken with some reserve. It is not likely that column (3) includes all loans to the Stock Exchange. Certain 'exotic' bills (including promissory notes, municipal bills and hire-purchase instruments) still continue to be carried under advances—presumably as they are regarded as merely serving as security against loans granted in that form or as overdrafts. The changes in book-keeping methods and the shifts in the importance of some instruments of credit as against others[1] should warn against too confident a use of bank balance sheets for concluding that the position of the banks became more or less 'liquid'.

Mr D. Spring-Rice suggested[2] that the ratio of Stock Exchange to discount market loans in 1923 was as 2 : 1. That ratio was not reached until 1929. But Mr Spring-Rice, like Mr Lavington, might have included loans carried under advances in this estimate. Mr Hyde[3] stated that his bank loaned (in the 1920's) £8–10 millions to the Stock Exchange.[4]

Since 1931 we have no detailed statistics on the development of the constituent items of the secondary liquidity reserve. The development of the monthly return is shown in Table XIV.

TABLE XIV

(Amounts are stated in £ millions)

Year	Money at call and short notice	Percentage to deposits	Discounts	Percentage to deposits
1931	121	6·9	256	14·6
1932	116	6·5	308	17·2
1933	102	5·2	354	18·1
1934	134	7·1	230	12·2
1935*	142	7·1	266	13·3
1936*	158	7·4	313	14·6
1936	165	7·5	320	14·4
1937	167	7·3	281	12·3
1938	151	6·6	280	12·3

* Ten banks: elsewhere eleven.

[1] And, indeed, the change in the character of some instruments in spite of their formal identity (especially bills, e.g. prior to 1914, 'pure financial bills' were relatively numerous; they disappeared for a time after the war only to make an unfortunate return prior to 1929).

[2] 'The London money market since the war', *Bankers' Magazine*, March 1923.

[3] *M.E.* Qu. 891.

[4] Money at call, etc., in that period was £40 millions on 31 December 1929. Advances amounted to £212 millions. Mr Sykes states (op. cit. p. 91) that the loans to the discount market were £100 millions, to the Stock Exchange £60 millions. He gives no authority for this estimate.

Several attempts have been made to continue the more elaborate statistics of the Macmillan Report. M. Truptil[1] gives the following figures (in £ millions) for the years 1931–4:

	Money		Bills	
	At call and to the discount market	At short notice to the Stock Exchange	Treasury	Commercial
1931	100	21	156	100
1932	100	16	250	58
1933	80	22	310	44
1934	90	44	180	50

The *League of Nations Monetary Review* (1937–8)[2] attempted a continuation of this series on the basis of the published figures of five clearing banks (of which, however, only three belonged to the category of the Big Five).[3] No attempt was made to separate loans to the discount market from loans to the Stock Exchange. The result is given in Table XV.

TABLE XV. BILL HOLDINGS OF LONDON BANKS

(Amounts are stated in £ millions)

	Ten banks* (Annual averages)			Five banks (31 December)			Ten banks (31 December)		
	1928	1929	1930	1935	1936	1937	1935	1936	1937
1. Commercial bills	118·2	122·9	127·2	44·5	33·6	44·0	(72·4)	(55·9)	(72·9)
2. Treasury bills	107·7	98·3	128·6	137·6	136·1	123·3	(224·3)	(226·2)	(204·1)
3. Total bills	225·9	221·2	255·8	182·1	169·7	167·7	296·7	282·1	277·0
4. (1) as % of (3)	52·3	55·6	49·7	24·4	19·8	26·3	(24·4)	(19·8)	(26·3)

* Cmd. 3897, p. 296.

Unfortunately, this method of estimate is open to serious doubt, because (as the *Monetary Review* for the next year[4] frankly admits) the policy of the banks whose figures can only be arrived at by extrapolation might be wholly different from the policy of the 'reporting' banks on the basis of the balance sheets of which the

[1] Op. cit. pp. 96 and 98. [2] P. 50.

[3] Presumably the Midland, Lloyds and National Provincial. It is interesting that the Secretariat overlooked the fact that Barclays usually give their Treasury bill holdings in the annual statement to the general meeting.

[4] 1938–9, p. 112.

calculation is made. The non-reporting bank (the Westminster) is important enough to upset the validity of the whole estimate.

There is yet another obstacle. Some of the banks give the distribution of their bill portfolio between commercial and Treasury bills only for the mid-year and year-end balance sheets. The seasonal fluctuation in the amount of Treasury bills outstanding is substantial. The year-end figure, therefore, does not give an accurate picture of the average position. Indeed, this is the reason given by the Westminster Bank for the refusal to publish the division of its bill portfolio at the year end, which was stated to have been purely accidental.[1]

The subdivision of the loans at call and at short notice has not been carried further. Mr McKenna stated in 1935 that the increase in this item was predominantly due to increased loans to the Stock Exchange. This would bring the total of Stock Exchange loans to some £50 millions in that year or one-third of the total, a figure which is not out of keeping with the previous policy of the banks or with Mr McKenna's suggestion that some 2·5 per cent of the deposits were employed in loans of this character to the security market.[2]

Money at Call and Short Notice. The first line of defence of the banks if they have to replenish their cash reserves are the assets included under loans at call or at short notice to the money market.[3] On account of the historical evolution of the structure of the British money and capital markets, it is through this channel that the banks have indirect recourse to the Central Bank by forcing the discount market to apply to the 'lender of last resort'. Barring wholly exceptional circumstances, the banks do not sell bills once they have acquired them.[4] Hence an expedient had to be found to obtain access to the Central Bank without being obliged to apply for rediscounting facilities. This expedient was found in granting loans to the money market on the security of bills which were eligible for rediscount or collateral on advances at the Bank of England.

The indirectness of the relationship between joint-stock banks

[1] *Annual Report* for 1929, p. 5. [2] Cf. below.

[3] Cf. also Chapter 5, A.

[4] This has applied and still applies to Commercial bills absolutely. To Treasury bills (which need no endorsement by the selling bank) this self-denying ordinance does not apply quite as sharply. As far as London private banks are concerned, rediscounting ceased after 1827; rediscounting by country banks after 1857 also declined, cf. King, op. cit. pp. 92–3 and 270, and also Rae, *The Country Banker* (1885, new ed. 1930), pp. 222–4, 253.

and the lender of last resort, explains the structure of the interest rates. In so far as the practice of the banks of not rediscounting eligible bills renders the bill portfolio relatively illiquid,[1] the banks must enable the money market to carry similar bills at some profit with money borrowed from them. In normal circumstances, therefore, loans to the market have to be below the bank rate—they were, in fact, fixed at 1 per cent below. Thus the market, whenever possible, avoids using the Bank of England as a continuous source of credit, and in its operation mobilizes all available bank cash automatically before it resorts to the Bank of England at penal rates.[2] In post-war years rediscounting by the market at the Bank of England was replaced by advances on eligible paper. The rate charged was even higher, ½ per cent above bank rate, but the conditions were less onerous.[3]

During the period of extreme shortage of bills, the competition of the banks drove the bill rate sharply below the normal rate quoted for call money. Consequently, the call loans of the banks to the market fell sharply in 1933, as the market limited its customary borrowing from the joint-stock banks to the minimum necessary to maintain business relations with the clearing banks.

Subsequently the banks modified their usual practice and reduced their rate of interest on call money and money at short notice to the money market against eligible paper to ½ per cent, equivalent to 1½ per cent below bank rate. Even this measure was insufficient to ensure maintenance of the necessary interest margin and had to be supplemented by an agreement to refrain from bidding for Treasury bills. The subsequent increase in the call and short loans of the clearing banks, however, cannot be altogether explained by the expansion of call and short loans to the discount market. These loans declined sharply after 1937 in spite of the increase in the volume of Treasury bills issued by tender.[4] The rise in loans to the Stock Exchange provides a possible explanation.

Interest on direct loans to the Stock Exchange—the so-called 'Stock Exchange Rates' (unless they are included in the category of advances[5])—is higher than that charged on loans to discount

[1] But in building up their bill portfolio the banks will take care to secure suitable maturities as against *expected* outgoings.

[2] Cf. Part II.

[3] Cf. Sir E. Harvey, *M.E.* Qu. 371 and *M.R.* p. 44. Cf. pp. 123 and 129–30.

[4] Cf. Part II.

[5] In which case the rate of interest charged is presumably on the lower range of the interest charged generally on advances.

markets. It used to be, in the middle twenties, roughly speaking ½ of 1 per cent above bank rate,[1] and it seems to have increased to ¾ of 1 per cent above bank rate in the thirties.[2] These figures are indicative of the level of the rate of interest, rather than intended to give a fixed rule. The Stock Exchange rate is charged on money borrowed from one Stock Exchange account to another.[3] For shorter loans and for temporary accommodation (e.g. to stock jobbers) special terms are made below the Stock Exchange rate, though somewhat above the rates charged to the bill market.

Such investigation of the assets of the joint-stock banks as is possible on the basis of published figures, especially of the structure of their advances, shows an unmistakable increase in their total loans for financial purposes.[4] This tendency, however, has not been so strong as to arouse misgivings such as have been voiced in America against call loans to the stock market. They could not be considered a menace to economic stability through engendering excessive speculative booms on the Stock Exchange. The problem of qualitative control, therefore, did not arise in this country.[5]

The short-term lending activity of some of the banks on gold and in connection with foreign exchange transactions, however, increased in the thirties. This activity was partly a legitimate consequence of the change in the technique of foreign trade finance (i.e. the replacement of the bill of exchange by the telegraphic transfer, and the hedging operations necessitated thereby); partly (and probably increasingly), however, swap operations were conducted as a result of the growing unsettlement in the foreign exchange market, due to the rise of political (internal and external) risks in important foreign countries and Europe as a whole in the thirties. Few of the joint-stock banks participated in this business: American banks, however, found at times a most profitable outlet for their funds.

The Bank of England, in co-operation with the French and American Central Bank Authorities, tried to discourage speculative transactions of this kind, and loans against the security of gold, and

[1] Sykes, op. cit. p. 91. [2] Ellinger, *The City*, 1940, p. 138.

[3] I.e. two, in exceptional cases, three weeks.

[4] Lloyds Bank is stated to have limited its Stock Exchange loans to 25 per cent of total lent at short or call notice (*M.E.* Qu. 2088). The Midland Bank figures in 1930 were even lower at between £8 and 12 millions out of a total of over £40 millions (Hyde, *M.E.* Qu. 891).

[5] E.g. such as has been passed in America, with respect both to instalment paper and security loans, giving powers to the Central Bank to fix maximum margin limits.

the finance of forward transactions in both gold and foreign exchange for other than commercial purposes were gradually eliminated under the pressure of the authorities.[1]

Discounts. The evolution of the bill portfolio and the change in its constituent elements reflects the evolution of the commercial bill of exchange as an instrument of internal and international finance, on the one hand, and the history of the British Floating Debt since the last war.[2]

The amount of bills drawn in Britain climbed steadily before the war of 1914–18. In 1913–14 the bill circulation was estimated at just over £500 millions, on the average (i.e. roughly two-thirds of the total deposits of nineteen banks which at that time gave detailed account of their balance-sheet items).

The amount of Treasury bills outstanding before the war, since they were inaugurated in 1877, was relatively insignificant.[3] Individual issues in the first twenty-five years were usually between two and three millions only and were made at infrequent periods. From 1902 onwards they were used for Ways and Means purposes and not merely for the purpose of the Consolidated Fund. Public issues there became more frequent and the amount outstanding expanded, but never reached £40 millions.[4]

Thus, while at times the variation of the volume of Treasury bills outstanding had some influence on the credit position, it was overshadowed in importance by the commercial bill.

In course of the war and the post-war boom the volume of deposits increased from £800 millions in 1913 to over £1,850 millions in 1920. The growth of the volume of commercial bills did not keep step with the expansion. After a severe relapse during the war[5] to below £300 millions in 1917–18, it did not expand

[1] In so far as the banks carried only part of their foreign exchange commitments in their balance sheets; in so far as this fluctuated violently; in so far as, moreover, most of these transactions appear, on the passive, rather than on the asset, side of the balance sheet, where they cannot be distinguished from deposits of a less volatile nature, no quantitative estimate of the importance of this new factor on the money market can be attempted. It seems, however, clear that some of the violent fluctuations in the liabilities of the joint-stock banks in the thirties, especially the deflation in 1938, could, to a large extent, be attributed to this factor. Cf. below, ancillary business of the joint-stock banks, p. 112; also Section II.

[2] Cf. Part II, and more especially Mr Paish's Memorandum, Appendix I, Part II; also Mr Paish, 'Twenty Years of the Floating Debt', *Economica*, August 1939 and 'British Floating Debt Policy', *Economica*, August 1940.

[3] Cf. King, op. cit. p. 275 and Part II.

[4] The bills had to be paid off entirely within the financial year in which they were issued.

[5] Estimated on the basis of the Stamp Duty Statistics.

even in the post-war boom of 1920–1 to more than just over £600 millions—i.e. by 20 per cent as against the 100 per cent expansion of deposit liabilities. At the same time, however, Treasury bills expanded to over £1,000 millions.[1] Whereas before the war, out of a total bill volume of upwards of £500 millions, the banks directly held almost £110 millions and indirectly financed another £100 millions—a proportionate holding after the war would have entailed a combined bill portfolio and 'money lent at call or short notice to the money market' of some £400 millions. Actually in 1920 the London clearing banks held only roughly £260 millions bills and advanced £78 millions 'loan at call and at short notice to the money market', i.e. not merely a smaller proportion of total deposits, but also an appreciably lesser proportion of the total bill material outstanding than before the war. In the following year, however, they succeeded in increasing their bill portfolio to £359 millions, with their short-term loans to the market remaining almost unchanged. In subsequent years the funding operations of the Treasury reduced both the total volume of Treasury bills outstanding and also their bill portfolio to about £200 millions—half in commercial bills and half in Treasury bills. A reliance on commercial bills to increase the ratio of quick assets would not have been possible, especially as the demand for bills outside the clearing-bank system increased very sharply.[2]

The policy of the individual joint-stock banks in determining the character of their bill portfolio was divergent. The Midland Bank seems to have employed a running broker to procure commercial bills. It also succeeded, through its correspondents abroad, in accumulating a higher proportion of commercial bills than the other banks. According to Mr Hyde,[3] out of a total bill portfolio

[1] Apart from £447 millions of Ways and Means advances (Paish, op. cit. p. 243) on 4 January 1919. By June 1921 the volume of Treasury bills rose further to £1,200 millions, but Ways and Means advances correspondingly diminished. In so far as the latter contained deposits of the joint-stock banks at the Bank of England this change did not affect the investment outlets of the banks.

[2] *M.E.* Qu. 2325, Mr Rae stated that Treasury bills were cheaper than commercial paper on account of the increasing competition of Central Banks and other public institutions, who were precluded by their statutes from buying Treasury bills.

M.E. Qu. 5368, Sir E. Harvey stated that the character of assets held by the Issue Department, Bank of England, was determined by the Bank of England. The increase in the fiduciary issue, however, obviously meant a drain of the supply of liquid assets, as the Central Bank, even though in its open-market operations it was not directed by considerations of profit or loss, was certainly having to keep at least part of these assets in the form of Treasury bills.

[3] *M.E.* Qu. 938.

of up to £60 millions, Treasury bills were not more than £15 millions (1930).[1]

The admittedly unsatisfactory calculations of the League of Nations (quoted above) show a further very sharp fall of the commercial bill holdings of the clearing-bank system to between a quarter and a third of the total bill portfolio in the thirties. This development is entirely in keeping with the decrease in the total volume of commercial bills to less than 50 per cent of its pre-1929 level in consequence of the crisis (i.e. to something between £250 and £275 millions, the latter at the top of the post-depression boom in 1937).[2] Under these conditions, the volume of Treasury bills became the main if not the sole determining factor in the fluctuation of the bill portfolio of the joint-stock banks.

The funding operations, which began in the early twenties, had to be interrupted on account of the weak position of the £ almost throughout the period after Britain's return to the gold standard. They recommenced immediately after Britain went off the gold standard and the return of confidence and the elimination of the irksome fetters exercised by an old over-valued gold parity. Consequently Treasury bills outstanding issued by tender declined from £478 millions to £377 millions from 1932 to 1935.[3] The banks succeeded in increasing their share in the total. This was only made possible by the cut-throat competition for bills, which pushed down the rate of interest below $\frac{1}{4}$ of 1 per cent per annum in 1933–4. Even so, the bill portfolio of the banks declined from £338 millions to £199 millions from April 1933 to April 1935.[4]

[1] By 1936 and 1937 the Barclays Bank ratio of commercial to total bills was higher than that of the Midland Bank, being 39 and 50 per cent, as against 30 and 37 per cent in the case of the Midland Bank for 1936 and 1937 respectively. The ratio of commercial to total bills in these two years is shown by Lloyds Bank, whose bill portfolio contained only 9 per cent of commercial bills.

[2] Actually the decline of the effective bill circulation was far sharper, as, of the amount of some £130 millions foreign bills outstanding, a large proportion consisted of standstill bills which did not come into consideration as a liquid investment. Cf. Part II. According to the Governor of the Bank of England (statements quoted by the *League of Nations Monetary Review*, 1937–8, p. 49) the volume of commercial bills 'covered by the Market' (thus, presumably, excluding bills held by the accepting banks or bankers themselves) which was believed to have amounted to £300 millions in 1929, fell from about £230 millions in 1931 to £130 millions in 1936. It was thought to have decreased further in 1937.

[3] Averages for April.

[4] The tender issue declined some £40 millions more—hence the ratio of the bill holdings of the clearing banks to total Treasury bills outstanding increased. At the same time foreign competition also increased (but cf. below on foreign deposits).

After the series of agreements had been negotiated with the discount market, in order to preserve its functioning on traditional lines (i.e. they undertook not to tender directly for bills or purchase 'hot' Treasury bills[1]), the ratio of the bill holdings of the banks declined. At the same time, the fixing of the rates on most of the loans to the money market at a lower level increased their share in the loans to the money market as a whole.[2]

M. Truptil[3] brings out clearly the fact that anticipated variations in the volume of bills available did not give rise to compensatory movements in other assets by the banks. The volume of the Treasury bills is subject to regular seasonal fluctuations and their volume, *ceteris paribus*, will reach its minimum in March and the maximum in December. This resulted, at any rate before 1931, for which period monthly figures are available, in a normal seasonal fluctuation in the bill portfolio, which usually resulted in a maximum Treasury bill holding in January with commercial bills reaching a seasonal high in midsummer, the total being highest in these months, with a seasonal low in early spring and early autumn. These normal seasonal movements did not seem to have considerably influenced the lending activities of the banks. Indeed, M. Truptil points out that discounts move seasonally inversely with advances, the repayment of Treasury bills in the periods of heavy tax payment being financed mainly by the banks.[4]

The maintenance of adequate liquid reserves after 1932 therefore depended entirely on the policy of the Treasury. The Treasury, however, was bent on increasing what Mr Paish terms 'its own liquidity'. The volume of tender bills which reached the high level of £666 million in the first week of 1933 showed an uninterrupted downward trend. They were reduced by March 1935 to £358 millions. Indeed, if it is taken into account that the increase in the gold stocks of the Exchange Equalization Account represents an automatic increase in the volume of bills outstanding in the market, the volume of the Treasury bills outstanding after the elimination of those originating from gold purchases was barely £200 millions in March 1938. The expansion of the value of gold stocks between March 1928 and 1938 was some £700 millions. The volume of the floating debt, on the other hand, increased only by £60 millions. Not less than £320 millions of gold were financed by long-term

[1] Cf. Part II. [2] Cf. Part II. [3] Op. cit. pp. 102–3.

[4] Op. cit. pp. 102–5. Cf. the contrary view expressed by Mr Keynes and Mr McKenna as against Sir E. Harvey (*M.E.* Qu. 7582–92), also their discussion with Sir R. Hopkins (*M.E.* Qu. 5436–76).

loans, £175 millions by the increase in the banknote circulation and bank cash. A greater part of the difference represented a profit on the gold stock due to the continuing depreciation of the £.[1]

This policy of the Treasury caused serious difficulties to the banks in 1933–4 and again in 1938–9 in obtaining bills. In the first instance the dearth of bills and with it the difficulties of the discount market disappeared as the consequence of the influx of foreign funds due mainly to the French political and economic crisis. In the second instance the increasing deficit due to the rearmament led to an increase in bill circulation.[2]

The Significance of the Secondary Liquidity Reserve. The influence of the difficulty in obtaining liquid assets depended on the importance attached by the banks to an asset structure of a definite pattern. Mr McKenna and Mr Hyde, the representatives of the most articulate deposit bank, were most emphatic and positive on

[1] Cf. Paish, 'British Floating Debt Policy', *Economica*, August 1940, p. 244; and 'Twenty Years of the Floating Debt', *Economica*, August 1939, pp. 266–7. Cf. also *Midland Bank Review*, July-August 1937, pp. 1–4, esp. Table on p. 2.

[2] Mr Paish rejects the explanation that the funding operations of the Treasury were due to the fact that 'the Treasury regarded a yearly average of round about £500 million as "reasonable" for the issue of tender bills and that, regardless of other circumstances, it viewed with distrust any tendency for the average to rise above that level'. 'Such an attitute', he says, 'would be as intelligent as for a businessman to regard £1,000 as a reasonable figure for an overdraft regardless of the amount of security he has to offer or of the liquid assets he holds.' Yet, the explanation he puts forward with approval is hardly more rational than that which he rejects with such scorn. He says: 'The possibility of a war is, of course, one of the factors which the Treasury must always bear in mind. As long ago as 1925 Sir Otto Niemeyer, in his evidence before the Colwyn Committee, expressed apprehension as to the effect on short-term interest rates should the country be involved in a European war while carrying a large floating debt, and feared that "we should have great difficulty in renewing our bills and might be forced into very undesirable courses". But it is not unreasonable to suppose that, at least since 1935, the Treasury has deliberately followed a course directed towards securing for itself a position of extreme liquidity—a course analogous to the building up of "war chests" in bullion by monarchs of earlier centuries.' The suggestion that the Treasury might have any difficulties in the renewing of their bills under any circumstances and more especially that that contingency should arise under a system of foreign exchange control, such as a modern war demands in any case, that therefore the reduction of the floating debt to the smallest proportion represented a contribution to effective war preparations is, to say the least, illuminating. Mr Paish maintains that a fall in the volume of Treasury bills outstanding constituted a 'serious embarrassment' to the money market and the banks. This embarrassment was a homage to the antiquated financial view on war economics. Cf. also Sir E. Harvey (*M.E.* Qu. 458–61, 7598, and Sir R. Hopkins, *M.E.* Qu. 5447). Neither the Treasury nor the 'Liberal' economists contemplated the consequences of the imposition of exchange control and were, consequently, wholly unprepared for it when the war started (cf. 'The Drift towards a Rational Exchange Policy', *Economica*, 1940, by the present author).

this point. Statistical evidence suggests that the other banks, through not accepting the pattern described by representatives of the Midland Bank to the Macmillan Committee, on the whole adhered to similar policies.[1]

In the evidence given before the Macmillan Committee the most frequently discussed ratio (apart from the cash ratio) was that of advances to total deposits. Yet in actual practice the most stable ratio in the ten-year term 1925–34 was that of advances plus investment to total deposits. This proportion was about 68·5 per cent, and its standard deviation in these years was only 1·15 per cent.[2] The proportionate variation of this ratio was less than that of the cash ratio, the latter being 4·39 per cent, despite the 'window dressing' which is undertaken in order to increase the apparent stability (apart from increasing the level generally) of the cash ratio. This method of investigating the policy of the joint-stock banks is more fruitful than considering the movement of the cash ratio and the proportion of the items, money at call and at short notice and discounts. 'Window dressing' will, in the main, be conducted through converting bills and call loans temporarily into cash to achieve the desired increase in the liquidity of the balance sheet for a given period. An increase in the cash ratio would, moreover, automatically follow if the banks did not replace their liquid assets by illiquid assets when their liquid assets shrink.[3]

[1] Goodenough, *M.E.* Qu. 485–7; Mr Hyde, ibid. Qu. 909–38; and Mr Pease, ibid. Qu. 2084–110.

[2] Cf. the brilliant article of Mr A. J. Brown, 'Liquidity Preference Schedules of the London Clearing Banks' in the *Oxford Economic Papers*, no. 1, 1938.

[3] Cf. Paish, op. cit. pp. 236–7. In point of fact Mr Paish found that the expected fall or rise in the cash ratio consequent to the increase (or decrease) of liquid assets was smaller than the actual rise (or fall) on account of the unwillingness of the banks to replace these items by either investments or advances. His contention that these movements do not provide a proof of the banks' secondary ratio-consciousness because from 1934 to 1935 and from 1936 to 1937 a decrease in the cash ratio was accompanied by a fall in the ratio of money at call and at short notice and discounts is somewhat too austere. Both these periods fell into a time of vigorous expansion and, contrary to Mr McKenna's contention that with increasing liabilities banks hold higher proportions of liquid bills on account of their increased fear of losing deposits afterwards (*M.E.* Qu. 7483), the ratio of cash and short-term loans to bills seems to decrease and the liquidity to fall in these periods, as could be expected (A. J. Brown, op. cit. p. 66). From this it follows that variations of 'investments' must take the brunt of change in the cash ratio because an increase of that item makes it possible to vary the proportion of the most liquid assets, and it is impossible to increase or contract advances rapidly. It is interesting also that as a result of the freezing of advances the banks' position is rendered more illiquid than they like to contemplate during a recession stage and that therefore as soon as they are able to do so they increase their liquidity, merely to be tempted into a less liquid position by a possibility of increasing advances and therefore increasing the total yield of their assets (ibid.).

The shortage in the supply of available liquid assets for the banking system due to the eclipse of the bill of exchange, first the inland, subsequently also the international, would therefore have had extremely disturbing repercussions on the banking system. Though they may not have been fully conscious in their actions, the banks decided after the sharp deflation of prices in 1921, which was not accompanied by a decline of their deposits, that a further deflation was unjustified. The authorities on their part do not seem to have objected to the adoption of a lower working cash and liquidity ratio (presumably because it was more likely to be kept as a minimum ratio for technical and not merely for psychological or traditional reasons in times of expansion, thus strengthening the hand of the authorities in controlling the volume of credit). At any rate, the present liquidity ratios of those banks which published detailed balance sheets before the war of 1914–18 do not seem to be significantly lower than they were before the agitation for strengthening both the gold reserves of the banking system was started by Goschen and Palgrave in the last decade of the nineteenth century.

The discussion of Lord Keynes with Sir Ernest Harvey and Sir Richard Hopkins[1] showed that the difficulties of the banking system prior to the abandonment of the gold standard in 1931 were caused by the uneasy balance of payments of Britain after 1925. It was this fact which prevented the Bank of England from increasing the basis of credit in order to increase the cash reserves of the banking system and thus offset any deflationary repercussions emanating from the reduction in the volume of Treasury bills outstanding.[2] The authorities, as is apparent from the evidence of both Sir Richard Hopkins and Sir Ernest Harvey,[3] were apprehensive lest the unresponsiveness of the volume of Treasury bills outstanding to the fluctuations of the short rate of interest should impede the operations of the Bank of England in managing credit.[4] Yet prior to the abandonment of the gold standard the combined

[1] *M.E.* Qu. 5401 and 7592.

[2] Lord Keynes pointed out (*M.E.* Qu. 7592) that, if the banks did not wish to increase their illiquid investments the Bank of England would have to do so and might have to sell at a loss at a moment when it wished to contract the volume of bank credit.

[3] *M.E.* Qu. 5432 and passim, and *M.E.* Qu. 5797 and passim respectively.

[4] They were also hoping that the decrease in the volume of Treasury bills would result in an expansion of the volume of commercial bills (Sir Ernest Harvey, *M.E.* Qu. 7598 and Sir Richard Hopkins, *M.E.* Qu. 5472, and also *Colwyn Committee Report*, p. 36). There was, of course, no justification for this belief on account of the changes in the institutional structure of international finance and banking as well as in the industrial organization (cf. also Section II).

effect of the weak balance of payments and of a reduction in the volume of Treasury bills outstanding was to weaken the rate of exchange, because foreign owners of funds were confronted with a shortage of the most suitable investment medium in London. A permanent cure for this development was not the funding of Treasury bills at inordinately high rates in order to bribe the holders of short-term loans into accepting less liquid assets, but a policy calculated to increase debt redemption during a phase of upswing.

The Treasury were apparently[1] under a misapprehension about the cause of their difficulties in renewing Treasury bills in 1930. They thought that the distrust of the public had been responsible. The apprehension of a repetition lasted well into the period of cheap money, and the Treasury undertook funding operations to prevent it. These operations, incidentally, counteracted the cheap-money policy which had, in the meantime, been inaugurated. The recovery could have been used for an accelerated redemption of the Government debt; this might have enabled the banks to adjust their liquidity position by selling long-term Government securities without incurring loss. The Government, however, was anxious to assist the recovery by cutting taxes. The opportunity ended with rearmament.

D. Investments

Investments of the clearing banks (or rather those of the Big Five, as the other banks have no affiliates) can be grouped into permanent participations in other banks and investments which can be freely mobilized. Table XXXIIA, which gives the detailed year-end balance sheets, shows that the former are insubstantial.

The bulk of the investment consists of direct or indirect obligations of the British Government. Martins, Lloyds, and Barclays have, so far as is known, relatively the heaviest investment in the stocks of the Indián and other Empire Governments and British Corporations.[2]

There were very substantial differences between the banks in their holdings of investments as is shown in annexed detailed tables (facing p. 114). Barclays, for example, in 1929 reached a ratio of between 16·3 and 18·1 per cent of investments to deposits. The Midland's corresponding ratio fluctuated between 8·3 and 9·3 per

[1] *M.E.* Qu. 5447, Sir Richard Hopkins.
[2] Cf. Table II.

cent in the same year. Any generalization in these circumstances is possible only provided it is kept in mind that though each bank adheres to its own pattern of asset distribution which might differ from that of the others, their policies on the whole are similar when confronted with identical problems.

The joint-stock banks have always used part of their funds to buy marketable securities.[1] In 1890 the percentage of investments, with their total assets standing at £82·2 millions, was 17·8 per cent.[2] At the eve of the 1914–18 war the ratio was lower at about 15 per cent out of a total of £121·2 millions. The ratio of investments to total assets of the big banks fell much more: e.g. Barclays from 29·8 per cent in 1895 to 16·8 per cent in 1913; Lloyds from 22·2 to 9·8 per cent; the National and Provincial from 32·8 to 17·5 per cent; Westminster, which was exceptionally liquid in 1895 at 14·3 per cent, showed 18·4 per cent in 1913. The Midland, which gave its ratio as 13·6 per cent in 1890, showed 7·2 per cent in 1913. The campaign for increased liquidity was successful.

The war saw a rapid expansion of the investments of the banks both absolutely and relatively, as the banks were called upon to ensure the success of the war loans both by their direct purchases and by their lending to clients for the purpose. By 1918 the percentage had risen to 22·2 per cent at £347·2 millions. Their policy of increasing investments from (average) 17·4 per cent in 1921 to a maximum of 23·1 per cent in August 1922 seems to have been the result of the funding operations: their bill holdings fell, contrary to usual seasonal variations, by more than £50 millions from March to August 1922, and they offset this fall by buying securities. Their combined investment plus advance ratio was only 65 per cent. In the ensuing period of halting and submerged recovery their advance ratio rose from just above 40 per cent to just under 60 per cent. This process was accompanied by a liquidation of investments and a fall of bill portfolios in equal proportions, the latter presumably due to funding operations. This steady liquidation can perhaps be explained[3] by the general trend in the first

[1] Cf. the Chairman of the Westminster Bank on railroad bondholdings. Gregory, op. cit.

[2] Following statistics published by *The Economist* (cf. Banking Supplement, 20 May 1939, p. 20). The figure for investments published there, £182·7 millions, is a misprint which has been repeatedly published, e.g. Sykes, op. cit. p. 16. The figures for the war period taken from the League of Nations *Memorandum on Commercial Banks*, 1913–1929.

[3] The evidence before the Macmillan Committee does not throw any ligh on this problem.

post-war decade in Britain. The volume of advances expanded because the normal liquidation of old advances had been interrupted by the semi-depressed state into which many of the older industries gradually sank, and because it was more profitable to the banks to grant new advances than to hold larger investments. But a *general* expansion of bank credit had to be prevented on account of the unstable balance of international payments. Hence they sold investments as they could not much reduce their other assets. In fact a slow deflation was enforced. The steady liquidation of their securities must have been one of the main direct factors which tended to stabilize the long-term rate of interest at a high level to the discomfiture of the Government and industry.

Such few incidental remarks on Government security holdings as were vouchsafed to the Macmillan Committee strongly suggest that up to the crisis the banks did not consider (even long-term) Government securities as part of their illiquid holdings. Mr Hyde, who was very much more articulate about the policy of his bank than his colleagues, stated explicitly that he included investments in the 45 per cent of assets which must be kept in a form 'in which you can get hold of them'.[1] The remaining 55 per cent could be used for loans and advances. The other bankers did not explicitly state their opinion about the liquidity of investments. But there is the implicit evidence that each of them had definite ideas as to the permissible level of advances,[2] lumping all other items together. The so-called 30 per cent ratio of quick assets did not seem to have influenced banking policy in that period.

The period of growing depression shows a slow reversal of the process of liquidation of investments. The floating debt outstanding was further reduced by funding operations, and with it one of the safest and most convenient outlets for banking funds was narrowed. At the same time a considerable reduction in advances took place. Investments in the holdings of the nine clearing banks increased from £225 millions in April 1930 (13·1 per cent of deposits) to £292 millions (17·2 per cent) in April 1931.[3] They were once more reduced to £272 millions in June by the acute crisis of confidence in the summer of 1931. The decisive change in the bankers' attitude to investments occurred after Britain abandoned the gold standard. The Treasury and the Bank of England decided on the

[1] *M.E.* Qu. 921. [2] Cf. below.

[3] The ratio of advances to deposits fell from 56·6 to 54·5 per cent in the same period. (It had fallen to as low a level as 49·5 per cent in January 1931.)

conversion of the 5 per cent War Loan. The cash reserve of the banking system, which had gradually been reduced from an average of about £185 millions in 1930 to the low point of £169·8 millions in February 1932, was rapidly increased in order to assist in carrying through the operation. It rose to £188·3 millions in June and £203·2 millions in December 1932.

The continued shortage of bills made an expansion of the short-term assets impossible. The volume of advances could not be increased quickly. The recovery enabled industry to repay hitherto frozen debts.[1] The fall in the long-term rate of interest (brought about partly by the action of the banking system) and the slowly returning willingness of the public to purchase shares enabled entrepreneurs to obtain finance from the capital market. Accordingly, when the open-market operations of the bank increased their cash reserves, the banks were forced to increase their security holdings. The difficulties in earning adequate profits, and the return of confidence after September 1931, restored their willingness to buy less 'liquid' assets. Their security portfolio rose consequently from £264·1 millions in February 1932 to £610·1 millions in October 1935. This increase was of such a magnitude as to change the attitude of the banks to investments.[2] Investments could no longer be regarded as liquid assets,[3] because the banks held a considerable share in the total of the outstanding national debt. The liquidation of an appreciable fraction of a holding of that size could not be undertaken easily, and certainly not without a sharp fall in their value.[4] After 1934 investments were, therefore, lumped together with advances rather than with the other assets. The secondary liquidity reserve of 30 per cent became a dominant factor in deciding the policy of the banks.[5]

[1] Cf. J. M. Keynes's *Treatise on Money*, vol. II (1930), pp. 90 and 116; also, for the Nazi experience, 'The German Economic System', *Economic Journal*, September 1938.

[2] In 1920–2 the value of investments was of the same order of magnitude as that of bills. By 1934 their ratio to deposits increased to twice that of bills. In the periods of acute bill shortage in 1935 and 1939 they held three times as many investments as bills.

[3] Their 'shiftability' remained high, but the risk of loss in the case of liquidation increased. Cf. Sayers, op. cit. pp. 214–32.

[4] This freezing of the banking structure could perhaps have been avoided had the increased buoyancy of the revenue been utilized to redeem debt rather than lower the rate of taxation, if it was not used for rearmament. This procedure would have tended to reduce the amplitude of the business cycle. The policy which was followed tended to increase it. Cf. *Lloyds Bank Review*, 1937, April.

[5] *Midland Bank Review* and Chairman's speech, 1939. Cf. above, p. 67, n. 2.

TABLE XVI

	£ millions			
	1914	1921	1929	1939
Nominal national debt and Government-guaranteed securities excluding floating debt (rounded)	800	5400	6250	7050
Government securities held by the Clearing Banks (rounded)	35	300	230	560
Percentage of outstanding debt held by the Clearing Banks	4½	5½	3½	8

It may be remarked that banks usually show their investments on their books below market value. The difference represents one of their secret reserves.

E. ADVANCES

Bank advances are granted in two forms in England: loans and overdrafts. Loans are credited on the current account of the borrower and he is debited with the total amount of the loan immediately, even if he only utilizes part of the credit. Overdrafts are permissions to draw on the bank within certain limits over and above the credit balance of the client. The borrower is only debited when he actually uses the credit.

The practice of lending on loans was the usual one in London. Overdrafts were used mainly in the provinces.[1] It seems, however, that the system of overdrafts is replacing almost universally the practice of granting credit on loans of fixed amounts for fixed periods.

From the book-keeping point of view of bank statistics both methods have advantages and drawbacks. The practice of granting loans inflates the balance sheet, especially if, as in the U.S.A., the borrower is required to keep a minimum credit balance on his current account at all times. On the other hand, unused overdraft facilities are in a sense obligations of the banks—though as Mr Goodenough pointed out, unused overdraft facilities can be cancelled.[2] Both he and Mr Hyde refused to give any indication of the size of unused overdraft facilities.[3] The former thought that the publication of such a figure, which might be interpreted as an additional hitherto suppressed obligation of the banks, would shake

[1] McKenna and Goodenough, *M.E.* Qu. 545–6.
[2] *M.E.* Qu. 526.
[3] *M.E.* Qu. 522–48 and 1066.

confidence. Mr McKenna, who agreed with him in withholding this information, made the additional point that the figure would be misleading because it was at least highly unlikely that the whole would be used at one and the same time.[1]

It was customary to grant loans against specific security. Overdrafts were usually unsecured. More recently collateral is usually asked in both forms of lending, though no statistical information is available on this point.[2]

The rate of interest charged on advances depends on the bank rate. It is usually 1 per cent above its level with a normal minimum of 5 per cent. In exceptional circumstances 1½ per cent above bank rate is charged. Large customers may be granted credit at ½ per cent above bank rate with a minimum of 4½ per cent. In the period of very cheap money cases were known where strong customers exacted even more favourable conditions by threatening to move their accounts to other banks or to avail themselves of different methods of finance.

In examining the distribution of advances amongst different sections of the economy it should be borne in mind that, to an appreciable extent, present-day business relations of the several banks still reflect the heritage of their past history and growth. As different industries are subject to different economic pressures in the various phases of a trade cycle, the statistics relating to all banks may conceal marked differences between figures of single banks. These differences were on occasion sufficiently substantial to cause divergence in their general credit policy.

The aggregate figures for advances granted by all banks to different classes of clients which have been published regularly since 1938[3]—the Macmillan Committee published figures for various dates from 22 October 1929 to 19 March 1930—show that 'personal and professional' advances increasingly predominate. Other increases were recorded in advances to the building trades,[4]

[1] *M.E.* Qu. 547–8.

[2] Goodenough, *M.E.* Qu. 784; Hyde, ibid. Qu. 892; Rae, ibid. Qu. 2428. Leaf, *Banking* (1935), p. 170, gives certain figures for the Westminster Bank, but only with respect to loans to agriculture which is of no general value. Debtors often create mortgage securities to cover their overdrafts.

'Other accounts', which are usually lumped together with advances, consist mostly of cheques or other claims on non-banking firms. They are not significant.

[3] Table XVII.

[4] Part of the 'other' advances benefited building through the finance of house purchases. In fact this item was the biggest single item in, for example, Barclays' advances about which even more detailed statistics are available. Cf. Table XX.

to miscellaneous trade customers, local authorities, and to amusements. Advances for finance purposes in the narrow sense of the word have been reduced—in spite of the fact that 1936 was a prosperous year and financial activity was very brisk. A substantial fall is shown in advances to industries which had been especially depressed prior to 1933.

A comparison between the scanty figures available for single banks—if they are strictly speaking comparable at all, which is doubtful—shows that Lloyds granted relatively more personal and professional advances than the other two banks which publish detailed figures, Midland and Barclays. The Midland was very much more ($7\frac{3}{4}$ per cent in 1928) interested in the heavy industry than either Barclays (4·9 per cent in 1935) or Lloyds (3 per cent in 1936).

Fairly full information is available on the provision of credit to agriculture. In 1923 the Committee on Agricultural Credit found that the Big Five alone had granted advances of £46½ millions. By the date of publication of the second report, this figure had risen to £51 millions. The Macmillan Committee found that agriculture and fisheries had received £68·6 millions from the clearing banks in spite of the inauguration of the Agricultural Mortgage Corporation.[1] This class of advances remained prior to

[1] This figure, however, is not comparable with the former. The Agricultural Mortgage Corporation was formed in 1928 to assist farmers by making available long-term credit under the Agricultural Credit Act, 1928. Its capital, the dividend on which is limited to 5 per cent, amounted to £650,000, held by the Bank of England and eight other banks. A State guarantee was provided. Its activities were hampered from the beginning in that it raised capital in the period of dear money, £8·5 millions at 5 per cent in 1929–30 and a further £2 millions at 4½ per cent in 1932. As in the case of the Central Electricity Board, the Bank of England in the case of the latter loan did not seem to have shown great foresight in view of the impending conversion. In consequence the Corporation found great difficulty in finding outlets for its funds after 1933. The Scottish Corporation was constituted in a similar way. Its capital was, however, only £100,000. It was more successful, as it raised its loan fund (£500,000) in 1933 at 3½ per cent.

It is clear that the scheme did not (and because of its unfortunate financial policy could not) contribute considerably to the solution of the agricultural long-term problem investigated by the two Committees. These found that no complaint could be made against the clearing banks' policy with respect to agriculture, though they recommended reforms so as to enable farmers to provide security against short-term credit. It appears from the second report that the farming community did not avail itself of the facilities to foster agricultural co-operative credit granted by the 1923 Act. Sir Otto Niemeyer thought (*M.E.* Qu. 6942) that the device merely enabled the banks to liquidate (frozen?) credits (cf. Sykes, op. cit. pp. 77–80). It is difficult to see how the problem could have been solved by financial means as it arose much as the financial problem of the depressed industries, partly out of the general depression

1939 approximately at the £50 million level. Barclays and Lloyds had a higher percentage of advances to agriculture than the other banks. The Midland had the lowest percentage. The average overdraft to agricultural clients was below £700.

The number of separate advances was very high. The Midland Bank, for example, reported 180,000 advances in 1935.[1] The average overdraft was under £1,000. Barclays in the same year granted 200,744 advances of an average amount of £774.[2] The statistics show that there has been no apparent discrimination against the small private individual or firm.

At the eve of the 1914–18 war the advance had definitely ousted the inland bill as chief method of short-term finance in Great Britain.[3] The volume of advances increased relatively little during the war, from £430·7 millions in 1913 to £518·9 millions in 1918. As a percentage of total assets they fell from about 45 per cent to about 30 per cent.[4] There was a sharp expansion to £926·6 millions in the two years of the post-war boom. Even at that level advances represented not more than approximately 42 per cent of all assets. This violent increase shows that the clearing banks did not consider it their duty to help in controlling the rampant inflation. There can be no doubt that their credit policies were not conservative. Many advances were granted[5] which should never have been permitted. The history of this period is an ample demonstration of the grave dangers of sudden decontrol after a war.

In the subsequent years a slow but steady and painful liquidation of these speculative excesses is seen. The low point in the volume of advances was reached in 1922 at £793·5 millions. Subsequently the volume of bank advances recovered and reached its highest peak of £1,026·5 millions in 1929. During the world crisis it fell again to £764·2 millions in 1933. At the end of 1937

of Britain, partly because of the special handicaps of agriculture in Britain which after having expanded during the war of 1914–18 was further prejudiced by its relative inefficiency.

[1] *Report* for 1936, p. 19.

[2] In subsequent years the average amount increased to £887. In 1936, 88 per cent of all advances were below £1,000 (*Report*, 1936).

[3] The League of Nations *Memorandum on Commercial Banks*, 1913–29. In 1871 the Midland Bank's bill portfolio was still four times greater than the amount of its advances. By 1880 the proportion was already 2 : 1 in favour of advances. Cf. Crick and Wadsworth, op. cit. pp. 82, 337. On the reasons of the decline of the inland bill, cf. Part II. Cf. p. 180, n. 3.

[4] Cf. also Part II.

[5] E.g. to the textile industry and generally for carrying excessive commodity stocks at inflated values; some of their credit was used also for speculative excesses in refinancing private companies.

advances were again at £980·6 millions and remained at about the same level (at £977·7 millions) until the end of 1938.

If the fluctuation of bank advances is compared with an index of business activity, two interesting conclusions emerge. First the volume of advances shows a definite lag to business activity. They continue to expand after business activity has begun to decline. And the liquidation of advances continues well after business has turned the corner. This lag is explicable on the one hand by the fact that the book-keeping methods do not show the unused portion of overdrafts,[1] on the other hand by the inability of debtors to repay loans in the acute phase of depression.

This comparison furthermore confirms the view that there exists a secular tendency for the demand for bank loans to decline. This tendency was overshadowed in the 1920's by the rapid increase of bank loans in the post-war inflation which could not be liquidated because of the subsequent depression in the very industries which had received most assistance from the banks—textiles and steel and iron.[2] The volume of advances after the crisis of 1920 declined slowly and less than in proportion to the sharp slump in prices, and remained rigid in the face of not insubstantial fluctuations which took place between 1922 and 1929. This peculiar behaviour indicates that the proportion of loans which became frozen was substantial. The banks, if they did not want to write off these loans —and in case their debtors went bankrupt they would have had to write them off more or less completely—were obliged to grant their clients in difficulties further help. This policy, though at times sharply criticized, was proved to have been correct by the eventual recovery which took place when Britain, much against the desire of the bankers, abandoned the gold standard. As soon as the general recovery enabled industry to liquidate these loans—either by liquidating inventories, by accumulating profits, or by being able to appeal once more to the long-term market—the volume of advances fell rapidly. It did not rise again proportionately to the subsequent revival in business.[3] The reasons for the decline in the

[1] Cf. Keynes, op. cit. vol. I, p. 42. Above figures are taken from the Appendix of the Macmillan Report and for subsequent periods from a private compilation of banking statistics put at the disposal of the N.I.E.S.R.

[2] Clay, *The Post-War Unemployment Problem* (1929). Sykes, op. cit. pp. 79–86, and Daniels and Jewkes, 'The Post-War Depression in the Lancashire Cotton Industry', *Journal of the Statistical Society*, 1928.

[3] It may be inferred from the curve that what rise occurred was to some extent due to rearmament finance. The analysis of this problem, however, is beyond the limits of this study.

demand for loans is difficult to trace in the almost complete absence of statistics. It is probable that the integration of industries is one of its causes, as it tends to eliminate the main reason for one 'classical' type of demand for bank loans: the seasonal credit requirement to pay for raw materials or for semi-manufactured goods.[1] If the size of working capital does not fluctuate seasonally, its long-term finance does not result in a loss of interest over part of the year through holding idle funds. But integration will have another consequence: the size of industry increases and with it the cost of investing idle funds (such as maintaining a Treasury Department) falls. As the interest margin on which the clearing banks are forced to work is substantial, a large firm does not necessarily lose if it provides working capital by long-term finance. The finance of business by issuing shares, which the managers (as contrasted with the shareholders) tend to regard more and more as borrowing without having to pay interest, must have given a great impetus to this secular trend.

The bankers therefore cannot in present conditions be blamed for the failure of advances to rise. In the period of increasing industrial discomfiture they slowly but steadily changed their ideas about the ratio which advances should bear to deposits. The attacks of Goschen persuaded them before the last war to reduce their illiquid assets and replace them partly by bills, which, as we shall see below,[2] were temporarily coming forward in greater quantities. In the post-war period they once more readjusted their ideas. From a ratio of advances to deposits of 50 per cent[3] their limit of safety rose to 55–60 per cent.[4] The spokesmen for the different banks gave the following ratios to the Macmillan Committee:

Barclays	Goodenough, *M.E.* Qu. 610–16	52
Midland	Hyde, *M.E.* Qu. 945 (actually it was 58, which he considered high)	55
National Provincial	Goschen, *M.E.* Qu. 1987 *et seq.*, 1924–30	57
Lloyds	Pease, *M.E.* Qu. 2090–2100	55–60
Westminster	Rae, *M.E.* Qu. 2413–20	50

[1] Sayers, op. cit. pp. 238–9.

[2] Part II, p. 177, The Decline of the London Bill.

[3] Goschen, *M.E.* Qu. 1906. He considered 60 per cent too high, ibid. Qu. 1904. Also Pease, ibid. Qu. 2092.

[4] Rae, *M.E.* Qu. 2413–21, thought that '40 per cent was better than 50 and 50 better than 60'. He thought that even 50 per cent was an advance on earlier days. Goodenough, ibid. Qu. 610, considered 52 per cent the maximum compatible with safety.

Since then advances have moved in different orders of magnitude:

	Minimum ratio since 1931		31 Dec. 1938
Barclays	39·2	Dec. 1933	46·1
Westminster	33·2	Jan. 1937	38·6
Midland	38	Jan. 1935	45·1
Lloyds	36	June 1935	43·5
National Provincial	36·9	Dec. 1935	45
Average clearing banks	37·3	Dec. 1935	43·3

On the basis of their ideal ratios as expressed before the Macmillan Committee the banks should have been willing to increase their advances substantially, especially as they earned higher returns on them. The problem (apart from the change in the demand for advances) was whether they were willing to reduce either their second line liquidity reserve or able to liquidate their investments. And it is by no means certain that the large volume of long-term Government obligations which they have acquired since 1932 will not reduce the flexibility of banking policy in the future in the same way as the frozen industrial advances did in the 1920's. If this should prove to be the case, the ultimate effect of the cheap money policy of the middle thirties (and the subsequent war finance) might be a creeping deflation in the economic system, should downward adjustments be required, unless direct controls were maintained over banking and industry as in wartime. This problem could be dealt with either by an appropriate banking and public debt policy or by measures calculated to facilitate the investment of an increased part of current savings which their owners wish to hold in liquid form without the intervention of the banking system.[1] An increase in public investment or an enforced decrease in saving are two other alternatives.

The discussion of the policy of the banks before the Macmillan Committee unfortunately does not shed real light on the attitude of bankers to these problems. Mr Hyde alone shared the outlook of Mr McKenna on economic problems and tended to attribute the industrial depression to monetary causes and stated frankly that his lending was limited by his lack of cash.[2] All other bankers were anxious to assert that they were never confronted with a

[1] That is to say, institutions will have to be sponsored which will attract idle deposits (i.e. current savings) and transmit them to industry or—which might appear more unorthodox—offset hoarding by further expansion of the cash reserve of the banking system. It could be argued with some force that the building societies performed this function in the recovery of the 1930's.

[2] *M.E.* Qu. 896–900; also McKenna, ibid. Qu. 4828. The latter remarked: 'My experience is obviously quite different from that of my colleagues in the banking world.'

necessity of refusing credit—for a 'meritorious case'.[1] The Macmillan Committee accepted this view:

> As such advances form the most lucrative part of their assets the banks indeed are very willing to do so, so long as their total lies within their customary percentages and within the limits set by general credit policy. In this direction British industry certainly suffers under no handicap in comparison with its competitors. The great English banks, undoubtedly among the strongest financial institutions in the world, use and have used their resources freely, sometimes too freely, in the provision of advances to industry.
>
> While, however, we do not propose a change in the character of present banking practice, we think that the co-operation of the big banks is required both in taking an interest in the share capital of such an institution and being ready to provide such credit facilities as the institution may require pending a public issue.

It is obvious from the context that the Committee rightly distinguished between a deflation which may be forced on the banking system and a curtailment of credit arising from an internal structural inability to make large advances.

In fact, the strict rules concerning advances which are repeated periodically—presumably to increase confidence[2]

> We must be reasonably confident that the transaction will be self-liquidating in a comparatively short period or alternatively that the amount advanced will be forthcoming with reasonable promptitude in the event of a demand for repayment being made.[3]

[1] Cf. Pease, *M.E.* Qu. 2082–3, 2107–25, 2143; Goschen, ibid. Qu. 1895–911, 1924–33; Rae, ibid. Qu. 2410–1, 2423–8; Goodenough, ibid. Qu. 617–38. But Goodenough was forced to admit that his standards as to what constituted a meritorious case varied (Qu. 617), but he thought that investments would be the first to be liquidated in the case of a shortage of cash, and Pease as well as Rae insisted that curtailments would take place at the expense of finance and not of trade. But Pease said (General Meeting, 1936, of Lloyds) that the shortage of outlets forced them to consider new avenues for their activities.

[2] The monotony of their statements would tempt one's suspicions if one did not take into account that at the time a Government was in office which was feared as being bent on nationalizing the banks. It is obvious that the bankers confounded structural weakness with the necessity of deflating and protested that they did not curtail credits even in deflation. The question of confidence surprisingly plays a great role in the motivation of bankers, though one would think that they ought to know that banks of their size cannot fail. It is unquestionably a wholesome influence considering the propensity to finance over-speculation in times of booms. It finds its expression in odd ways in the evidence, e.g. the refusal of Mr Goodenough to publish the unused overdraft facilities. Cf. *M.E.* Qu. 537: 'You could not carry on business... people would not longer have confidence.'

[3] Chairman's speech, Barclays Bank.

or the classical formulation of Leaf:[1]

> It is a cardinal point of sound English banking that there must be no lock-up of capital.

have been interpreted in practice in a very liberal fashion. Otherwise there would have been deflation every time the public decided to hold more of its assets in the form of cash than correspond to the strictly seasonal demand for working capital which is carried by bank loans. Mr Hyde stated that loans granted vary between three, six and nine months, but he added that reasonable propositions are considered on their merits, e.g. a three-year credit would not be refused.[2] Mr Goodenough said that corporations often receive advances pending the issue of funding loans.[3] The published statistics show that a large proportion of the proceeds of industrial issues is used to repay banking loans.[4] Lloyds, for example, made an advance of £3 millions to Stewart and Lloyds in 1932 which was repaid by an issue in 1935. Another, rather less successful, operation was that in connection with Richard Thomas where the Bank of England had to step in in order to provide long-term loans (with the aid of the banks) to repay advances.[5] In recent years local authorities have been increasingly accommodated with intermediate finance pending long-term issues.[6] The banks also increasingly advance money to the building trade. Certain of the banks have even begun to consider applications for medium term credits (up to ten years) on the basis of regular yearly repayments by local authorities and by corporations.

The criterion of 'shiftability', i.e. the facility of obtaining cash at short notice for the asset concerned, is being abandoned. As long as the banks have due regard to the security of their loans this development can only be welcomed. In a centralized system of banking the fear of errors leading to losses amounting to a considerable part of deposits is hardly justified. A deflation of the same magnitude which would be equally destructive of money

[1] Op. cit. p. 157.

[2] *M.E.* Qu. 976–8. Also Goschen, *M.E.* Qu. 1912–23. The advances are at most for a year, but they are renewable. Rae said that (ibid. Qu. 2404–5) there is no fixed period, but they must be reconsidered every year.

[3] *M.E.* Qu. 628–32.

[4] Cf. Section III.

[5] Pre-1914 examples of similar nature are quoted, e.g. by Wieser, *Der finanzielle Aufbau der Englischen Industrie.*

[6] Goschen spoke of this already in 1930 as a major factor (*M.E.* Qu. 632).

values is also unthinkable.[1] But the old criterion had its uses.[2] If a bank only gave loans for seasonal working capital purposes, that loan was not only liquid but also safe: the borrower presumably would have fixed capital and permanent working capital to be able to produce, and this capital would provide the bank loan with a margin of security. Financing of long-term investment is risky—very much as the issue business—because it may lead to heavy and accumulating losses without an adequate equity margin.

It is in this respect that criticism of the present methods of banking are mostly justified. Partly on account of complacency,[3] partly because they were generally afraid of the political consequences of their controlling industry,[4] the banks were unwilling

TABLE XVII. LONDON CLEARING BANKS. CLASSIFICATION OF ADVANCES

(Amounts are stated in £ millions)

	Ten banks	Eleven banks		
	1929*	1936†	1937‡	1938§
1. Textiles (cotton, wool, silk, linen, jute)	81·6	39·9	43·8	38·1
2. Heavy industries (iron, steel, engineering and shipbuilding)	63·0	40·7	49·9	45·9
3. Agriculture and fishing	68·6	57·7	60·1	62·5
4. Mining and quarrying (including coal)	30·0	18·1	15·1	15·2
5. Drink, food, and tobacco	63·2	29·4	32·5	36·1
6. Leather, rubber and chemicals	22·0	12·6	15·3	14·0
7. Shipping and transport (including railways)	25·2	23·2	20·1	26·5
8. Building trades	47·8	61·5	68·2	68·1
9. (*a*) Miscellaneous trades	—	67·4	74·7	69·1
(*b*) Retail trades	146·5	60·1	64·0	66·4
10. Local Government Authorities and Public Utility Companies (excluding railways)	52·4	50·4	54·2	59·2
11. Amusement, clubs, churches, charities, etc.	26·5	40·5	44·5	46·6
12. Financial (including banks and building societies)	142·5	109·6	118·2	109·0
13. Other advances	218·4	258·5	300·4	297·7
TOTAL	987·7	869·5	961·0	954·3

* Various dates from 22 October 1929 to 19 March 1930.
† Nearest available date to 31 October 1936.
‡ Various dates between 4 August and 26 October 1937.
§ Various dates between 3 August and 31 October 1938.

[1] Cf. on this problem *Term Loans by Commercial Banks*, Institute of International Finance, New York University, 1939. Also W. R. Burgess, *Meeting Public Needs in Banking* and *Trade Changes and Monetary Policy* (1939). The problem is, of course, much more acute in the U.S.A.

[2] Cf. Sayers, op. cit. pp. 218–45.

[3] Goodenough, *M.E.* Qu. 579–85.

[4] This fear seems to have had an equal share in the reluctance to take the required vigorous action with respect to bankrupt enterprises as their reluctance to take losses. Cf. Kindersley, *M.E.* Qu. 1511–25.

to evolve an industrial lending policy. This refusal still persists, in spite of the repeated efforts to overcome it. Its consequences, aggravated by the fact that general economic information is neither developed nor used by the clearing banks apart from a few exceptional cases, are seen in the recurring freezing of advances under circumstances which suggest that a reasonable degree of foresight would have mitigated the ensuing discomfiture. The real source of trouble is not so much the insistence on too rigid or unworkable 'conservative' principles, but the refusal to apply general rules under expert guidance to their particular problems.[1] The problem of the long-term market they cannot and must not directly solve.

TABLE XVIII. LLOYDS BANK. CLASSIFICATION OF ADVANCES

	31 Dec. 1926 £ millions
Personal and professional	43·5
Retail	13·2
Agriculture	18·5
Paper, printing, publishing	1·8
Local authorities	7·1
Chemical fertilizers	0·9
Iron and steel	3·2
Coal	3·9
Cotton	3·8
Oils and fats	1·7
	97·6

TABLE XIX. MIDLAND BANK. PERCENTAGE OF TOTAL LOANS

	1928 %
Textiles	12¼
Building	11¼
Wholesale	11¼
Heavy	7¾
Agriculture	6½
Food, drink and tobacco	6
Leather, rubber and chemicals	4
Miscellaneous	4
Shipping	3½
Coal	2½
Others	31

[1] Cf. Part III and the bibliography quoted there.

TABLE XX. BARCLAYS BANK

A. *Percentage of Total Loans*

	End Oct. 1935		End Nov. 1936
	£ millions*	%	%
Loans to:			
Farmers	12	7·9	7·1
Productive industries:			
Textile	2	1·1	—
Clothing	3	1·9	—
Heavy	8	4·9	—
Building	12	7·5	8·8
Food, etc.	3	1·7	—
Coal mining	8	5·0	—
Others	4	2·7	—
Merchants (raw materials)	4	2·6	3·5
Merchants (manufactures)	4	2·7	—
Retailers	14	8·7	—
Hotels, laundries, etc.	4	2·5	—
Local Government and Public Utilities	6	4·2	—
Shipping	2	1·4	—
Finance, insurance	8	4·9	7·5
Professional, private	56	35·7	34·0
Entertainments, etc.	7	4·6	—
	155*	100·0	

Average advance £774.

The advances to professional and private persons were classified as follows in November 1936:

* In round figures.

B. *Professional and Private Loans (November 1936)*

	Amount (£000's)	% of total	No. of customers	Average per head
				£
Loans for:				
Land and for house purchase	17,408	10·1	16,682	1,043
Investment for securities	9,625	5·6	5,867	1,640
Loans to:				
Architects, estate agents, etc.	2,296	1·3	2,627	872
Business directors, managers, employees	8,536	4·9	22,151	386
Doctors, etc.	2,523	1·5	4,724	535
Lawyers	2,042	1·2	2,186	932
People of private means, etc.	11,503	6·7	44,482	259
Others	4,729	2·7	20,290	233
	58,662	34·0	119,009	498

F. Bank Premises, Buildings, etc.

This item is peculiar in so far as it represents investments which must be regarded as illiquid. The banks normally own the premises not merely of their head offices but also those in which they have their various branches in the country. The value, less amounts written off, is shown as follows:

			No. of branches	Value of buildings per branch £	£
Midland Bank	£9,377,000		2,137	4,388	
plus	£1,142,000	for other properties and work in progress		534	4,922
	£10,519,000				
Barclays Bank	£7,447,000		2,131		3,504
Westminster Bank	£5,056,000		1,098		4,605
Lloyds Bank	£7,499,000	premises	1,912	3,922	
plus	£1,740,000	other assets including sundry properties		910	4,832
National Provincial Bank	£7,395,000		1,324		5,585
Total Big Five	£39,656,000*		8,602		4,610

* The latest figure for the District Bank is £1,593,000 (569 branches) and for Martins £2,747,000 (584 branches).

It is seen from this table that the average value of properties as carried in the books is extremely low. The total at £39,656,000 represents, however, almost 2 per cent of the balance sheet and just over one-third of total capital and reserves.[1] This is somewhat higher than the corresponding figure in other countries. It must be taken into account, however, that English site values are notoriously high.

Each year, except for the worst depression years, between £100,000 and £250,000 were written off from the book value of this item by each of the big banks.[2]

It is more than questionable, however, that, even with this extremely careful policy, the banks would be able to realize much more than the book value of the assets, should they be forced to liquidate their business altogether, as their premises in general are

[1] Including carry-over.

[2] The Midland Bank for two years wrote off £500,000 in each year and continued the policy of heavy amortization between 1929 and 1937, presumably in order to write down the great extensions undertaken at the head office. The Chairman of Lloyds declared in 1931 that 'the whole cost of the building of our new head office premises was certainly provided for some years ago, and not a penny of this cost has been added to our premises account'.

rather specific in character and not well usable for other purposes. The magnitude of this item shows how the increasing competition between the banks, which takes the form not so much of increased payment of interest on deposits but of increased services to the customers, influences policy. The banks were forced to open branch after branch in order to increase the accessibility of their services. There can be little doubt that some of these branches represent a luxury which is not altogether warranted or required for the efficient service of the clients and which, to some extent, explains the very high cost of the banking service.[1]

CHAPTER 6. *BALANCE SHEET: LIABILITIES*

A. DEPOSITS

DEPOSITS of the banking system are a reflection of the lending activities of the banks and thus mirror their policy.[2]

[1] To some extent an identical phenomenon can be observed in the retail trade. Given the high profit margins maintained by agreement, competition forces the retail traders to increase the services for the better-to-do customers without option to those who would prefer lower prices.

[2] The vexed problem of whether banks 'create' deposits cannot be discussed in this context. It was regarded as solved in the last twenty years—only to be reopened recently when an era of reform threatened. There can be no question that (*a*) if the banks have a sufficient cash basis, in its turn created by the central bank, and (*b*) if they are willing to depress the rate of interest (in practice by competing either for bills or for securities), they can 'force' the public to hold higher cash balances. It is possible (but by no means necessary) that the fall in the rate of interest will have secondary repercussions in starting a cumulative process of expansion. This in turn will increase the demand for cash balances. If the banks do not satisfy this demand, the rate of interest will rise again. A direct control of investment (in fixed and circulating capital) combined with a *control of capital export* could prevent these secondary effects and would suffice to control the level of the rate of interest (i.e. it would be equivalent to rationing). The recent tendency to deny the power of the banks to determine the volume of credit (and thus deposits) is a tactical move in countering demands for the State control of certain key-factors in the economic system in order to achieve full employment without jeopardizing stability. The banks by their credit policy influence the direction of productive activity (they are of course in no sense 'guardians of the nation's liquid resources' or anything like it). Unless therefore more direct controls are applied on the distribution and use of productive factors (which in any case might become necessary) a qualitative (as contrasted with the existing quantitative) control over the credit policies of the banks is essential if a repetition of overlending and thus of the intensification of business fluctuations is to be avoided. They have not been and will not be in a position to judge the scope of credits which can be granted to any one industry in a period of violent and large changes. On the other hand, a control of the banking system cannot by itself ensure stability.

They can be divided into deposits used as a means of payments, usually called cash deposits. These are traditionally included into the volume of money in countries in which the cheque payment system is developed. There are, furthermore, deposits, usually called savings deposits, regarded by their owners as liquid assets, which therefore embody savings prior, or as an alternative, to their investment in less liquid forms.

There is a continuous interchange between the two kinds of deposits, as businesses and individuals accumulate liquid reserves for larger payments due ahead and then disburse them by the act of payment. The distinction between these two types of deposits roughly corresponds to the division in the English banking system between current accounts and deposit accounts. As usually no interest is paid on current accounts, individuals and businesses may from time to time transfer balances from one to the other, pending a more profitable longer-term use.

Table XXI gives the movement of deposit and current accounts

TABLE XXI. DEPOSIT AND CURRENT ACCOUNTS OF THE LONDON CLEARING BANKS

	Total deposit and current accounts* (£ millions)	Current accounts (£ millions)	Deposit accounts (£ millions)	Proportion of current accounts to total	Proportion of deposit accounts to total
	(1)	(2)	(3)	(4)	(5)
1919	1,511	1,016	495	67·2	32·8
1920	1,720	1,098	622	63·8	36·2
1921	1,754	1,025	729	58·4	41·6
1922	1,707	998	709	58·5	41·5
1923	1,614	966	649	59·8	40·2
1924	1,616	950	666	58·8	41·2
1925	1,603	923	680	57·6	42·4
1926	1,609	921	688	57·3	42·7
1927	1,659	932	727	56·2	43·8
1928	1,709	954	755	55·8	44·2
1929	1,738	940	798	54·1	45·9
1930	1,741	921	820	52·9	47·1
1931	1,699	895	804	52·7	47·3
1932	1,750	867	883	49·5	50·5
1933	1,908	978	930	51·3	48·7
1934	1,839	953	886	51·8	48·2
1935	1,958	1,054	904	53·8	46·2
1936	2,179	1,197	982	54·9	45·1
1937	2,244	1,233	1,011	55·0	45·0
1938	2,277	1,244	1,033	54·6	45·4

* These figures are the total of columns (2) and (3) and do not include 'Other accounts'.

NOTE. The figures for 1919–30 are taken from the Macmillan Committee Report; those for 1931–8 are from the *Bank of England Statistical Summary*.

of the London clearing banks between 1919 and 1938. It will be noted that there has been an almost continuous increase in deposit accounts, showing that part of the current savings was 'invested' in this type of asset. Deposit accounts fell in three periods only: from 1921 to 1923 and in the years 1931 and 1934. The fall in 1934 was probably due to the coincidence of extremely cheap money with a general fall in total deposits, i.e. the opportunity for increased use of the existing money stocks in face of the reluctance of the banks to extend credit because of the lack of suitable liquid investments.[1] This explanation is supported by the fact that the velocity of circulation of bank deposits increased by some 10–20 per cent between 1933 and 1934. The subsequent fall of the velocity of circulation, in spite of continued expansion of business, to and below the levels reached in 1933, shows that it was less sensitive to business conditions than to the general banking position.

Current accounts declined slowly until 1926 from the high level attained during the last war and post-war years of inflation. They show subsequently a gradual rise from 1926 until 1929, and a further abrupt decline during the crisis only to expand again during the recovery.

The ratio of deposit accounts to total deposits showed a parallel rise from 1919 to 1932 from 32·8 to 50·5 per cent. The greatest expansion was between 1919 and 1921 and from 1931 to 1932, i.e. during the acute phase of the two depressions. In the latter part of the 1930's it once more declined and stood at 45·5 per cent in 1938.

The ratio of deposit to current accounts varies widely between banks. This is illustrated by contrasting the figures available between 1913 and 1928 for the Midland and Lloyds Banks as compared with the aggregate figures for all clearing banks.

TABLE XXII. RATIO OF CURRENT ACCOUNTS TO TOTAL DEPOSITS

Year	Midland Bank %	Lloyds Bank %	Year	Midland Bank %	Lloyds Bank %
1913	—	51·6	1924	58·5	51·0
1919	71·4	60·7	1925	57·3	49·6
1920	66·2	56·7	1926	56·3	48·6
1921	60·3	50·7	1927	55·7	47·4
1922	60·0	49·7	1928	55·3	46·4
1923	59·8	51·5			

[1] Cf. above, Chapter 5, C.

Rate of Interest. At the beginning of joint-stock banking the banks competed sharply for deposits, and the main weapon used to attract funds was the rate of interest. Prior to 1886 the deposit allowances of the London banks were on the average 1 per cent below bank rate. This level was then reduced to 1½ per cent below bank rate where it remained until 1920. It was then fixed at 2 per cent below bank rate.[1]

Provincial banks, however, paid higher rates of interest. Where these banks were amalgamated their accounts, in general, continued to be allowed 2½ per cent (but were charged fees or commissions by the clearing banks).

Competition for deposits through giving more attractive rates of interest to depositors came to an end. It was replaced by offering indirect services to the clients. These indirect advantages consisted partly of giving more and more services without additional charges or at least offering more attractive terms than their competitors.[2]

In London, where current accounts do not carry interest, usually no charges are made for keeping accounts.[3] The banks recoup themselves by requiring that an adequate credit balance should be kept. The size of this balance of course is subject to negotiation which gives an opening for competitive bidding for balances.[4]

In the provinces, where a small interest is paid on balances on current account, the banks charge a commission for keeping accounts. This commission is usually made not according to the number of cheques collected,[5] but on the average turnover of the account, a somewhat irrelevant criterion. Its level varies according to the standing of the customer, the competitive position between banks, etc.

The indirect method of competing for accounts is one of the causes of relative rigidity of the rates of interest charged by the banks on advances and overdrafts. It increases the expenses of the banks both by increasing the direct expenses of attracting deposits (opening of branches, etc.) and, probably even more, by the cost

[1] With the bank rate standing at 2 per cent the rate of interest allowed on deposit accounts was, before the Nazi war, ½ per cent. In the middle period, i.e between 1886 and 1920, a rate of 1 per cent was paid when the bank rate fell to 2 per cent, i.e. the margin fell to 1 per cent. The margin was increased to 2 per cent whenever the bank rate rose above 5 per cent.

[2] Cf. below, Chapter 7, pp. 109–110.

[3] Hyde, *M.E.* Qu. 1071–82.

[4] Associations have been formed to enable their members, who individually would hardly be granted preferential treatment, to obtain the same advantages (Civil Servants, etc.).

[5] Hyde, ibid.

of extending services without charge. It also tends to widen the fluctuations in the profit margins of the banks. When credit is restricted not only will the total resources of the banks tend to shrink but balances on current accounts will be shifted into deposit accounts on which a higher interest has to be paid. In times of expanding trade, however, current accounts expand, and at the same time advances, which represent the most profitable outlet for the banks, also increase. It is probable that the tendency towards decreased liquidity in the late phases of the recovery is stimulated by this accentuated rise in profitability. Should banking not be nationalized, some authoritative regulation of their charges and interest payments is clearly desirable to restore flexibility.[1]

TABLE XXIII

BANKS WHOSE DRAFTS PASSED THROUGH ONE OR MORE OF THE LONDON CLEARINGS, 1937

Bank of England	Martins
Midland	District
Barclays	Glyn, Mills
Lloyds	*National
Westminster	Williams Deacon's
National and Provincial	Coutts

BANKS WHOSE DRAFTS PASS THROUGH THE COUNTRY CLEARING

Bank	Branches cleared	Agent in clearing house
Bank of British West Africa	Liverpool Manchester	Lloyds
Bank of London and South America	Bradford	Williams Deacon's
Clydesdale Bank	Carlisle Whitehaven Workington	Midland
C.W.S. Ltd.	Manchester Newcastle-on-Tyne Bristol	Westminster
Ellis Bates and Co.	Liverpool	Midland Bank, Castle St, Liverpool
Gunner and Co.	Bishop's Waltham	Barclays
Royal Bank of Ireland	Birkenhead	Midland
Union Bank of Manchester	All country branches	Barclays
Yorkshire Penny	All country branches	Glyn, Mills

BANKS WHOSE DRAFTS PASS THROUGH THE METROPOLITAN CLEARING

Bank
Grindlay and Co.
Hoares

* The National Bank clears only drafts on its twenty-seven branches in England and Wales; in 1935 it had 142 branches in Ireland, and the figure given is for its total deposits in all branches.

[1] The importance of such reform should not be exaggerated. The influence of the short term rate of interest on investment seems very slight (cf. Lord Keynes's controversy with Hawtrey).

Clearing. Cheques drawn on current accounts paid into the same bank are cleared within the bank. Surplus cash from branches is transmitted to the head office or to the nearest branch of the Bank of England. In London delivery and collection of cash is made several times a week by special van. Some branches make their remittances through the Post Office.[1]

Clearing between the main banks is organized through London and provincial clearings. In 1938 three London and eleven provincial clearings existed. The Bank of England is a member of the London Clearing House. But the Bank participates, according to Mr Phelps Brown and Mr Shackle,[2] in the clearing in one direction only. It presents cheques drawn on the clearing banks; cheques drawn on the Bank of England, however, are presented directly by the banks.[3] The other banks affiliated to the clearing can be divided into three categories: those admitted to full clearing, those whose drafts pass through the country, and those whose drafts pass through the Metropolitan clearing.[4] Cheques drawn on banks other than those listed in Table XXIII are cleared through the agency of one or more clearing banks.[5]

The London Clearing House consisted[6] of three sections, according to geographical divisions:

(*a*) *The Town Clearing*, consisting of the head offices of the clearing banks, and such of their branches as were within five minutes' walk of the Clearing House. Roughly 100 bank offices formed part of this clearing.[7] Most of the transactions handled were of a financial character, commercial transactions formed an insignificant part.[8] There were two each day. After 3.30 p.m. it

[1] According to Ellinger, op. cit. p. 125, Lloyds Bank aims at keeping a fixed cash ratio at each of its branch offices (10 per cent).

[2] Royal Economic Society, Memorandum 74, *Statistics of Monetary Circulation in England and Wales*, 1919–38, September 1938 from which Table XXII was also taken.

[3] Drafts on the Law Courts Branch of the Bank of England are cleared through the Metropolitan clearing, those drawn on its provincial branches through the country clearing.

[4] Ibid. Table III, p. 6.

[5] The cheques drawn on these banks and cleared through a clearing bank are presented to those banks through the Walks Department of the clearing bank. Final settlement is made either by a cheque drawn on the clearing bank or on the Bank of England or on another clearing bank.

[6] The position prior to the Second World War.

[7] Truptil, op. cit. p. 183; Phelps Brown and Shackle, op. cit. p. 7.

[8] According to the *Board of Trade Journal* (7 June 1934, Phelps Brown and Shackle, op. cit. p. 7), since November not merely the balances but all cheques drawn on banks in Scotland, Ireland and the Channel Islands, for which the clearing banks act as clearing-house agents, pass through the Town Clearing This seems to have increased clearings by some £2 to £3 millions per day.

was not possible to obtain the clearing of a cheque, but cheques could be handed in. The balance of the clearing against any single bank was settled by a cheque on the Bank of England in favour of the clearing house. The creditor banks instructed the Bank of England to credit their account.

(*b*) *Metropolitan Clearing.* This clearing covered an area of 5 miles' radius in London. In 1925 it comprised 511 branches. There was only one clearing daily.

(*c*) *Country Clearing.* This comprised only cheques drawn on country branches or banks in England or Wales for which the banks acted as agents. It did not, however, receive cheques which were cleared either through the Metropolitan or the Town Clearing or which were dealt with locally or by provincial clearing houses.

The Metropolitan Clearing figures fluctuated monthly between £120 and £200 millions in the two post-war decades, those of the Country Clearing between £210 and £350 millions. Town Clearing rose from around £1,500 to £3,000 millions monthly in 1919–20, fell back only slightly in the twenties, rose up over £3,800 millions during the boom of 1928 and 1929, and declined below £1,900 millions per month in the slump. In 1934 they once more reached the £3,000 million level.

Liverpool and Manchester together represent over 60 per cent of the total turnover of the provincial clearings, Birmingham another 10 per cent. The remaining 30 per cent are divided between eight smaller clearings. In the boom year of 1919 total provincial clearings were as high as £300 millions. They fluctuated around £150 millions in the twenties, around £100 millions in the early thirties, and between £110 and £130 millions in 1937.

In smaller provincial towns either local clearings are organized or weekly settlements are arranged and balanced by drafts on the London head offices.

The Velocity of Circulation. The total debit on all current accounts of London clearing banks is given in Table XXIV.[1] On the basis of these statistics the velocity of bank deposits can be estimated. This estimate is given in Tables XXV–XXVI. It is seen that the rate of turnover of current accounts fell from the yearly average of 70·2 in 1930 to below 50 in 1932. There was some increase in the rate of turnover in 1934. In 1935 it again declined to a new low level at 35 per cent below the average of 1930.

[1] Phelps Brown and Shackle, op. cit. p. 40, Table.

TABLE XXIV. TOTAL DEBITS ON CURRENT ACCOUNTS OF THE LONDON CLEARING BANKS, 1930–8*

(Amounts are stated in £ millions)

	1930	1931	1932	1933	1934	1935	1936	1937	1938
Jan.	5,833	5,772	3,835	4,049	4,660	5,186	4,817	5,279	5,328
Feb.	5,169	4,843	3,443	3,772	4,457	3,985	4,340	4,989	4,390
Mar.	6,066	4,983	4,424	4,446	4,756	4,440	4,636	5,350	4,998
Apr.	5,304	4,954	3,972	3,565	4,145	4,256	4,285	5,266	—
May	5,632	5,221	4,006	4,048	3,850	4,593	4,506	4,542	—
June	5,129	4,947	4,197	3,768	3,991	4,521	4,620	5,497	—
July	5,900	5,438	5,114	4,319	4,121	4,984	5,004	5,395	—
Aug.	4,787	4,221	3,904	3,738	3,772	4,232	4,511	4,382	—
Sept.	4,965	4,044	3,635	3,935	3,659	3,933	4,695	4,439	—
Oct.	5,687	4,072	4,243	4,226	4,255	4,560	5,392	4,883	—
Nov.	5,147	3,550	3,952	4,139	4,802	4,409	4,951	4,976	—
Dec.	5,023	3,668	4,321	4,007	4,243	4,773	5,489	4,993	—

* E. H. Phelps Brown and G. L. S. Shackle, *Statistics of monetary circulation in England and Wales*, Royal Economic Society, Memorandum 74, September 1938, Table II, p. 40.

Mr Kalecki[1] has shown that the velocity of circulation was in close correlation with the short-term rate of interest; except for one year, 1931. This exception can be easily explained by the financial crisis of that year which increased the desire to hold cash. This close relationship illustrates limitations of banking policy in influencing effective demand. All that banks can achieve is to induce individuals and companies to change the distribution of their assets. It is doubtful whether this indirect influence is sufficient to affect the level of investment in an upward direction.

The Importance of Bank Deposits as Assets. A comparison of the rate of growth in the holdings of the more important liquid assets in Britain is given in Table XXVII. It is seen that the deposit accounts of the clearing banks which in 1921 had grown to more than 50 per cent of the total of these liquid holdings had by 1936 fallen relatively to just over 35 per cent, despite this steady growth. Had the increase in deposit accounts stayed at the rate of some £50 millions reached in the years 1934–7 their total would have increased to some £1,500 millions since 1920. Such an increase would have had important consequences on banking policy, as the cash ratio of the banks covers saving and current deposits alike.

The greatest relative and absolute expansion is found in the deposits and shares of the building societies, especially since 1929, i.e. from £297 to £717 millions. If this outlet had not been offered

[1] *The Review of Economic Statistics*, vol. XXIII, no. 2, May 1941.

to investors, it is arguable that a continuous deflationary pressure would have been exerted by the accumulation of savings deposits in the banking system which the banks could not have offset even if they had been willing to decrease the liquidity of their asset structure.[1]

TABLE XXV. RATE OF TURNOVER OF CURRENT-ACCOUNT BALANCES IN LONDON CLEARING BANKS

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Yearly average
1930	72·2	75·5	81·7	75·3	71·3	68·8	71·6	64·2	63·2	69·6	68·3	62·2	70·2
1931	68·2	67·9	65·7	71·6	75·7	61·4	66·1	58·3	54·0	53·9	53·8	48·0	62·2
1932	55·4	54·6	68·0	59·5	60·7	57·1	66·9	51·3	47·3	54·8	50·5	51·5	56·3
1933	49·4	50·6	54·0	48·0	47·8	46·0	51·5	44·6	47·0	50·8	49·9	50·5	49·2
1934	54·4	61·3	61·7	57·7	49·1	49·4	50·7	47·4	47·4	50·4	58·2	52·0	53·2
1935	57·0	50·5	52·7	54·3	53·4	54·0	51·9	46·8	44·7	48·7	48·2	53·6	51·3
1936	50·5	49·0	50·4	49·5	47·6	48·3	48·1	47·3	46·7	51·3	50·7	54·1	49·5
1937	51·6	54·3	56·8	53·9	50·0	50·1	51·2	45·1	43·7*	48·0	47·5	45·9	49·8
1938	48·8	45·2	46·5	45·9	46·3	45·2	47·7	42·5*	44·5	45·8	43·9	49·9	46·0

* Lowest rates recorded.

TABLE XXVI. INDEX OF RATE OF TURNOVER. AVERAGE FOR 1930=100

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Yearly average
1930	102·3	107·8	116·4	107·2	101·5	98·0	102·2	91·5	90·0	99·1	97·3	88·6	100
1931	97·2	96·7	93·6	102·2	107·8	87·5	94·2	83·0	76·9	76·8	76·6	68·4	88·6
1032	78·9	77·8	96·9	84·8	86·5	81·3	95·3	73·1	67·4	78·1	71·9	73·4	80·2
1933	70·4	72·1	76·9	68·4	68·1	65·5	73·4	63·5	67·0	72·4	71·1	71·9	70·1
1934	77·5	87·3	87·9	82·2	69·9	70·4	72·2	67·5	67·5	71·8	82·9	74·1	75·8
1935	81·2	71·9	75·1	77·3	76·1	76·9	73·9	66·7	63·7	69·4	68·7	76·3	73·1
1936	71·9	69·8	71·8	70·5	67·8	68·8	68·5	66·4	66·5	73·1	71·9	77·1	70·5
1937	73·5	77·3	80·9	76·8	71·2	71·4	72·9	64·2	62·2	68·4	67·7	65·4	70·9
1938	69·5	64·4	66·2	65·4	65·9	64·4	67·9	60·5	63·4	65·2	62·5	71·2	65·6

The tables are calculated from the total debit items debited on clients' current account urnover) and the monthly averages of current-account balances. To make them comparabl ıe number of working days in each month has been considered as well as the total numbe working days in each year, thus:

$$\frac{\text{Turnover}}{\text{Current-account balances}} \quad \frac{307}{\text{Days}} = \text{rate of turnover.}$$

The standard year is taken as having 307 working days.)

Foreign Deposits. Foreign deposits could in the main be classed into two categories:

(*a*) Deposits of private investors who, fearing political disturbances in their own country or a depreciation of their currency, from time to time exported their capital to London.

[1] Cf. Statement of Evidence by Mr D. H. Robertson, *M.E.* vol. I, p. 321, especially §§ 6 and 7.

TABLE XXVII. DEPOSITS OF VARIOUS CREDIT INSTITUTIONS

(Amounts are stated in £ millions)

	Building Societies' shares and deposits	(Nov. 20) Trustee Savings Banks' funds	(31 Dec.) Post Office Savings Bank deposits	(Average of months) Clearing banks' deposit accounts	Industrial and Provident Societies' assets	Total
1919	73	115	266	495	153	1,102
1920	82	121	267	622	178	1,270
1921	90	125	264	729	174	1,382
1922	101	132	268	709	177	1,387
1923	118	137	273	648	187	1,363
1924	137	142	280	666	202	1,427
1925	160	146	286	680	216	1,488
1926	183	149	284	688	173*	1,477
1927	211	155	285	727	189	1,567
1928	255	164	289	755	210	1,673
1929	297	168	285	798	222	1,770
1930	354	179	290	820	237	1,880
1931	399	190	289	804	245	1,927
1932	448	203	306	883	262	2,102
1933	477	215	327	930	271	2,220
1934	528	227	355	886	286	2,282
1935	571	242	390	904	303	2,410
1936	622	257	432	982	328	2,621
1937	672	272	471	1,011	345	2,771
1938	717	287	—	1,033	—	

* Before 1926 the figures include the amount invested by some societies with others. From 1926 onwards these inter-investments have been excluded.

(*b*) Banking funds which flowed into London partly as a result of interest arbitrage often encouraged by the deliberate monetary policy of the Central Banks which established an interest differential between their own country and London, and partly as a result of foreign exchange speculation which, by creating discrepancies between 'spot' and 'forward' foreign exchange rates, enabled bankers to undertake profitable counter-operations without foreign exchange risk.[1]

If the most important forward exchange market, the dollar, is studied, it is noticeable that, apart from a few periods, the forward

[1] There was also a third source of foreign funds in London, i.e. the reserves of the Exchange Equalization Accounts or the Central Banks of foreign countries which, prior to 1931, were on a gold exchange or mixed gold and gold exchange standard, and after 1931 joined the sterling bloc. These established a fixed rate of exchange with the pound, and not only cleared their balances of international payments through London, but held their first-line international reserve in sterling. These funds, however, if not left with the Bank of England, were held at first in first-class bankers' acceptances: afterwards (with the gradual relaxation of the former stringent statutory regulations) mainly in Treasury bills and longer-term British Government securities. The competition of these funds for investment outlets aggravated the position in the short-term market.

exchange rate was but little influenced by the normal interest arbitrage. In the two months before the break of sterling in 1931 the premium on forward dollars was smaller than should have been expected from interest arbitrage alone—a fact which can only be explained by the continuous intervention of the authorities supporting the pound. After each sharp fall of sterling, there was a prompt recovery of the forward rate, testifying the strength of the speculative movement.

The League of Nations, in its *Report on Money and Banking* for 1936–7,[1] plots a chart of the forward market rates and interest differences. Unfortunately, however, they used the difference between the discount rate on three-month bank bills on London and New York as the basis of their comparison. This difference, however, was not, in the main, the operative one during this period of temporary extreme bill scarcity in London, and the almost complete disappearance of the bill market in New York. There was, in these years, an intense competition by some of the clearing banks for large deposits, mainly of foreign origin. In securing these deposits, special concessions were made to the foreign owners, partly by granting them rates of interest otherwise only given to fixed deposits of long currency, at the same time waiving the right of refusing to repay at shorter notice; in other cases affiliate banks were used to attract foreign deposits, affiliates which were not bound by the agreement concerning the rates of interest to be granted which had been arrived at by the English deposit banks.

Thus anything up to 1½ per cent per annum was paid for foreign deposits, at a moment when the banks' lending rate on the money market was ½ of 1 per cent and the bill rate oscillated between about ¼ of 1 per cent and just slightly above 1 per cent.

From an analysis of the individual bank balance sheets, in the periods of hasty withdrawal of foreign funds (such as occurred after the second French devaluation in 1937, and then again in the critical period before and after the Munich crisis) it seems tolerably clear that these foreign funds were lodged, in the main, in two of the great joint-stock banks. That the management of these banks did not regard them as of a stable character is furthermore indicated by the fact that the pattern of the distribution of assets of these banks was more liquid than that of the rest of the banking system. It seems that the competition for deposits (i.e. mainly on

[1] Vol. 1, pp. 44–46.

TABLE XXVIII. THE STRUCTURE OF BANK CAPITAL

Bank	Issued	Paid	Reserve (1939)	Shares type	Nominal value	Authorized total	Paid per share
Barclays Bank Ltd.	£15,858,217	£15,858,217	£10,750,000	A B C	£4 £1 £1	£20,000,000	£4 £1 £1
District Bank Ltd.	£10,560,428	£2,976,428	£2,977,000	A B C	£5 £1 £1	£10,560,428	£1 £1 £1
Lloyds Bank Ltd.	£73,302,076	£15,810,252	£9,500,000	A B	£5 £1	£74,000,000	£1 £1
Martins Bank Ltd.	£20,602,272	£4,160,042	£3,550,000		£20 £1	£20,791,120	£2. 10s. £1
Midland Bank Ltd.	£42,414,871. 10s.	£15,158,621	£12,410,000		£12 £2. 10s. £1	£45,200,000	£2. 10s. £2. 10s. £1
National Provincial Ltd.	£43,617,080	£9,479,416	£8,500,000	A B	£5 £5 £1	£60,000,000	14s. £1 £1
Westminster Bank Ltd.	£30,533,127	£9,320,157	£9,320,000		£4 £1	£33,000,000	£1 £1

Bank	Callable capital per share	Reserve per share	Voting power per share	Dividends	Liquidation	Authorized by share type	Issued by share type
Barclays Bank Ltd.	— — —	— — —	1 vote per £4	All shares rank *pari passu* up to 10% p.a. Surplus to 'B' and 'C' *pari passu*	All share *pari passu* to amounts paid up. Balance after 'C' having had 10% p.a. premium *pari passu* to 'A' and 'B'	£5,700,000 £14,300,000 £20,000,000	£3,430,356 £11,760,811 £667,050 £15,858,217
District Bank Ltd.	13*s.* 4*d.* — —	£3. 6*s.* 8*d.* — —	1 vote per 'A' or 'C' share 1 vote per 5 'B' shares	'B' shares up to 10%. Surplus *pari passu* with 'A' and 'C'	'B' shares rank *pari passu* with 'C' and first £1 of each 'A' share. Surplus assets to 'A' and 'C' *pari passu*	£9,480,000 £316,000 £764,428 £10,560,428	
Lloyds Bank Ltd.	5*s.*	£3. 15*s.*	1 vote per 'A' share or 5 'B' shares; maximum 500 votes	'B' shares rank *pari passu* with 'A' shares for maximum 5%	'B' shares *pari passu* with £1 of every 'A' share for repayment —no further participation	£72,500,000 £1,500,000 £74,000,000	£71,864,780 £1,437,296 £73,302,076
Martins Bank Ltd.	£5. 10*s.* —	£12 —	1 vote per £50 or less held for 2 months; 1 vote per £50 further capital	Both shares rank *pari passu*. Liable for notes in circulation	Do.	£18,791,120 £2,000,000 £20,791,120	£18,791,120 £1,811,152 £20,602,272
Midland Bank Ltd.	£2. 10*s.* — —	£7 — —	Less than £300 1 vote £300–600 2 votes £600–1,200 3 votes £1,200–1,800 4 votes £1,800–2,400 5 votes £2,400 and over 6 votes	All shares rank *pari passu*.	Do.	£34,428,948 £5,000,000 £5,771,052 £45,200,000	£34,428,948 £4,804,192. 10*s.* £3,181,731 £42,414,871. 10*s.*
National Provincial Ltd	19*s.* 4*d.* 13*s.* 4*d.* —	£3. 6*s.* 8*d.* £3. 6*s.* 8*d.* —	£1,500–6,000 1 vote £6,000–18,000 2 votes £18,000–30,000 3 votes £30,000 and over 4 votes	All shares rank *pari passu*	Do.	£3,000,000 £48,000,000 £9,000,000 £60,000,000	£3,000,000 £39,447,080 £1,170,000 £43,617,080
Westminster Bank Ltd	£1 —	£2 —	£400–1,600 1 vote £1,600–4,000 2 votes £4,000–8,000 3 votes £8,000 and over 5 votes	£1 shares rank rateably with £4 shares up to maximum of 12½%	£1 shares rank for capital repayment but not for surplus	£30,000,000 £3,000,000 £33,000,000	£28,283,960 £2,249,167 £30,533,127

prestige grounds) was mainly responsible for this policy, which unquestionably resulted in unnecessarily burdening the foreign balance of payments of Great Britain.

The importance of these fluctuations is shown by the rapid deflation of total British deposits in 1937. It is doubtful whether the attraction by relatively high rates of interest of transitory foreign funds by the banking system can be welcomed from the point of view of the community as a whole, especially as it complicated the task of monetary management which was, in any case, not easy in this period of rapid fluctuations.

B. Capital

The joint-stock banks are at present organized as Public Limited Liability Companies. Yet the principle of limited liability was not adopted until rather late in the banking world. The capital structure of the joint-stock banks is shown in Table XXVIII. On 31 December 1938 the subscribed capital of the seven big deposit banks[1] amounted to £236,888,071. Of this, however, only £72,763,133 was paid up. Only a smaller part of the issued and uncalled capital is callable at the discretion of the directors in accordance with the legislation passed in 1879 after the break of the City of Glasgow Bank. Part of it is 'reserved' capital, i.e. capital which can only be called in case of liquidation. This amounts to £134,016,843. Of the seven main deposit banks only Barclays and its affiliate, the Union Bank of Manchester,[2] have no reserved capital. The whole of the issued capital of Barclays Bank is fully paid up. It is seen that Lloyds Bank has by far the largest subscribed capital, most of which is, however, reserved.

The shares of the deposit banks are usually divided into two or more categories. This division resulted from the historical evolution of the big branch banking systems through amalgamations which resulted in the issue of 'special' shares without full rights of participation in the amalgamating bank.

The paid-up capital of the banks of £72,763,133 was matched by declared reserve funds of £57,007,194 on 31 December 1938. The Westminster Bank and the District Bank have reserves equal to their paid-up capital. The ratio is least favourable

[1] 'Big Five' and the District and Martins Bank Ltd.
[2] Part of the capital of this bank, however, is callable.

in the case of Lloyds Bank.[1] The total declared own resources of the banks amount therefore to £179,770,329 excluding carry-over.[2]

According to the League of Nations *Memorandum on Commercial Banks* (Table XXIX–XXX) the ratio of the banks' resources to their liabilities, excluding acceptance and sundry accounts, was 6·1 per cent in 1937, or definitely less than either in the U.S.A. or in France. It has to be remembered, however, that the paid-up capital alone is taken into account, and not the subscribed and callable or reserve liability. This procedure is to some extent justified as it is not altogether certain whether the owners of the shares could in all circumstances be expected to be able to honour their liability, especially if it is taken into account that the liquidation of one of the bigger banks would, if ever, in practice take place in times of very acute crisis only.

The Committee on Bank Amalgamations[3] drew attention to the fact that the ratio of the paid-up capital and reserves to their deposit liabilities of English joint-stock banks declined from 18 per cent in 1890 to 13 per cent in 1900, 11 per cent in 1910, and reached the low level of 6 per cent in 1917. This decline was in the main due to the extraordinary expansion of deposits without a corresponding increase in their own resources. The Committee took the view that further amalgamations were undesirable, as amalgamations in practice tended to reduce the security of depositors. It quoted the amalgamation of the London City and Midland Bank Ltd. with the London Joint Stock Bank Ltd., in which case a reduction of nearly £1,000,000 in the paid-up capital and of over £9,000,000 or over 50 per cent in the uncalled liability of the shareholders was proposed. In the view of the Committee this represented an undue benefit to the shareholders at the cost of the security of the depositors.

The fall of the ratio of capital to liabilities continued even after the report of the Committee had put an effective stop to large-scale amalgamations. The inflation of 1919 resulted in a further fall to less than 5 per cent of the ratio of paid-up capital reserves. In the

[1] Cf. Table XXVIII. It is interesting to note that only Lloyds Bank limited the payment of dividends to 10 per cent until reserves reach one-fifth of the capital paid up.

[2] In 1938 carry-over represented £2,784,000 in the case of the Big Five as against £65,626,000 paid-up capital, i.e. just over 4 per cent.

[3] Op. cit. p. 4, Table 3.

subsequent years the increase in capital and the fall in deposits brought the ratio up to 7·5 per cent in 1926.[1]

TABLE XXIX. PERCENTAGE RATIO OF BANKS' OWN RESOURCES TO THEIR PUBLIC LIABILITIES, EXCLUDING ACCEPTANCES AND SUNDRY ACCOUNTS*

End of...	1913	1920	1921	1922	1923	1924	1925	1926	1927	1928
England and Wales	10·1	6·5	6·5	7·0	7·1	7·3	7·5	7·5	7·4	7·3

TABLE XXX. PERCENTAGE RATIO OF BANKS' OWN RESOURCES TO THEIR PUBLIC LIABILITIES, EXCLUDING ACCEPTANCES AND SUNDRY ACCOUNTS*

End of...	1929	1930	1931	1932	1933	1934	1935	1936	1937
England and Wales	7·4	7·3	7·4	6·6	6·7	6·7	6·3	5·9	6·1

* League of Nations *Memorandum on Commercial Banks*, 1913–29, Table IV, p. 26; 1938–9, vol. I, p. 170.

The rapid expansion of the deposits, with capital and reserves hardly changed, resulted in the renewed fall in the middle thirties to about 6 per cent.[2]

Apart from the reserves which are shown in the balance sheet of the joint-stock banks, the banks have considerable hidden reserves. These consist mainly of differences between the market value of their investments and the value at which they are carried in their books, and the less easily realized hidden profits on buildings, etc.

According to M. Truptil[3] these reserves were estimated 'at a figure nearly equal to the combined figure of the capital and official reserves'.[4] As a result of the crisis four of the Big Five[5] drew upon their open reserves to the extent of some £8 millions, apart from an unknown reduction of hidden reserves. Since the beginning of the cheap money era in 1932 most of this amount has been restored to the open reserves. The hidden reserves must have

[1]

	Paid-up capital and reserves before and after the increase in capital in the early 1920's (in £000's)		Ratio of own resources to total liabilities per cent	
Midland	16834	21720	4·0	5·1
Barclays	15820	23841	4·9	6·6
Lloyds	19096	24138	5·1	6·2
Westminster	17253	18007	5·0	5·1
National Provincial	15046	18187	5·5	6·0

[2] Cf. Table XXX.
[3] Op. cit. p. 86.
[4] Cf. below.
[5] Barclays was the exception.

substantially increased as a result of the considerable appreciation of British Government securities between 1932 and 1935.[1]

If an estimate of hidden reserves is added to the published resources of the deposit banks and due attention is paid to the fact that at least part of the callable and reserve liability could be enforced against the shareholders of the banks, the fears of the Treasury Committee seem exaggerated.

The adequacy of the banks' own resources as compared with total liabilities, moreover, will depend not merely on the respective ratio but also on the risk attached to their investments. Roughly speaking, on at least 30 per cent of their assets losses are unlikely, except in case of a banking crisis of such severity as to endanger the stability of the whole of the London money market, and render prime commercial bills and bank acceptances worthless. In contingencies such as would cause such catastrophic results, public intervention to maintain the solvency of the banking system is in any case inevitable.[2]

The depreciation on 'investments' depends mainly on the long-term rate of interest on British Government securities. In the vain efforts to maintain the gold standard after 1930 the Treasury and the Bank of England were forced to adopt policies which resulted in a heavy depreciation of Government securities and imperilled the solvency of the weaker members of the money market. As long as the gold standard is not restored the power of maintaining a low rate of interest depends on the willingness to permit a depreciation of the currency or in certain circumstances to control foreign payments.

The risks incurred by granting advances is determined by much the same considerations. As long as the authorities pursue internal policies calculated to maintain employment the risk of a general freezing of the advances of the banking system—in contrast with specific bankruptcies—is negligible. A general deflationary pressure could, of course, start a cumulative process of bankruptcies which

[1] Ellinger, op. cit. p. 117, tried to use another method of calculating the hidden reserves of the Big Five on the basis of the statement of the chairman of the Midland Bank (at the annual general meeting) that the dividends of his bank for 1934 did not represent more than 5 per cent yield on the total own resources of the bank. On this basis he arrives at a figure of over £30 millions, which seems an under-estimate.

[2] This happened both in 1914 and in 1939. The knowledge that it would happen was sufficient to prevent the recurrence of the temporary paralysis which in 1914 could not altogether be avoided. Co-operation between the banks under the leadership of the Governor of the Bank of England was sufficient to ensure solvency in 1931 without Government action.

might impair the solvency of a greater part of the debtors. From this point of view the policy of the English joint-stock banks of limiting their commitments to short-term advances provides some safeguard. This measure of security is not due to the specific merits of such advances as contrasted with longer-term financial commitments. A rapid and catastrophic fall in the prices of commodities would freeze loans even of short-term character. The safeguard is derived from the fact that undertakings which only borrow on short-term are likely to possess considerable additional own resources representing, from the point of view of lending banks, a safety margin protecting them from the consequences of any losses suffered by the debtor.

British banking, as it consists of nation-wide branch banking systems, will be able to distribute its risks more evenly than banks which have a local character only. This will not merely reduce the necessity for higher cash reserves (in so far as the in and out flow of funds is evened out), but it will also average out the risks incurred in granting loans to industry, etc. Unit banks with a highly specialized clientele would be more vulnerable, as specific causes might result in a sectional breakdown.

A general run on the banks, as has been shown in 1931, is less likely to occur in this than in any other country. The general air of confidence surrounding them is such that the contingency of a mass withdrawal of deposits by frightened depositors can be ruled out. In the absence of a general run, however, the banks would not be forced to liquidate investments and try to withdraw advances suddenly at a risk of incurring severe loss. Thus the banking system would be enabled to replenish its resources and deal with a possible depreciation of assets over a longer period of time.[1] This also increases, *ceteris paribus*, the 'safety' of the bank depositors.

These considerations tend to show that the conventional criteria for safety and liquidity are largely irrelevant. A reckless policy of lending might, of course, imperil a banking system and the stability

[1] It is reasonable to assume that the slowness with which German assets were liquidated after 1933 was mainly caused by the unwillingness of the banking community to write down losses immediately. The policy of the U.S.A. banks to take losses as quickly as possible was justified in this instance by the continuous worsening of the outlook for the creditors of Nazi Germany. On the other hand, the steady flow of profits enabled most British banks to write off those assets altogether. It is questionable whether this procedure could have been accomplished within the same time if the actual losses on these assets would have had to be declared before sufficient reserves had been accumulated to deal with them, i.e. bankruptcy of the weaker banks could not be avoided.

of the economic life of the country before the Central Bank and the Government could check the speculative excesses by appropriate deflationary measures. This contingency is unlikely to arise.

In modern conditions the very size of the banks and their importance in national life is such as to force the Government to undertake immediately measures to avoid a general banking crisis. It would be regrettable, however, if a clearer insight by the banking community into the working of the monetary system under modern conditions should result in a relaxation of the canons of safety which, in the absence of direct State control over banking, are the sole safeguard of a conservative banking policy.

Complaints against the banking system were on the whole not voiced on account of recklessness but rather on account of what was considered their excessive conservatism. Yet, as long as the risks of enterprise rest with the individual entrepreneur, including the banker, and the community as such does not by some method eliminate or at least distribute business risks, those who blame bankers for their conservatism and exhort them to extend risky credits at their own peril seem singularly ill-advised. The agitation for a higher ratio of capital to own resources has somewhat similar implications—it comes from those who wish the banks to undertake wider and greater risks. This tendency was rightly resisted by the Macmillan Committee. Any reform—and reforms of the financial apparatus to facilitate investment are admittedly necessary—must not look to a deterioration of the standards of deposit banking for an improvement of business activity and the promotion of economic stability and progress, but (in so far as it can be achieved by institutional changes of a limited character and not by changes in the economic system and in high economic policy only) to a reorganization (possibly under public ownership and certainly under public control) of the institutions which scrutinize and encourage riskier long-term investment.[1]

C. Profits

The variations in the profitability of bank capital between banks seems to have been appreciable, as shown in Table XXXI. The banks do not disclose the sources of their revenue or their expenses.

Mr Sykes[2] tried to estimate the different sources of revenue of

[1] Cf. *M.R.* Chapter IV, para. 375 and passim. Cf. also pp. 25–26 and p. 37.
[2] *Present Position of English Joint Stock Banking*, pp. 99–110.

TABLE XXXI. BANK PROFITS (1938)

	Capital	Reserves	Carry-over	Total	Profit	%
	(1)	(2)	(3)	(1+2+3) =(4)	(5)	(5) of (4)
Westminster	9,320,000	9,320,000	527,000	19,167,000	1,557,000	8·1
Barclays	15,858,000	10,750,000	528,000	27,136,000	1,926,000	7·1
National Provincial	9,479,000	8,500,000	574,000	18,553,000	1,813,000	9·8
Lloyds	15,810,000	9,500,000	527,000	25,837,000	1,763,000	6·8
Midland	15,159,000	12,410,000	628,000	28,197,000	2,492,000	8·8
Total	65,626,000	50,480,000	2,784,000	118,890,000	9,551,000	8·0

the deposit banks (for 1926), but in the absence of any direct information he had to base his calculations on hypotheses which are somewhat insecure. According to him, the gross profits of Barclays Bank for 1926 were as high as 31·5 per cent of the total capital. Net profits in the same year amounted to little more than 50 per cent of gross profits. Only about one-fifth of total profits were distributed in dividends. He found that expenses were increasing before the war of 1914–18 and were still rising at the time of his inquiry.

The gross profit margin of the banks is highest between the interest paid on deposits other than current accounts and advances. It amounts to some 4–4½ per cent. With the advances of the seven largest deposit banks[1] standing at some £900 millions at the end of 1938, profits from this item alone must have been of the order of magnitude of £40 millions. On money at call and at short notice and discounts which amount to roughly £350 millions, profits earned could not have been more than from ¾ of 1 per cent to 1 per cent, i.e. some £3–3·5 millions. Investments at £600 millions might have yielded between 2 and 3 per cent on the average or some £17–18 millions. Total gross profit from interest charges therefore might have been something like £55–60 millions.

On some foreign deposits the banks paid up to 1½ per cent in interest, but these deposits could not have accounted for more than at most £100 millions, i.e. £1·0 million in interest. Roughly half of their deposits might have carried an interest of between ½ and 1 per cent or some £5–7 millions. This would not account for more than at most £8 or £9 millions (Home Savings Bank deposits on which 2½ per cent is paid are too small to be of any moment, and

[1] Big Five, the District and Martins Bank.

if some interest is allowed on certain provincial current account balances, this tends to be offset by separate charges). Thus, disregarding revenue from other sources, e.g. trust business, letters of credit, commissions, etc., a gross revenue of some £45–50 millions is shown. Yet total declared gross profits were less than £10 millions.

In their dividend distribution policy the banks were extremely conservative.[1] In general the dividends were reduced on the fully participating shares from 18 to 16 per cent in the case of the Midland Bank in 1931, from 16·66 to 12 per cent in the case of Lloyds Bank, from 18 to 15 per cent in the case of the National Provincial Bank, and from 20 to 18 per cent in the case of the Westminster Bank; only Barclays Bank did not reduce its dividend during the crisis.[2] Substantial sums remained undistributed, and were used to write down premises, strengthen contingency accounts, reserve and pension funds and increase the carry forward. The recovery of profits was almost complete in the case of Barclays and Midland Bank and the least successful in the case of Lloyds Bank.[3]

Mr McKenna stated that the salaries of the staff of his bank alone amount to £5 million, on which basis the total pay-roll of the Big Five was estimated at £20 million.[4] The ratio of expenses to total profits seem thus somewhat high, and one cannot quite agree with Mr Ellinger when he considers that the average charge of 15*s.* per £1,000 of turnover is not excessive. The cost per cheque amounted to not less than 6*d.* Competition for deposits, however, prevented the placing of this cost on to the depositors. It had therefore to be earned by the banking system by charging on the basis of a restrictive agreement high rates of interest on advances. It is questionable whether this system is conducive to a smooth working of

[1] The ratio of dividends to gross profits shows violent fluctuations and some divergence between banks. At times it was less than half. The Westminster Bank's distribution is the lowest, the National Provincial's the highest. Little importance can, however, be attached to these statistics as gross profits are given *after* provision for contingencies, and the book-keeping policy of the banks is known to vary. In spite of a considerable published rise in profits the banks are still not liable to Excess Profits Tax. This shows that their profits must have been far higher in the 'standard' years between 1935 and 1938 than shown in the balance sheets. Cf. above.

[2] In 1933 it failed by a few £1,000 to earn the full dividend which was made up by reducing the carry forward.

[3] It earned £2·6 millions in 1929, but only £1·8 millions in 1938 as against Barclays, whose profits were in 1929 £2·3 millions, in 1938 £1·9 millions, and the Midland Bank whose profits had recovered from £2·1 millions in 1932 to £2·5 millions in 1939 as against £2·7 millions in 1929.

[4] Ellinger, op. cit. p. 189.

the economic machine. Even though it appears very likely that the marginal cost of short-term borrowing does not play as important a role in the decisions of entrepreneurs as classical economic theory, disregarding the borrower's risk, would have us believe, there can be no question that by some rationalization of branches considerable economies could be achieved with little added inconvenience, which might enable a lowering of the rate of interest. The number of competing branches each requiring responsible and comparatively highly paid staff, each having a manager who has to maintain the prestige of the bank in the community in which he is living, represent a burden on the economic system which cannot be regarded as desirable or necessary.[1]

Considering the high gearing of the banking business, its profitability might not be excessive, though the risks incurred by banks are not commensurable with the risks of entrepreneurs in industry and distribution.[2]

CHAPTER 7. *THE ANCILLARY SERVICES OF THE DEPOSIT BANKS*

THE traditional attitude of the joint-stock banks with regard to their business is well expressed by the chairman of Lloyds Bank: 'For myself I regard our first duty the safe custody of our depositors' money.'[3] All functions which are deemed to conflict with this basic duty are—at least in theory—frowned upon. As we have seen above the choice of assets is dominated by this consideration. The principles, and therefore the canons, of safety, however, change with time. And with this change the activities of the banks become diversified.

The reasons for this diversification are not difficult to discern. With the growth of each bank the circle from which they draw their customers increases. Their clients need diverse financial services. As long as the banks are small units they are content to pass

[1] Some cost would have to be incurred by the community to avoid the danger of potential debtors having to rely on *one* bank alone—even if publicly owned—as the sole source of short-term finance. This danger could be avoided if several independently managed banking systems existed even if they were publicly owned.

[2] A comparison between the profitability of banking and industry such as undertaken by Ellinger is therefore of little real value.

[3] Speech at Lloyds Annual Meeting, 1936.

any occasional demand for financial services other than banking to specialized firms which can supply them more effectively and cheaply. Fewer economies of this character are possible when the banking units become very large. At the same time with the growing standardization of rates of interest paid on deposits and of banking charges the variety of services offered, as we have mentioned, becomes the most effective weapon of attracting deposits. On the other hand, the growth of the banking units results in a more even balance in the character of their liabilities and assets. This renders certain activities practicable, which would have been considered daring for a small local bank.

A. Internal Business

(i) *Ancillary to Deposit Business.* The competition for deposits at first expressed itself in the rates of interest granted. In the last decades of the nineteenth century the clearing banks—as we have seen—realized that the attractiveness of interest rates was relatively small for the potential depositors;[1] they also realized that any aggressive action would inevitably be followed by retaliation and accomplish little in increasing the total of banking funds. In order to acquire and hold deposits large strata of the population would have to be induced to open banking accounts. Special services and conveniences were introduced to provide facilities for clients and try to hold their custom. Letters of credit, telegraphic transfer, the undertaking of periodic payments on behalf of the clients, provide illustrations. 'Night Safes' were established for traders whose cash accumulates after banking hours. Safe-deposit facilities were provided. The savings' deposit business was intensified by introducing home safes and emergency savings.

The banks also provide facilities to pass on orders to brokers in securities dealt in on the Stock Exchange. For this service they receive part (usually 50 per cent) of the brokerage commission.[2] They are not prepared to make any investigation or recommendation of securities, but usually are prepared to pass on the recommendation of established brokerage firms. The system is not without some drawbacks. The banks will tend to give their orders to brokerage firms which maintain active accounts with them, i.e. the

[1] Hyde, *M.E.* Qu. 1025–7.

[2] The Stock Exchange has endeavoured to reduce the commission of the banks, but in the two inter-war decades without success.

older and bigger firms. It is not certain whether this is the best method of selecting investment advisers. At the same time it must be recognized that this method is preferable to that followed in most other countries where the deposit banks themselves or their affiliates sponsor issues of securities and recommend them to their clients.

The banks (or special 'nominee' companies[1]) are prepared to hold securities on behalf of customers and deal with dividends, rights, etc.

(ii) *The Trustee Business.* After the war of 1914–18 a new field of business was opened by the banks accepting trusteeships and executorships both on behalf of private individuals and for shareholders (bond issues, unit trusts, etc.). Especially Barclays and the Westminster were very active and successful in this respect. The new unit trust movement has mostly used three of the Big Five. It is too early to come to any final conclusion about the consequences and merits of this development especially as the secrecy maintained about it is almost impenetrable. There is no doubt that the continuity and honesty assured by appointing banks to trustee and executorships is a real gain for the community. Whether their present organization and staffing, the usual lack of industrial and economic research departments, the somewhat conventional approach to problems of investment, is helpful in preserving capital values and facilitating economic progress when it comes to dealing with the investment of estates and not with such routine duties as holding securities or moneys for unit trust shareholders or bondholders, is another question.

(iii) *The Role of the Clearing Banks in the Issue Business.* The clearing banks in theory refuse to provide long-term finance and do not participate or sponsor capital issues on their own account.[2] There seems to be only a partial (and somewhat indirect) exception in favour of first class borrowers to whom they grant (or rather participate in granting) intermediate credit facilities prior to long-term issues to the market.[3] These seem to have been restricted mainly to public authorities. As the Bank of England provides such facilities to British borrowers of the required standing, the clearing banks extended them to overseas borrowers.

[1] The anonymity secured by the use of these companies by the real owners remains subject to violent, and on the whole justified, criticism.

[2] Goodenough, *M.E.* Qu. 574–7.

[3] Cf., however, the section on advances and their recent developments, e.g. the Richard Thomas and other cases. Also Part III for the proportion of issues used to repay advances.

Their participation in the underwriting of subsequent long-term issues was restricted to small amounts.[1] They did not—at any rate at the time of the Macmillan Committee—undertake similar business with respect to British industry except in special circumstances.[2] This has subsequently changed somewhat, though banks were and remain disinclined to involve themselves in industrial affairs. In many cases their advances became illiquid. But even then they usually refused to intervene actively in the reorganization of industry[3]—in contrast to the private bankers.[4]

In the main their role in the issue business is restricted to acting strictly as banking agents to the business, i.e. receiving the money and making the allotments. For this service they charge a small, sometimes flat fee. Even this practice led to widespread criticism, as the name of the banks—which in fact merely acted as 'in-tellers'—was in some cases prominently printed on the prospectus of the issue and this might have misled the uninstructed general public. This point was repeatedly made at the hearings of the Macmillan Committee.[5] The banks refused to admit that by accepting the technical job of handling the banking end of the issue they could be assumed to be recommending these issues. Indeed, if their function as banking agents to the issue would imply such approval, the scope of their technical help to the long-term capital market would have to be further limited as they could not handle speculative though sound issues. This would prevent such issues—which, except perhaps in certain fields (e.g. mining), as we shall see, are in any case much handicapped in the London market. The representatives of the deposit banks stated, however, that their name on an issue implies that they are satisfied that the issue is a reasonable proposition[6] and that the formal statements are accurate.[7] They therefore often, indeed according to several

[1] Cf. Kindersley, *M.E.* Qu. 1511–25, on the necessity for active intervention. But answering to a direct question of McKenna he thought that issue houses are better fitted for this role, ibid. Qu. 1507–9.

[2] Cf. ibid. Qu. 632 discussed above and Qu. 578–86.

[3] Even Hyde, the representative of the Midland Bank, which is known to have progressive views, declared: 'We do not want to get on the board because we do not want to be responsible for the policy pursued by the directors. We are bankers....We should put in a supervisor....A watch dog' (*M.E.* Qu. 1083–5). In the same sense Gordon, ibid. Qu. 1823–37. Also Rae, ibid. Qu. 2384–5; Pease, ibid. Qu. 2203–47.

[4] Ibid. Qu. 576.

[5] Cf. *M.E.* Qu. 1100–7, 1992–4, 2378–87.

[6] Goodenough, *M.E.* Qu. 578.

[7] Rae, *M.E.* Qu. 578.

bankers more often than not,[1] refuse to act as bankers to proposed issues. Unfortunate cases continue to occur, however, and the criticism against the banks periodically resurges.[2]

B. International Business

(i) *International Business prior to* 1905. Certain of the London joint-stock banks were eager from the beginning to recruit international clients. The London Joint Stock Bank, for example, succeeded in acquiring the agency of the North German Confederation before the Franco-Prussian war and was intimately concerned with the German war finance and arrangements concerning the transfer of the French indemnity.[3] But in general the international private banking houses maintained their supremacy in this field. The deposit banks mostly refused to grant acceptance credits, though some of the provincial banks and the London branches of the Scottish banks seem to have been active in this field.

(ii) *Foreign Exchange.* In 1905 the Midland Bank was the first to enter a new international field by establishing a foreign exchange department and, though this innovation was received with hostile comment, the other banks had to follow suit. This was the beginning of that organization of the foreign exchange market as it was known in the 1930's, though it remained in a rudimentary form up to the outbreak of the war of 1914–18. The foreign exchange business of the clearing banks became certainly more important than that of the private banking houses, though this development was brought about not so much by the decay of the business of the other firms as by the capture of the increase in the total business. When the authorities came to operate in the foreign exchange market after the abandonment of the gold standard in 1931 they at first used some of the newer 'international' banks (e.g. the British Overseas Bank). Subsequently, the Bank of England dealt directly with the clearing banks. The rise of 'swap' market, i.e. the combination of forward and spot transactions, further strengthened the position of the deposit banks.[4]

(iii) *Acceptance Credits.* The participation of the clearing banks

[1] Hyde and McKenna, *M.E.* Qu. 1101–2. Also Rae, ibid. Qu. 2379.
[2] Cf. *The Economist*, 1934, 10 May.
[3] Crick and Wadsworth, op. cit. p. 308.
[4] Cf. above on the problem of attracting foreign deposits.

in the acceptance business also dates to the first decade of this century—and may be one of the explanations of the vigorous recovery of the London bill in that period.[1] But it seems—though certain doubts were cast on this view before the Macmillan Committee[2]—that the clearing banks were not then aggressive in their competition. The acceptance commission—according to Sir F. Schuster—remained at 1 per cent per annum with even higher rates charged on credits where the bank had to follow the value of the security deposited. The reimbursement type of acceptance credit was, however, beginning to appear, though no 'clean' credits were usually granted.[3]

In the post (1914) war period this attitude completely changed. The clearing banks became formidable competitors of the acceptance houses. As accepting represented only an ancillary activity and as the size of their capital resources relative to their engagements were greater than those of the international private bankers the deposit banks were willing and eager to expand this business. Moreover, their deposits remained far more stable during critical periods than those lodged with the acceptance houses,[4] because in their case the domestic deposits predominated. The clearing banks were thus in a better position to grant acceptance credits.[5] This fact must have contributed to their rather aggressive competition for new business and thus not merely to the decline of charges to uneconomic levels but also to the loosening of the control over credits by London bankers through the increase in the importance of 'clean' credits.[6]

(iv) *Foreign Affiliation.* The increasing internationalization of the business of the clearing banks led to a wholly new departure just prior to the war of 1914–18 through one of the Big Five (Lloyds) acquiring a banking firm, Armstrong and Co., of Paris and Havre. Three others of the five followed suit. Only the Midland Bank remained aloof from direct foreign expansion and continued to conduct its foreign business entirely through foreign correspondents.[7]

[1] Cf. Part II.
[2] Cf. Parts II and III on the competition between clearing banks and acceptance houses.
[3] Sir F. Schuster, U.S. Monetary Commission, 1910, No. 405, 61st Congress.
[4] Though they had absolutely more foreign deposits than those houses.
[5] Kindersley, *M.E* Qu. 1162.
[6] Cf. Parts II and III.
[7] Cf. Hyde (*M.E.* Qu. 936), who stated that the Bank obtained bills abroad at better rates than the market rate on Treasury bills.

The affiliates or participations of the four big banks in foreign banks were as follows in 1939:

Lloyds Bank	Lloyds and National Provincial Foreign Bank (jointly with the National Provincial) Bank of London and South America[1] Bank of British West Africa National Bank of New Zealand Several branches were acquired in Egypt, India and Burma as the result of purchasing Cox and Co. incorporating King and Co. (the Egyptian business was sold to the National Bank of Egypt)
National Provincial	Lloyds and National Provincial Foreign Bank Ltd. Bank of British West Africa Grindlay (in so far as it operates in India)
Westminster Bank	Westminster Foreign Bank Ltd. (established in 1913)
Barclays Bank	Barclays Bank (France) Ltd. (formerly Cox and Co. France Ltd.)[2] Barclays Bank S.A.I., Rome Barclays Bank, Canada, Montreal (1929) Barclays Bank (Dominion, Colonial and Overseas, 1925), reincorporating the Colonial Bank and absorbing the Anglo-Egyptian Bank and the National Bank of South Africa

Interlocking directorships existed furthermore (1937) between:

Lloyds	and	Standard Bank of South Africa National Bank of Australia
Barclays	and	Bank of London and South America Bank of New South Wales
National Provincial	and	Chartered Bank of India, Australia and China P. and O. Banking Corporations Bank of Australasia

The foreign expansion of the deposit banks did not on the whole have satisfactory results. The Westminster suffered heavy losses in

[1] Formed by amalgamating the London and River Plate Bank acquired in 1918 with the London and Brazilian Bank in 1923. The South American Bank was also taken over on being reorganized after the 1929–32 crisis.

[2] Shareholding acquired through the absorption of the London, Provincial and South-Western Bank. Full control was secured subsequently.

Position of Joint-Stock Banks in England. December 1913. Assets (£000's)

	No. of Branches	Capital Subscribed	Uncalled Capital		Capital Paid up	Reserve Funds	Undivided Profits	Notes in circulation	Drafts, etc.	Acceptances and endorsements	Misc. Credits, etc.	Deposit and Current Accounts	Total Liabilities
			Callable	Reserved									
*Bank of Liverpool	139	11,300	3,107	6,780	1,413	850	126	—	—	581	—	18,785	21,754*
Bank of Whitehaven	9	296	197	—	99	60	8	6	3	—	4	592	771
*Barclay and Co.	570	1,800 7,200	— 5,400	— —	1,800 1,800	1,600	—	—	—	437	—	60,806	66,442*
Baring Bros. and Co.	—	1,025	—	—	1,025	100	11	—	—	6,637	—	8,042	15,815
Bradford District and Co.	15	860	172	344	344	280	60	—	—	224	—	5,475	6,383
British Mutual Banking Co.	—	200	129	—	71	40	6	—	—	—	—	587	704
*Capital and Counties Bank	280	8,750	1,750	5,250	1,750	800	90	—	—	1,807	—	39.224	43,671*
Civil Service Bank	—	48	24	—	24	4	2	—	—	—	1	60	91
*Coutts and Co.	—	600	Unltd.	—	600	400	—	—	—	105	—	8,792	9,897*
Crompton and Evans Union	47	1,250	1,000	—	250	200	31	—	—	—	—	5,613	6,094
Equitable Bank	3	34	21	—	13	10	2	—	—	—	—	209	234
*Glyn, Mills, Currie and Co.	—	1,000	—	—	1,000	500	—	—	—	—	195	17,194	18,799*
Guernsey Banking Co.	1	250	75	125	50	60	8	38	—	—	6	271	433
Halifax Commercial Banking Co.	17	400	—	200	200	105	18	3	—	69	9	1,903	2,306
Halifax and District Permanent Banking Co.	4	30	19	—	12	11	3	—	—	—	—	268	294
Isle of Man Banking Co.	8	150	20	100	30	38	4	25	4	—	—	893	994
Lancashire and Yorkshire Bank	129	1,725	863	—	863	650	104	5	—	136	15	11,794	13,566
Lincoln and Lindsey Banking Co.†													
*Lloyds Bank	679	26,304	2,367	19,728	4,209	3,000	436	—	—	7,462	—	91,512	106,619*
*London and Hanseatic Bank	—	1,500	750	—	750	350	65	—	—	5,750	22	1,442	8,378*
*London and Liverpool Bank of Commerce	—	600	—	—	600	165	36	—	—	3,735	—	141	4,678*
*London and Provincial Bank	224	2,000	1,000	—	1,000	2,000	352	—	—	—	—	20,246	23,598*
*London and South-Western Bank	196	3,000	1,825	—	1,175	1,350	150	—	458	1,254	—	21,063	25,451*
*London City and Midland	867	20,874	4,349	12,176	4,349	3,700	539	—	—	6,163	—	93,834	108,584*
*London County and Westminster	342	14,000	3,500	7,000	3,500	4,250	529	—	2,819	7,656	100	85,395	104,248*
*London Joint Stock Bank	304	19,800	6,930	9,900	2,970	1,125	226	—	—	3,153	54	37,583	45,111*
Manchester and County Bank	115	5,460	273	4,095	1,092	850	103	—	—	718	—	10,876	13,639
*Manchester and Liverpool District	208	9,480	1,264	6,320	1,896	1,600	217	—	—	2,689	—	25,917	32,318*
*Martins	12	1,000	—	500	500	180	46	—	—	292	—	2,912	3,931*
*Metropolitan (of England and Wales)	156	5,500	2,200	2,750	550	380	92	—	5	189	9	11,761	12,987*
Middlesex Banking Co.	—	50	23	—	27	—	—	—	—	—	—	7	33
*National Provincial Bank of England	32	15,900	2,300	10.600	3,000	2,000	92	—	—	824	—	67,882	73,799*
Northamptonshire Union Bank	22	1,080	324	360	396	404	36	2	—	5	—	3,155	3,998
North-Eastern Banking Co.	99	1,286	900	—	386	180	28	—	—	—	—	5,072	5,666
Nottingham and Nottinghamshire Banking Co.	37	1,440	360	720	360	192	29	9	—	—	—	4.316	4,903
Palatine Bank	9	500	138	250	113	3	6	—	—	55	—	280	455
*Parr's Bank	275	11,024	2,205	6,614	2,205	2,000	493	5	465	5,481	—	43,199	53,847*
Sheffield Banking Co.	27	1,155	750	—	404	296	50	—	—	44	—	3,680	4,474
Sheffield and Hallam Bank†													
*Union of London and Smith's Bank	113	22,934	7,912	11,467	3,555	1,150	381	—	—	5,016	824	41,260	52,185*
Union Bank of Manchester	88	1,250	700	—	550	350	44	—	—	674	—	6,429	8,048
United Counties Bank	206	5,967	1,790	2,983	1,193	765	83	—	—	—	—	14,983	17,025
West Yorkshire Bank	34	1,000	200	400	400	400	57	2	—	—	22	5,991	6,872
*Williams Deacon's Bank	115	7,813	1,875	4,688	1,250	650	130	—	—	550	32	17,188	19,800*
Wilts. and Dorset Banking Co.	118	3,500	350	2,450	700	550	78	33	—	—	75	12,719	14,155
Totals of Banks marked*	4,804	192,379	48,734	103,773	39,872	28,050	4,000	5	3,747	53,144	1,146	706,136	836,097
Totals, all Banks	5,792	221,335	57,062	115,800	48,474	33,598	4,771	128	3,754	61,706	1,278	809,351	963,050

† Amalgamated with London, City and Midland Bank Ltd.

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Russia and Spain.[1] Some other branches also had to be closed. Lloyds Bank had similar experiences. The South Russia Banking Agency was liquidated in 1925. The Italian venture of Lloyds undertaken jointly with the Westminster and the Credito Italiano, the British-Italian Banking Corporation and the Banca Italo-Brittannica was also a failure. Consequently the banks were adversely criticized although the fears expressed that losses incurred abroad might prejudice their position were exaggerated. The experience of the 1930's could not have been much happier.

[1] Sykes, op. cit. and Westminster Bank Annual Meeting, 1921–3.

Table XXXII a. English Joint-Stock Banks as on 31 December 1938

Name of bank	No. of branches and sub-branches	Capital subscribed £	Uncalled capital, £		Capital paid up £	Reserve funds £	Dividend payable and undivided profits £	Notes in circulation* £	Drafts, etc. £	Acceptances and endorsements £
			Callable	Reserved						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Barclays Bank	2,131	15,858,217	Nil	Nil	15,858,217	10,750,000	—	—	—	14,933,082
District Bank	569	10,560,428	1,264,000	6,320,000	2,976,428	2,976,428	476,157	—	—	9,027,586
Lloyds Bank	1,921	73,302,076	3,593,239	53,898,585	15,810,252	9,500,000	1,178,730	6,701	—	40,542,400
Martins Bank	584	20,602,272	5,167,558	11,274,672	4,160,042	3,550,000	640,733	20,297	—	8,198,181
Midland Bank	2,137	42,414,871	7,172,697	20,083,553	15,158,621	12,410,609	1,507,515	—	—	17,217,848
National Provincial	1,324	43,617,080	5,839,611	28,298,053	9,479,416	8,500,000	573,588	—	—	7,951,839
Westminster Bank	1,098	30,533,127	7,070,990	14,141,980	9,320,157	9,320,157	1,089,882	12,927	—	24,176,283
Totals	9,764	236,888,071	30,108,095	134,016,843	72,763,133	57,007,194	5,466,605	39,925	—	122,047,219

Name of bank	Deposit and current accounts £	Total liabilities and assets £	Cash in hand and at Bank of England £	Money at call and short notice £	Investments		Discounts and advances		Premises and sundries including cover for acceptances £
					British Government securities where stated separately £	Bonds, stocks and other investments £	Discounts where stated separately £	Advances loans, etc. £	
	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Barclays Bank	433,081,185	474,622,484	68,114,569	26,207,550	89,527,002	14,346,358	54,594,153	199,452,980	22,379,872
District Bank	83,468,809	98,925,408	11,592,993	8,629,718	26,717,389	2,550,914	6,201,704	32,583,941	10,648,749
Lloyds Bank	397,667,232	464,705,315	60,205,851	30,563,485	90,470,147	21,115,172	40,955,247	173,354,442	48,040,961
Martins Bank	100,038,392	116,607,645	15,463,584	6,100,000	24,786,759	8,778,021	4,678,707	45,859,178	10,941,396
Midland Bank	462,742,242	509,036,835	71,464,409	25,089,239	116,818,132	11,004,057	48,498,810	209,255,066	26,907,122
National Provincial	310,383,397	336,888,240	44,971,761	17,991,280	77,016,980	9,785,799	32,189,714	139,586,104	15,346,602
Westminster Bank	346,220,783	390,140,189	49,853,025	20,803,191	110,252,251	4,926,382	40,942,785	134,129,844	29,232,711
Totals	2,133,602,040	2,390,926,116	321,666,192	135,384,463	535,588,660	72,506,703	228,061,120	934,221,555	163,497,413

* In Isle of Man.

Table XXXII B. Scottish Banks

Name of Bank	Date	No. of branches and sub-branches	Capital subscribed £	Uncalled capital, £		Capital paid up £	Reserve funds £	Dividend payable and un-divided profits £	Notes in circulation £	Drafts, etc. £	Accept-ances and endorse-ments £
				Callable	Reserved						
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Bank of Scotland	28 Feb. 1939	263	2,400,000	750,000	Nil	2,400,000	2,100,000	256,318	3,414,725	358,543	4,448,119
British Linen Bank	14 Jan. 1939	215	1,250,000	Nil	Nil	1,250,000	2,500,000	173,162	2,655,129	371,454	1,131,537
Clydesdale Bank	31 Dec. 1938	208	5,350,000	Nil	4,000,000	1,300,000	1,800,000	245,914	3,013,187	—	1,101,844
Commercial Bank of Scotland	31 Oct. 1938	385	7,500,000	2,450,000	2,800,000	2,250,000	3,150,000	189,924	3,727,709	—	4,069,835
National Bank of Scotland	1 Nov. 1938	192	6,000,000	1,500,000	3,000,000	1,500,000	1,900,000	230,716	2,947,412	—	3,056,443
North of Scotland Bank	31 Dec. 1938	161	3,260,000	163,000	1,956,000	1,141,000	1,335,000	195,123	2,306,004	—	—
Royal Bank of Scotland	8 Oct. 1938	258	3,780,192	Nil	Nil	3,780,192	4,125,965	232,954	3,101,688	662,263	4,110,834
Union Bank of Scotland	1 Apr. 1939	220	5,200,000	Nil	4,000,000	1,200,000	1,800,000	374,012	2,648,525	—	1,118,681
Totals		1,902	34,740,192	4,863,000	15,756,000	14,821,192	18,710,965	1,898,123	23,814,379	1,392,260	19,037,293

Name of bank	Date	Deposit and current accounts £	Total liabilities and assets £	Cash in hand and at Bank of England £	Money at call and short notice £	Investments		Discounts and advances		Premises and sundries, including cover for acceptances £
						British Government securities where stated separately £	Bonds, stocks, and other investments £	Discounts where stated separately £	Advances, loans, etc. £	
		(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Bank of Scotland	28 Feb. 1939	37,851,691	50,829,396	5,908,151	4,021,000	24,738,089	938,710	582,930	9,727,397	4,913,119
British Linen Bank	14 Jan. 1939	36,471,231	44,552,513	11,260,767	—	20,817,855	433,380	—	10,496,871	1,543,640
Clydesdale Bank	31 Dec. 1938	35,645,422	43,106,367	6,255,779	2,205,000	13,521,518	5,849,672	458,085	13,101,566	1,714,747
Commercial Bank of Scotland	31 Oct. 1938	44,739,106	58,126,574	7,440,848	2,375,000	28,510,332	346,040	937,250	13,472,269	5,044,835
National Bank of Scotland	1 Nov. 1938	38,282,425	47,916,996	6,278,593	5,257,500	17,699,295	925,835	1,972,510	12,162,681	3,620,582
North of Scotland Bank	31 Dec. 1938	29,123,507	34,100,634	4,904,448	932,500	19,809,433	732,584	136,226	7,410,635	174,808
Royal Bank of Scotland	8 Oct. 1938	69,921,934	85,935,830	8,013,529	7,724,265	27,193,628	5,859,263	3,501,035	28,416,786	5,227,324
Union Bank of Scotland	1 Apr. 1939	33,218,668	40,359,886	2,751,060	4,717,091	15,801,333	4,248,122	800,464	10,521,897	1,519,919
Totals		325,253,984	404,928,196	52,813,175	27,232,356	168,091,483	16,239,855	8,388,500	105,310,102	23,758,974

Table XXXII c. Northern Ireland Banks

Name of bank	Date	No. of branches and sub-branches	Capital subscribed £	Uncalled capital, £		Capital paid up £	Reserve funds £	Dividend payable and undivided profits £	Notes in circulation £	Drafts, etc. £	Acceptances and endorsements £
				Callable	Reserved						
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Belfast Banking Co.	31 Dec. 1938	51	2,500,000	200,000	1,500,000	800,000	900,000	127,736	1,045,455	—	—
Northern Bank Ltd.	31 Dec. 1938	93	3,500,000	700,000	2,100,000	700,000	500,000	69,473	1,218,567	—	263,905
Ulster Bank	31 Dec. 1938	115	3,000,000	Nil	2,000,000	1,000,000	1,000,000	68,298	1,675,997	42,947	—
Totals		259	9,000,000	900,000	5,600,000	2,500,000	2,400,000	265,507	3,940,019	42,947	263,905

Name of bank	Date	Deposit and current accounts £	Total liabilities and assets £	Cash in hand and at Bank of England £	Money at call and short notice £	Investments		Discounts and advances		Premises and sundries, including cover for acceptances £
						British Government securities where stated separately £	Bonds, stocks, and other investments £	Discounts where stated separately £	Advances, loans, etc. £	
		(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Belfast Banking Co.	31 Dec. 1938	13,518,847	16,392,038	1,776,215	148,288	7,011,368	627,915	221,835	6,563,636	42,781
Northern Bank Ltd.	31 Dec. 1938	13,604,303	16,356,248	1,749,006	—	4,393,627	1,539,878	—	8,110,741	562,996
Ulster Bank	31 Dec. 1938	20,710,753	24,497,995	2,367,920	—	11,010,601	1,359,598	—	9,463,520	296,356
Totals		47,833,903	57,246,281	5,893,141	148,288	22,415,596	3,527,391	221,835	24,137,897	902,133

PART II. THE MONEY AND DISCOUNT MARKET

THE money and discount markets provide the link between the clearing banks and the Bank of England as well as between the foreign exchange and the long-term capital markets. The peculiar pattern of the discount and acceptance markets in London gives an unusual character to the monetary and financial organization in Great Britain. This pattern is again the result of historical accidents rather than of deliberate considerations, which will be discussed below. Although the principles on which the system works were made familiar by Bagehot in his *Lombard Street* as early as 1873, they were put into practice only in the two decades preceding the 1914–18 war as a result of changes introduced by Mr Lidderdale when he was Governor of the Bank of England in the years 1890–2.

CHAPTER 8. *THE TECHNIQUE OF THE DISCOUNT MARKET*

A. GENERAL

THE discount market performs two operations which, in practice, cannot be separated from one another: first, it secures the fullest remunerative use of all available reserve cash of the banking system, and secondly, it makes good any temporary deficiency in these reserves by having recourse to the Bank of England. In so far as the latter is in complete control of the conditions on which such accommodation is made available, it is through the money and discount market that Central Bank policy is made directly effective.[1] It discharges these two functions by carrying out its normal business, dealing in (*i.e.* buying and selling) bills and holding bills purchased with borrowed money. Before the great depression the remuneration of the market was principally derived from the difference between the rate of discount at which it buys bills and the rate of interest at which it is able to borrow the funds to finance its purchases. Incidental profits accrued when it was able to resell bills at a more favourable price than it paid for them.

[1] Indirectly (and conventionally) the bank rate determines many of the other rates of interest. The policy of the Bank has also immediate psychological repercussions which are, in all probability, even more important as far as business activity is concerned than these 'technical' influences on the rates of interest.

Since the agreement between the banks and the discount market was concluded by which the banks promised to abstain from tendering directly for Treasury bills, the market has made more profit reselling than running bills.[1] In addition, discount firms have always used part of their own and of borrowed funds both to deal in and to hold short-term gilt-edged securities (floaters). This practice has usually assured to them a minimum income out of which to meet their expenses. The decline in their earnings derived from bills after 1932[2] has increased their willingness to hold bonds.[3]

The function of the discount market is to provide the banks with an outlet for funds which they want to keep remuneratively employed yet sufficiently liquid to be usable whenever they experience a drain upon their immediate reserves. The discount houses, therefore, convert money which is 'short', i.e. may be called at any moment by the lender, into 'longer' money for the benefit of their borrowers. They accumulate the liquid reserves of a number of firms and institutions and convert an irregular flow of temporary savings into a steady pool which can be used for purposes of finance. They can count on the stability of a total volume of funds the constituent parts of which are highly unstable. As a rule, therefore, they are able to meet their commitments by attracting existing banking funds from wherever they happen to be. While they may constantly change their creditors, they vary the extent and character of their assets only on special occasions and under particular circumstances.

At first sight it may appear that money lent at call and short notice to the market is not more liquid than discounts, because it represents merely an indirect method of carrying bills. But in normal circumstances this is not the case. The bill market is in touch with *all* banks, and withdrawals by any *one* bank, however, tend to reappear almost immediately as the surplus of another bank and the market retains the use of the balance as it shifts from one bank to another.[4] Hence while the discount market may carry less liquid assets—bills—without any effective loss of liquidity, no

[1] Cf. below.

[2] Even smaller houses consider bond holdings of a volume six times as large as their own capital as safe, as a permanent depreciation of over 10 per cent in the value of short-term bonds is thought to be improbable. Larger firms do not seem to shrink from an even higher ratio.

[3] Cf. below.

[4] Unless the withdrawal is caused by an increase in the bank-note circulation or in the volume of public deposits with the Bank of England (e.g. during tax payments), or, under the gold standard, by an export of funds.

single bank can do so unless it is prepared to rediscount directly at the Bank of England, or to borrow from one of its competitors 'Bank of England funds'.[1]

It is the function of the bill brokers to discover which of the banks is the recipient of the cash which changes hands in the clearing.[2] They will try to reborrow from the bank receiving cash through the clearing the funds which the bank which has an unfavourable balance in the clearing called from them in order to meet its obligations. In this manner the first immediate adjustment is made by both banks. If the drain on the cash-paying bank is merely a temporary one, and an incidental outcome of the operations of its clients, and if, therefore, the diminution of its cash reserves does not indicate the necessity for a revision in its general lending and investment policy, this mechanism both obviates temporary strains and ensures the full use of surplus cash. The market has every reason to collect the surplus funds of the banks. Its failure to do so is penalized, for it would cause a deficiency in the funds at its disposal and such deficiency would have to be made good by borrowing from the Central Bank at a rate of interest higher than that charged by the clearing banks. It is unlikely therefore that rediscounts at the Central Bank will increase as long as there still exists an unused margin of cash in the banking system as a whole.

The discount market is able to use funds subject to immediate call because of the character of its business, i.e. the whole of the assets it acquires, and because it has in the last resort access to the Bank of England. Its first safeguard is provided by the thoroughness of the scrutiny of the credit standing of bills made by the acceptance houses and bill brokers before such paper finds its way into the market. Its second safeguard is provided by the careful adjustment of dates of maturity of the assets, especially of bills, which it holds. The Bank of England on its side must render the use of its facilities unattractive in order to ensure that the market will restrict to a minimum the use of cash. It is on this relationship between the money and the market, clearing banks and Central Bank that the British system of monetary management was based.[3]

[1] Similar to the market in 'Federal Reserve Funds' which functioned from time to time in the U.S.A.

[2] Cf. Foa, *M.E.* Qu. 1684.

[3] And, by varying the quality of the assets which it is prepared to discount or against which it is prepared to grant advances, the Central Bank exerts some qualitative control on the operations of the credit system.

Regular variations in the volume of the loanable funds at their disposal need not disturb the bill-broking firms as these are foreseeable in advance and can be provided for by appropriate variation of these maturities, i.e. the market will try to acquire bills maturing before and after the expected drain by quoting more favourable rates. Even small week-by-week variations can be smoothed out by an application of this technique, and if difficulties arise and the market has to have recourse to the Bank to meet calls made upon it, the short-term maturity of its assets provides for an automatic limitation both upon the extent to which and the period of time for which such assistance is necessary. Any reduction in the amount of bills bought and discounted in a period of stringency immediately reduces the volume of payments to be made out of the market, but has no effect upon the payments which have to be made into the market to meet maturing bills which had been purchased in preceding weeks or months. Thus a stiffening of the rate of discount and a reduction in the volume of new business may impair the profits of the discount market, but it will automatically and cumulatively increase its liquidity. The mechanism as it now exists still provides for the maximum utilization of reserve funds. Before 1914, when the commercial bill was an important instrument of (international) finance, it also provided for the almost automatic adjustment of the timing of payments into and out of the market to changes in their volume.[1]

B. The Eligibility of Bills

The discount market can consider as absolutely liquid only those assets which it can rediscount and/or against which, as collateral, it can obtain advances from the Bank of England. The rules governing the eligibility of bills are identical for both purposes.[2] Firms recognized as members of the market possess a discount account.[3] The eligibility for rediscount and collateral is in general

[1] The burden of adjustment is thereby shifted from the centre of the banking system into the peripheries (and especially prior to the 1914–18 war, from London and Britain to foreign countries). It would not be true to say, of course, that this mechanism obviated the necessity for basic readjustment at home. But it lessened the risk of a crisis at the centre and thus of secondary deflations. Cf. below for an analysis of the growing importance of Treasury bills and its consequences and Part III on the implications of the worsening of Britain's international economic position. The discount market sought to find a new outlet for its funds and also a new and important role in its dealings in Government securities.

[2] Harvey, *M.E.* Qu. 3659.

[3] See p. 121 above.

restricted to bills (apart from Treasury bills and certain other one-name paper) which carry two first-class British names, *one* of which must be the acceptor, the other may be the discount firm which takes the bills to the Bank.

The relationship between the Bank of England and the discount market is so intimate and the latter depends so much on the goodwill of the former that within this general framework the Bank can and does enforce other conditions.[1] The firms in the discount market must regularly (twice yearly) inform the Bank of their position by submitting balance sheets and giving all information requested by the Bank. Hints by the Bank about the size of their commitments and quality of their assets have the character of commands, as no firm can continue in business if it loses its discount account with the Bank. Thus the Bank is able to exercise through the discount market a direct control over that part of the banking system which undertakes acceptance business, as the loss of eligibility would exclude any offending firm from the list of those whose names secures credit on the cheapest terms in the London market. Accepting beyond what the Bank considers to be safe limits can thus informally but as effectively be checked as an over-extension of the engagements of any firm in the discount market itself.[2]

A more direct limitation of the size of borrowing by the market is provided by the rule of the Bank which demands 5 per cent margin on advances irrespective of whether the collateral security consists of bills or of Government securities. In the latter case the margin is calculated on the basis of nominal value only if the market price is above par. As the conditions on which the Bank grants advances are less onerous than those for rediscounts, the market must either have enough of its own capital to cover this margin or be prepared to meet the more onerous requirements.

[1] In the pre-war period the variation of eligibility rules was one of the recognized weapons of central banking policy. Cf. Sayers, op. cit. pp. 63–8.

[2] Conversely the continuation by the Bank of the privilege of eligibility in favour of firms whose names would otherwise not be accepted in the market is one of the most powerful weapons to prevent panic. It has been successfully used in the critical periods of the First World War and Great Depression. The Bank made arrangements to safeguard the intermediate holders of bills against eventual losses. This took the form of establishing private guarantee funds (1890 and 1931) with or without state guarantee (1914). The problems arising out of the increasing influence of the Bank and, more especially, the problem of ultimate responsibility for its policy and actions, cannot be discussed here.

C. The Operations of the Discount Market

(i) *Jobbing in Bills.* In its early stages, at the beginning of the last century, the discount market acted primarily as an intermediary agent between provincial banks. The usury laws prevented them from acting as principals. In exercising this function it built up a knowledge of the standing of potential borrowers in the country and abroad which small local banks, having surpluses to invest, could not obtain directly. The rapid growth of the discount houses and the repeal of restrictive legislation enabled them later to deal in bills as principals. In this phase they endorsed bills which they sold and made them marketable. By buying bills in 'deficiency' areas and selling them to banks in 'surplus' areas—especially the agricultural districts—the discount market provided for a nation-wide equalization of the demand and supply of funds prior to the development of branch banking.[1]

The rise of joint-stock banks with nation-wide networks of offices and specialized accepting houses tended to eliminate the trade bill as an important financial instrument and therefore reduced the usefulness of the discount firms in this respect. The signature, whether as acceptor or as endorser, of a joint-stock bank or an acceptance house on a bill determined its quality irrespective of the credit of the ultimate debtor. With the increase in the size, and the widening in the scope of the activities of the banks, the necessity for expert intermediaries diminished and the banks were able to acquire directly information about the status of commercial users of bill finance. The latter development operated against the bill broker as an independent expert, the former against the bill as a method of redistributing funds. The Midland Bank was one of the first amongst the big banks to acquire commercial bills directly. It seems to have employed for the purpose a running broker on a salaried basis. Its operations enabled it to maintain its commercial portfolio at about 75 per cent of its total bill holdings prior to the crisis of 1931, while the total bank portfolios showed a higher percentage of Treasury bills.[2] The other banks steadily became eager competitors for bills, and the general position of the brokers appeared to be threatened. They were able to maintain their position mainly because banks preferred to buy short maturi-

[1] Cf. King, op. cit.

[2] Cf. *M.R.* Annex Table I, and Table E at the end of Appendix I to Part II below.

ties (up to two months) or parcels of bills which were already well assorted by names and by maturities. Brokers who obtain bills directly from abroad and from the London agencies of foreign banks were in a better position, acting as a central pool, than the banks themselves to sort and assemble the bill material as it was needed by the banks, that is to say in groups of bills with maturities so distributed as to have a constant flow of inpayments roughly corresponding to the estimated outpayments. This procedure smooths and simplifies the operation of the Treasury departments of the banks, and it makes it worth while to purchase this service from the brokers by paying to the market a commission in the form of a 'turn' for services rendered.[1] It is questionable, however, whether this service alone would justify the maintenance of the discount market as an independent organization.

The market also endeavours to augment its earnings by including in the parcels of 'fine' bills sold to the banks, which are rediscountable at the Bank of England, bills which do not carry this privilege and for which it therefore charged higher rates of interest. In periods when there is a shortage of bills the banks are willing to purchase these 'mixed' parcels at the rate for fine bills.

The discount market endorses bills it sells—except, of course, Treasury bills. The contingent liability of the firms varies therefore with their turnover and with the proportion of Treasury bills in their holdings. M. Truptil[2] states that the Bank of England permits brokers, in normal times, to assume such contingent liability to a limit not exceeding five times their own capital. It seems that in an effort to make the discount market endorsement 'count' the authorities have, shortly before the 1939–45 war, lowered this limit. Considering, on the one hand, the standing of the firms whose acceptance is carried on the majority of the bills and, on the other hand, the profit margin on the basis of which the market has to work if it is to survive, this change is not likely to have very far-reaching results.

(ii) *Fixtures and Day-to-Day Money.* Although developments since the crisis have made it difficult for the discount market to earn large profits by improving the quality of the bills traded by their endorsement and by acting as an intermediary between buyers and sellers, its role as a mobilizer of short-term money is still of

[1] If a borrower would have to sell his bill directly, his bank might not want the maturity offered and might charge a higher rate of interest accordingly.

[2] Op. cit. p. 118.

considerable importance to the credit mechanism as a whole. Without it banks would be deprived of the opportunity to make remunerative yet highly liquid use of surplus funds.

In the main the money market obtains its funds from two sources: first, from the clearing banks and, secondly, from the large and miscellaneous group of financial institutions which include foreign banks, merchant bankers and insurance companies. From both these sources the money market receives funds of two different types, 'fixtures' and 'day-to-day' money. 'Fixtures' are, from the lender's point of view, part of an emergency cash reserve to which the lenders would not, under normal circumstances, be forced to have recourse. On the use of these funds the money market can confidently rely. They derive principally, though not exclusively, from the larger clearing banks, but the arrangements made for placing them differ from bank to bank. Some, like Barclays and Lloyds, arrange to give weekly loans. Others, like the Midland, prefer to give even 'fixtures' in the form of day-to-day loans. Certain banks will have both call and short-notice fixtures. But in all such cases the discount house can implicitly assume that the loans will be renewed automatically unless wholly unforeseen circumstances arise. At first sight such arrangements must appear somewhat illogical, but the relations between banks and brokers, like many other business relationships in the City, are not dictated primarily by considerations of immediate or short-run profit. In the particular case of 'fixtures' neither side tries on any occasion to drive the closest possible bargain in respect of either the rate of interest to be paid or of the precise duration of the loans. Banks know that if they are to have satisfactory outlets for their funds in times of extreme monetary ease they must try to safeguard the position of the money market when money is tight. Brokers, on the other hand, will not pay off clearing banks as soon as there is a chance of obtaining money cheaply from outside sources because they bear in mind that circumstances may arise when these banks will be their sole source of money apart from the Bank of England.[1]

In addition to 'fixtures', the banks themselves and other financial institutions of many types have funds in their keeping which they must regard either as transitory or, from any single bank's point of view, as unstable. These funds are lent only on a day-to-day basis. The market calls a new loan of this character 'fresh/new

[1] Cf. Foa, *M.E.* Qu. 1773–5. He confirmed that it was difficult for bill brokers to refuse money offered by the banks.

money'. If 'fresh/new money' is left with the broker for a long enough period, it becomes 'old money'. The brokers reviewing the money which they obtain from all sources distinguish between 'good money' and 'bad money'. They try to keep the latter, being day-to-day loans liable to be called at an early date, to a maximum of 20 per cent of their total borrowing.

Formerly it was also customary to lend money at notice. This practice has been largely discontinued. A broker who finds himself short of money to balance his books in the afternoon will try to obtain funds overnight from a bank which has unexpectedly a surplus on its hands. This arrangement is called 'night money'. It is never renewed and never becomes 'good' money. It is repaid in the morning as a matter of course. The rate of interest on it is fixed either in the evening or in the morning on the basis of the rate then obtaining in the market.

Lenders are supposed to call their loans before 12 o'clock. Scottish banks, which reserve the right to call at any time during the working day, have to be content with somewhat lower interest ($\frac{1}{4}$ below the rate for identical loans without this option to call).

'Outside' money is derived mostly from the merchant and foreign banks and the big insurance companies. In earlier periods this source used to be very fluctuating. In the last few years the most unstable parts of it seems to have found other outlets, especially in the foreign exchange market, and the extreme ease on the market has impressed upon would-be lenders the importance of constant business relations. The variations in the volume of funds has therefore become less marked. The suspension of the gold standard and thus the end of the automatic dependence of the volume of banking funds on changes of the gold reserve had the same effect. The rapidly changing flows of foreign capital have influenced the market mainly indirectly.

In addition to loan from banks the market receives some of its resources in the form of direct deposits. In the case of two of the discount companies (Union and National) these played a considerable role. The third public company used this method of obtaining funds to a lesser extent. The private firms also accept regular deposits. No collateral security is given for these deposits. They are usually fixed for a period and are accepted only in units of a substantial amount. Every discount house has arrangements with the clearing banks to overdraw within certain limits to cover an unexpected outfall of funds (e.g. because a 'parcel' of bills

arrives too late). These overdrafts are called 'privilege money' or 'rights'.

(iii) *Collateral.* The collateral tendered by the market in security of its bank loans consists of bills and of short-term Government bonds. In contrast to the Bank of England, which, as we have seen, demands 5 per cent margin, the clearing banks in general only demand a margin sufficient to cover the amount of discount due on the bills (i.e. the difference between the present and the eventual value of the bills deposited). The bundles of bills sent to the banks as collateral are called 'parcels'. They are made up for round figures, usually at least £5,000. Borrowers can readily transfer them when a loan is repaid by borrowing from another bank. Repayments are effected by cheques drawn on the bank to which the parcel is transferred, the funds to meet the cheque being made available after the parcel has been received. Brokers may replace any bill in a parcel during the currency of a loan by another of approximately the same quality and currency if they need a particular item. The lender also exercises some discretion in accepting a parcel. If he finds that the names in it are unsuitable, either because he already has many bills bearing the same names, or because it contains too many names not eligible for rediscount, he can demand the substitution of other bills for the items to which he objects.[1]

Apart from bills, short-term Government securities called 'floaters' have long been used as collateral. The banks usually accepted such bonds up to 10 per cent of the value of a parcel. If the borrower wished to include a higher proportion he had to notify the lender and the rate of interest was fixed at a somewhat higher level. The changes in the business of the market since the crisis of 1931, which resulted in the increase in the volume of Government securities dealt in by discount firms, led to a much stricter separation of 'bond' and 'bill' money, i.e. loans secured by Government securities and bills respectively. Banks still seem to accept 'floaters' as margin on parcels of bills without charging 'bond' money rate. The margin on purely bond collateral has, however, been increased since borrowing against bonds alone was accepted as a practice. Clearing banks demand a margin of 3 per cent and outside lenders up to 5 per cent on the current market price. In widening the market for Government obligations the discount houses perform an increasingly important and valuable function.

[1] Harvey, *M.E.* Qu. 365–70.

D. The Structure of Interest Rates

Preceding sections have shown that the capacity of the discount market to pay its way depends upon the relationship between the rate at which it can obtain its funds and the rate which it earns upon the limited classes of assets which it can safely hold. The market exploits such differences as may arise between the cost of borrowing at call and the yield upon bills of different kinds and upon high-grade longer-term securities.

The banks, in determining the minimum rate of interest at which they lend to the market, take into account what they themselves have to pay upon fixed deposits entrusted to them by their customers. This rate was fixed at 2 per cent below bank rate, and the rate of fixtures was customarily 1½ per cent and money at call[1] 1¼ per cent below bank rate. After 1929 the banks successfully enforced a rate of 1 per cent below bank rate.[2] Thus the whole structure of interest and discount rates in the market is closely related to the rate fixed by the central bank. At first sight the relationships between these rates appear so rigid that little or no opportunity can be seen for their exploitation by the firms which make up the discount market. The volume of earning assets is so highly geared to their capital,[3] however, that they are interested in differences as small as a sixteenth or an eighth of 1 per cent. The skill of members of the market was customarily devoted to utilizing these small differences. In the tables below (pp. 130–1) figures for the yearly averages of the more significant rates, including bank rate, are set out.

The market rate could not rise for any length of time above the published minimum bank rate.[4] It must be remembered, however, that borrowing from the Bank was rendered expensive by the Bank insisting on a minimum duration of at least a week,[5] and at half-

[1] Money at notice, especially from Scottish banks, was charged at ¼ per cent above the rates demanded for fixtures. This differentiation has disappeared. Some Scottish banks also insist on being able to call in the afternoon. Money is then lent ¼ below the normal rates. Cf. above.

[2] Foa, *M.E.* Qu. 1771–5; also Harvey, *M.E.* Qu. 370 and *M.R.* p. 41.

[3] See Chapter 9, B below.

[4] The market, of course, may be forced into the Bank without the market rate rising above or up to bank rate as the discount houses would judge and adapt their position not by the actual cost of borrowing at any given moment but their average cost over the period of the currency of the bills. Cf. Foa, *M.E.* Qu. 1760.

[5] If a discount firm exhausted its 'quota' of borrowing for any specific day the minimum length of the loan was increased.

year ends of eleven days, for advances, and that it charged ½ per cent above the published bank rate for them. In case of rediscounts the Bank charged the published minimum rate, but insisted on parcels which had an average currency of twenty-one days with a minimum of fifteen days for any single bill. Hence the effective cost of borrowing from the Bank may be higher than shorter-term but more expensive loans from other sources, so that if the 'money

TABLE XXXIII. RATES OF INTEREST IN THE LONDON MARKET, 1919–27.* PERCENTAGE HALF-YEARLY AVERAGES

Year	Bank rate	Treasury bill rate, three months	Market rate, bank bills, three months	Bankers' deposit rate	Short-money rate	Rate on Stock Exchange loans
1919: Jan.–June	5·00	3·50†	3·46	3·00	3·23	5·12
July–Dec.	5·30	4·33†	4·39	3·38	3·73	5·45
1920: Jan.–June	6·38	5·93	6·11	4·38	4·78	6·84
July–Dec.	7·00	6·50	6·67	5·00	5·54	7·50
1921: Jan.–June	6·82	—	6·15	4·82	5·35	7·34
July–Dec.	5·39	4·14	4·20	3·39	3·79	5·94
1922: Jan.–June	4·35	2·79	2·95	2·35	2·90	4·91
July–Dec.	3·03	2·28	2·34	1·03	1·70	3·53
1923: Jan.–June	3·00	2·12	2·20	1·00	1·57	3·50
July–Dec.	3·98	3·15	3·21	1·98	2·17	4·48
1924: Jan.–June	4·00	3·13	3·37	2·00	2·50	4·50
July–Dec.	4·00	3·66	3·70	2·00	2·75	4·50
1925: Jan.–June	4·65	4·15	4·20	2·65	3·48	5·15
July–Dec.	4·51	3·99	4·10	2·51	3·46	5·01
1926: Jan.–June	5·00	4·43	4·40	3·00	4·07	5·50
July–Dec.	5·00	4·61	4·51	3·00	4·05	5·50
1927: Jan.–June	4·80	4·16	4·05	2·80	3·87	5·30
July–Dec.	4·50	4·33	4·32	2·50	3·62	5·00

* Kock, *A Study in Rates of Interest* (1929), p. 243.
† Sales of Treasury bills suspended 1 June–14 July.

squeeze' is expected to be only a passing phenomenon and the discount houses can be certain of obtaining money at normal rates from the usual lenders within a few days, they are likely to go to these other sources rather than use their quota at the Bank.

The rate on day-to-day loans and on loans from outside sources was fixed by supply and demand fluctuating around the more stable rates. The rate on 'old' or 'good' money, however, tended to remain lower than that on 'fresh' or 'bad' money (including outside money) when the market suddenly tightened, nor did it fall to the same extent when the supply of funds was plentiful. This was in accordance with the business principles of the discount

market and of the banks, both parties desiring to stabilize their relations to their mutual longer-term advantage. The rate on overnight money was usually fixed next morning on the basis of that day's rate for 'new money'. It stood usually at the rate charged for fixtures. The average cost of borrowing of the discount firms therefore depended on the sources of supply utilized and fluctuated between the limits indicated.

TABLE XXXIV. MONEY AND BILL RATES. YEARLY AVERAGES

Year	Bank rate‡	Treasury bills* (weekly allotment)	Daily rates from *The Times*‡		
			3 months' fine† bank bills	Loans for short periods	Day-to-day money
1928	4·500	4·146	4·16	3·65	3·52
1929	5·498	5·264	5·26	4·61	4·47
1930	3·414	2·484	2·57	2·45	2·27
1931	3·969	3·593	3·61	3·07	2·94
1932	3·008	1·486	1·87	1·82	1·61
1933	2·000	0·591	0·69	0·77	0·69
1934	2·000	0·727	0·82	0·86	0·82
1935	2·000	0·546	0·58	0·75	0·73
1936	2·000	0·583	0·60	0·50	0·50
1937	2·000	0·563	0·58	0·50	0·50
1938	2·000	0·611	0·63	0·51	0·51

* Weighted average. † Brokers' buying rate.
‡ Average rate for all working days.

Under the terms of the agreements made between the banks and the money market in 1934 in consequence of the position created by the 'cheap' money policy and the 2 per cent bank rate which became a stable feature in British monetary policy, rates vary according to the collateral tendered. On bills the banks charged $\frac{1}{2}$ per cent and on bonds 1 per cent, except on Treasury 1 per cent bonds on which money could be obtained at $\frac{3}{4}$ per cent. The difference between fixtures and other types of money consequently disappeared. Outside lenders usually charged $\frac{1}{2}$ per cent against bills and $\frac{3}{4}$ per cent against bonds under the new dispensation. These limits have, on occasion, been lowered to $\frac{3}{8}$ and $\frac{5}{8}$ per cent respectively. But outside lenders usually charged the same rate for 'bill' money as clearing banks and in consequence before the war the latter supplied the greater part of this type of loan.

The discount houses usually paid a rate of interest $\frac{1}{4}$–$\frac{1}{2}$ per cent above the rates paid by the clearing banks for identical deposits.

For deposits fixed for long periods the rate was subject to negotiation and the difference was usually higher.

As we have seen above, the bulk of the profits of the market was derived from the difference between the interest rates at which they could buy bills, on the one hand, and at which they could borrow money or resell bills on the other. This depended upon the relative volume of funds seeking an outlet in bills and available for the money market respectively.[1] A special margin arose in the case of trade bills which the discount firms buy at varying rates often 1 to 2 per cent higher than those ruling for fine bills. Trade bills were bought by the Westminster, Barclays and the Midland Banks particularly. The market succeeded sometimes in including these bills in parcels sold at the 'fine' rate to banks.

Another margin between interest rates arose when the market held longer bills (i.e. over three months) until they were nearer to maturity.[2] A similar margin existed between rates of discount on bills of two and three months' currency as the banks preferred to buy the former. In periods when bills were scarce these differences tended to diminish. The great increase in the importance of Treasury bills which did not require endorsement on sale had the same effect.[3] The banks could and sometimes did sell these, while they never sold commercial paper, as they would have disliked having their names seen on bills in the market.

Since 1934 the agreement between the market and the banks tended to re-establish the margins between rates of discount charged on identical bills with different currencies.

E. Changes in Discount Market Practice after 1931

In the immediate post-war years the margin between the rates of interest paid and obtained, i.e. the working profit margin of the market, was satisfactory. The discount firms, moreover, made considerable capital gains in consequence of the general fall in the rates of interest. Thus the older firms were able to accumulate considerable reserves.

[1] Cf. Paish, Appendix I. It is noteworthy that 'outside' interests other than central banks and such public authorities, British and foreign, as tender through the Bank, did not usually tender below $\frac{3}{4}$ per cent.

[2] Bills are usually sold to banks on the day after they 'make up'. The discount firms try to apportion their sales to clearing banks. No bills are sold on Saturdays, as the National Bank, the only bank making up on Fridav, does not buy bills.

[3] Cf. Foa, *M.E.* Qu. 1764.

The crisis of 1931 did not affect the position of the discount houses as gravely as that of most other City institutions. The depreciation of their longer-term and gilt-edged holdings was not severe enough to force liquidation. Thus paper losses were not made permanent. The contingent risk involved in the holding of bills which became frozen was eliminated by the action of the Bank of England in sustaining the acceptance houses in order to avoid a general collapse. But the events since 1932, and more particularly the 'cheap' money policy inaugurated prior to the conversion of the 5 per cent War Loan and continued in subsequent years, were felt in some quarters to threaten the very existence of the discount market, though its capital position was in many cases better than at any time. The appreciation of gilt-edged securities to levels not approached since the 1914–18 war and the rapid fall in the bank rate from 6 to 2 per cent resulted in very substantial capital gains. The success of the conversion, however, enabled the Government to undertake funding operations which reduced the available supply of Treasury bills and short-term bonds to relatively low levels. At the same time the world crisis, the monetary instability and financial troubles reduced the volume of available commercial bills by probably more than half.

The clearing banks and other financial institutions were actively competing for such short-term assets as were still available. At the same time the clearing banks, which were the principal single source of short-term funds for the discount market, tried to maintain the customary relationship between bank rate and the interest charged for 'fixtures'. The latter was, as we have seen, normally 1 per cent below the former so that, with a bank rate stabilized at 2 per cent, the customary 'fixtures' rate was 1 per cent. Low as this rate was, the discount on Treasury bills had fallen even lower by the beginning of 1933. By the middle of that year the competition for fine bank bills reduced the rate of discount below the money rate.

The customary differential between the yield upon bills and the cost of 'fixtures' disappeared. The discount market was left with no profit margin on bank loans. Outside lenders were willing to lend money at rates below the minimum charged by the clearing banks. The volume of call money borrowed from the latter shrank to a minimum at the end of 1933. Considering the basic pattern of the markets and its functions, it was clear that its continued existence depended upon the restoration of satisfactory relations with the clearing banks.

From the point of view of the banks the position which had developed was not less anomalous. They were willing to buy bills at rates below those charged on loans secured by similar bills regardless of the fact that by holding bills as direct assets, instead of as collateral, they reduced their liquidity, for they carried risks that would otherwise have been borne by the discount houses. This was the result of maintaining an artificial minimum rate of interest on short loans by mutual agreement without attempting to regulate the rates at which they were willing to buy bills. Assuming that the regulation of the short money rate was justified—and it was deemed to be so by the clearing banks, for it was associated in their minds with agreed rates paid by them on deposits which also had a customary relationship to bank rate—some equivalent regulation had to be introduced for the buying rates for bills.[1]

The solution of the problem of the discount market did not come quickly and it did not come without much preliminary friction. At first the clearing banks maintained their lending rate at 1 per cent and tried to come to an agreement to raise the rate on bills by maintaining their Treasury bill tenders at a rate which left a profit margin for the market and by refraining from buying commercial bills below that rate. This first 'pact' was arrived at in September 1933. The loans to the money market increased somewhat, but the improvement did not last long, and by the autumn of 1934 the position in the discount market was once more precarious. Increased competition from foreign funds which had been transferred to London and a further shrinkage in the volume of bills outstanding had deprived the banks of the supply of bills which they regarded as necessary. Forced to choose between their portfolios of bills and their call loans they chose the former and bill rate once more sagged below money rate. In November 1934, however, the banks agreed to reduce their minimum charges on loans against approved bills to ½ per cent. Loans against bonds were to remain at the earlier minimum of 1 per cent. But this change did little to bring about a solution to the problems of the discount market. The competition for bills between the banks, the market and the outside investors continued. On 25 January 1935, the average rate of discount on Treasury bills declined to a new low level of 3*s.* 10·91*d.* per cent, less than 0·2 per cent. At the same

[1] As will be shown below (see Chapter 11), several factors were at work preventing the very low rate charged upon commercial bills calling forth a larger supply.

time banks quoted $\frac{3}{16}$ per cent as a buying rate for Treasuries irrespective of maturity.

It was evident that a solution could be found only if the banks instituted a minimum buying rate for both Treasury and commercial bills. A third 'agreement' had to be made, and this differed in important details from the first two. It embraced all clearing banks[1] and related not only to dealing on the market, but also to Treasury bill tenders. Its central feature was that the minimum buying rate for bills by the clearing banks was to be at least equal to the minimum rate at which they were willing to lend on bills and not merely a minimum rate to be agreed upon from time to time.[2] This agreement was subsequently strengthened by the banks undertaking not to participate directly in tenders for Treasury bills and not to buy any bills until they had run for at least one week.

This arrangement worked fairly well.[3] The rate of interest for Treasury bill tenders and bill rates in the market were consistently maintained above $\frac{1}{2}$ per cent, even in periods of great scarcity of bills.[4] The discount market was also able to count upon a regular margin between the rates of interest on longer and shorter bills. Both margins, however, remained extremely narrow, except in periods when political scares raised the bill rate suddenly to higher levels as a result of a cessation of outside competition for bills.

The agreement between the clearing banks and the discount firms has had an important influence on the structure of the market. Prior to the agreement, rates of interest were fixed by negotiation. Outside money tended to be cheaper than borrowing from the clearing banks, and the market used outside sources within limits judged as safe taking into consideration the continuity and stability of the funds.[5]

Prior to 1931 the bankers' call and short-notice money represented about 50–60 per cent of the total funds of the market. This ratio declined after 1931. But the third agreement largely restored the position. While, however, there was relatively little net change

[1] One of the Big Five did not join the earlier pact.

[2] Cf. King, 'Financial News', *Banking Review*, 6 March 1936, p. 5, and Bareau, ibid. 13 May 1935, p. 19.

[3] There seem to have been cases when clearing banks used affiliates or others to tender for Treasury bills on their own behalf. Such evasions were not on a wide enough scale to smash the agreement.

[4] The longer-run success of the agreement has probably been due to the increase in the supply of bills and the end of the extreme monetary ease subsequent to the recovery of business activity.

[5] Cf. Foa, *M.E.* Qu. 1771–4.

in the source of the market's funds, different sections of the market reacted differently to the policy of the clearing banks in charging more for bond money than did other lenders. Private firms no longer borrowed from the clearing banks against bond collateral. The public discount companies seem to have continued to do so. Their total borrowing from this source was relatively less important than that of the private firms, as they tended to obtain a large proportion of their funds as deposits. On the other hand, as the difference between the interest charged by the clearing banks and by other lenders on 'bill' money almost completely vanished, private firms after 1939 tended to take 'bill' money almost exclusively from the clearing banks. The result was that some firms took up to 80 per cent of their borrowed funds from the clearing banks, and it seems to be understood that no private firm took less than 50 per cent. The average ratio of clearing-bank lending to 'outside money'[1] thus seems to show a definite and very considerable increase as compared with the level which M. Truptil indicated for the period of 1932–4.

This change in the origin of the funds used by the market had a somewhat unsettling effect on the mechanism and stability of the market. Outside funds (and to these had to be added large deposits by foreign financial institutions) were, as we have mentioned, less stable than those which the clearing banks put at the disposal of the market. But these funds were used by the weaker firms to finance the more risky part of their business, borrowing short upon the collateral of dated bonds. As these could not readily be realized in really tight monetary conditions without capital depreciation and would be accepted at the Bank of England, if at all, only with a substantial margin, the separation of 'bill' and 'bond' money, the latter coming from the less rather than the more stable lenders, created new risks for the market. These seem to have been successfully dealt with, though no real test arose. The importance of the task of widening the market for Government securities should, however, secure them help in case of need.

F. The Discount Market Syndicate

The agreement between the clearing banks and the market created the opportunity for a further regulation of market dealings. During the period when extreme competition for bills began to force the

[1] It may be somewhat misleading to talk of an average, as the ratio varies considerably according to the policy of each discount firm.

bill rate below the money rate, discount firms could secure a profit only on the resale of bills, especially Treasury bills, to the banks. As they were unable to hold bills profitably, it was in their interest to secure as large a part of the weekly tender for Treasury bills as possible. Before the first pact between the banks was signed, this competition manifested itself in rate cutting. After the banks had established a minimum buying rate, discount firms could no longer adopt this method to secure a large share at the tender as they could not resell the bills at a profit to the banks. They therefore maintained the rate above the minimum buying price of the banks, but increased the volume of their tenders, hoping thereby to secure a larger share of the total. By the end of the spring of 1935 this new competition raised the weekly applications for Treasury bills far above the amount for which tenders had been invited.[1] The existence of the pact with the banks was seriously endangered. A collapse of the pact, however, under the conditions as they then were, would have jeopardized the existence of the market. The more important discount houses therefore undertook to restrict their tenders to an agreed figure. This informal arrangement was then extended and soon embraced all members of the discount market. Certain outside firms were also invited and consented to join the syndicate.[2] The banks informally assented to this further regulation of market dealings.[3]

The 'syndicate' allotted to each of the firms a 'quota' on the basis of its capital resources. If a firm ceased to participate, its quota was distributed among the rest. The big companies seem to have agreed to tender for quotas which are smaller in proportion to their capital than those allotted to the lesser firms.[4] The total market syndicate tender amounted to approximately £26 millions. A quota of about £4 millions was alloted to outside firms. The amount of the weekly tender of each of the firms forming part of the syndicate was rigidly fixed and could not be varied. The only

[1] Maximum being a tender of £116 millions for £35 millions bills on offer.

[2] Such as Keyser and Co. Some other firms closely followed the policy of the syndicate.

[3] They discouraged the inclusion of 'hot' bills, i.e. bills which had not run at least eight days, into 'parcels' by firms who were known to have increased their tenders.

[4] Three categories were specified under the syndicate agreement: (1) Firms with capital of over £1 million; they tender for an amount equivalent to 120 per cent of their capital. (2) Firms between £½ and 1 million capital. Their quota is 226½ per cent of their capital. (3) The rest tender at the scale of 410 per cent of their capital. Odd £1,000 are neglected.

method by which a firm could avoid, and on several occasions has avoided, taking up bills was by tendering at a lower price than the market. This it was permitted to do, but if it used this escape clause it had to notify the syndicate.

The maximum rate of interest (or the minimum price) at which members of the syndicate were permitted, and usually did, tender was fixed at an informal meeting every Friday between representatives of three private firms[1] and each of the public discount companies in turn. The discount companies previously held a meeting of their own. Representatives of the discount companies and of the private firms also saw officials of the Bank of England each Thursday and reported to the market at a so-called 'tea party' whatever information or suggestions the authorities might have wished to be imparted.[2]

The tightening regulation of the working of the discount market was a direct consequence of the increasing restriction of competition by co-operative action between the banks and discount firms. It seems rash to label the new working order of the discount market 'artificial' and to contrast it too sharply with conditions under which money rates in general were fixed by bargains between banks and discount houses. It is difficult to believe that the former system was more 'natural' or 'organic' than the pre-war regime which has grown out of it under the influence of marked changes in the conditions in which both banks and markets had to carry on their business. Both were in this period considerably influenced by the volume of Government financial transactions and by the policy followed by the Treasury, by Government departments, by the Bank of England and by the Exchange Equalization Fund.

The rigid maintenance of the bank rate at 2 per cent irrespective of the state of business, the increasing rigidity of the structure of interest rates, the increasing importance of open-market operations, the change in the structure of world trade and thus in the pattern of its finance, were the basic causes of the need for the monopolistic regulation of the discount market. It is questionable whether with this need for regulation, the flexibility in the utilization of bank reserves attained by the activity of the discount market could not be attained by the Central Bank directly or indirectly (perhaps through an 'official running broker') dealing with the banking system. It is in the increasing role of the discount houses as dealers in gilt-edged securities that their main economic usefulness must be sought.

[1] Jones and Brown; King and Shaxon; Smith, St Aubyn and Co.
[2] Cf. Harvey, *M.E.* Qu. 365.

CHAPTER 9. *THE INTERNAL STRUCTURE OF THE DISCOUNT MARKET FIRMS*

A. The Members of the Discount Market

The internal structure of the discount market has not changed markedly since the 1914–18 war. It then consisted and still consists of three discount companies, incorporated with limited liability, and a number of private firms. The latter were about twenty in number before the 1914–18 war.[1] The Report of the Macmillan Committee states that in 1931, in addition to the three public companies, there were four private limited liability companies and seventeen private firms. Of these twenty-one firms, four had been founded since the war: Jessel Toynbee and Co. (1922), Seccombe Marshall and Campion (1922) (the firm which acts as brokers to the Bank of England), Brocklebank, Hoare and Brown (1924) and Fairfax and Co. Ltd. (1925). Although there appear to have been twenty-four discount firms at this period, Sir Ernest Harvey, Deputy Governor of the Bank, stated in his evidence before the Committee that the Bank only maintained twenty-three discount accounts.[2] There were also eight running brokers who did not act as principals but merely as agents for the other houses or banks.[3] In 1934 Smith, St Aubyn and Co. became a limited liability company, and the number of private partnerships has been (1938) further reduced to twelve by the amalgamation of the firm of White and Shaxon with King and Foa and by the liquidation of Baker Duncombe and Co., Lyon and Tucker, Reeves Whitburn and Co. Ltd. and Wm. P. Bonbright and Co. The number of running brokers has also fallen. There was also some contraction by the retirement of capital from the business.[4] One of the private limited liability companies (Fairfax and Co.) restricted its operations. At the end of 1937, therefore, the 'private' sector of the market consisted of five private limited liability companies with total capital of roughly £1·75 millions, four unlimited companies with a total capital of £0·9 million, and five partnerships with almost £1·0 million.[5] There were three further firms which did not seem to be active of

[1] Lavington, op. cit. p. 142.
[2] Harvey, *M.E.* Qu. 369.
[3] *M.E.* Qu. 1748.
[4] One instance of withdrawal of capital of which the details are known is the repayment of something like £900,000 of capital by Blydenstein, reducing its capital to £100,000.
[5] Cf. Table XXXV.

which one was still recognized as a discount firm and presumably still had a rediscount account at the Bank of England.

The total capital of the market in 1930 was estimated by Mr Foa at £15 millions.[1] The changes since that date until 1938 are illustrated in Table XXXV. The relative importance of the discount companies in the market as measured by capital resources increased from below 40 per cent to nearly 70 per cent. If at first sight the capital of the private firms appeared to be very small, it should be remembered that many of them, whether their liability is formally unlimited or not, have partners or shareholders of great personal wealth who in case of need would necessarily come to their aid.[2]

TABLE XXXV. CAPITAL STRUCTURE OF THE DISCOUNT MARKET

	1930*	1934†	1938
Discount Cos.	6,215,000	7,500,000	7,800,000
Private Ltd. Cos.	1,625,000	2,250,000	1,745,000
Others	8,000,000	5,000,000	1,885,000
	£15,840,000	£14,750,000	£11,430,000‡

In 1914 the capital of the discount companies was £3,500,000: that of the private companies is not known.

* Mr Foa's estimates. † M. Truptil's estimates.

‡ The three outside firms have a capital of £480,000 which brings the total up to £11,910,000.

B. THE POLICIES OF THE DISCOUNT HOUSES

Such wide variations existed in the practices of the different discount houses that it is not possible to describe in general terms, as has been done in the case of the clearing banks, the principles which guided them in determining the proportional distribution of their assets. Even within the two main categories—the public and the private companies—the divergence is so considerable as to make any generalization worthless. The ratio of their own to loan capital, which is comparatively uniform within each category, varied considerably. The distribution of their assets between the different categories of bills and short-term Government securities was determined by the nature of their business connections. These were sufficiently different in character to introduce an element of

[1] *M.E.* Qu. 1748.

[2] The Bank of England, however, tends to discourage the conversion of unlimited liability companies and partnerships into limited liability companies if their resources are less than £500,000. Cf. Truptil, op. cit. p. 120.

specialization, far larger than has been usually recognized, into the business practices of the several houses. The impression that discount houses do identical business has probably arisen from the fact that most writers on the discount market have concentrated their attention on the relations between the market and the banking system and the Bank of England, for these relationships are superficially more susceptible to generalization than are the internal policies of the several houses.

It is true that all discount houses borrowed on collateral, that they all applied to the Bank if other lenders failed to renew their loans, and that they all quoted more or less identical rates of interest. But within this uniform framework wide divergencies of practice existed. Discount firms which had close relationships with merchant bankers carried a large proportion of bankers' acceptances. Others with traditional ties with certain trades which were, even in the 1930's, still financed by way of bills of exchange, showed a greater proportion of fine trade bills. As they obtained greater earnings upon them as a reward for carrying greater risks, it was both unnecessary and undesirable for them to carry the same volume of bills, relatively to capital and reserves, as would be both necessary and safe if they had specialized in dealing in Treasury bills or in bankers' acceptances. On the other hand, a firm which specialized in holding short-term Government stock[1] would probably do so up to a maximum of six times its capital and confine its total commitments to twenty-five times its capital. In comparison, a firm which held in bonds only four times its capital would probably consider it safe to extend its total engagements, especially if these consisted largely of Treasury bills, up to thirty-three times its capital. Further differences arose from variations in the rediscount obligations of the several firms. These would be large if they were actively dealing on the market and traded mainly in commercial bills which would have to be endorsed at sale. They would be small if they dealt mainly in Treasury bills. This qualification on the danger of easy generalization must be kept in mind in the subsequent analysis of the policy of the members of the discount market.

(i) *The Public Companies.* The three big discount houses were public limited liability companies and were therefore obliged to publish annual balance sheets. The changes in these between 1914 and 1938 are shown in Table XXXVI.

[1] Cf. Truptil, op. cit. p. 118.

TABLE XXXVI. POSITION OF THE LONDON DISCOUNT COMPANIES

(Amounts are stated in £ millions)

	1913	1918	1920	1924	1927	1928*	1929	1931	1932	1933	1934	1935	1936	1937	1938
ASSETS															
1. Cash at bankers	1·7	2·0	2·3	2·5	2·4	2·5	2·6	2·4	2·7	2·7	2·9	3·0	3·1	3·3	3·3
2. Investments	5·0	8·8	5·4	10·4	13·7	17·3	13·5	13·7	20·2	28·4	35·5	37·8	40·7	35·9	21·2
3. Bills discounted	58·0	64·0	91·5	115·0	121·3	118·9	121·6	111·2	117·0	111·5	90·6	101·7	110·6	115·5	123·7
4. Loans and sundry accounts	2·2	4·5	3·8	4·0	4·4	1·9	2·5	1·2	2·8	1·8	3·0	5·0	3·6	3·4	4·4
5. Total assets	66·9	79·3	103·0	131·9	141·8	140·6	140·2	128·5	142·7	144·4	132·0	147·5	158·0	158·1	152·6
LIABILITIES															
6. Capital and reserves	3·5	3·8	4·2	5·1	5·8	6·2	6·2	7·0	7·0	7·0	7·0	7·0	7·7	7·8	7·8
7. Loans, deposits, etc., including undivided profits	46·7	59·7	70·5	85·5	93·9	93·2	92·4	86·4	105·0	111·7	105·9	114·2	121·8	121·1	124·9
8. Bills rediscounted	16·2	15·1	27·2	39·9	40·5	39·8	40·3	33·7	28·9	24·9	18·3	25·5	27·6	28·3	19·4
9. Rebate, etc.	0·5	0·7	1·1	1·4	1·6	1·4	1·3	1·4	1·8	0·8	0·8	0·8	0·7	0·9	0·5
10. Total liabilities	66·9	79·3	103·0	131·9	141·8	140·6	140·2	128·5	142·7	144·4	132·0	147·5	157·8	158·1	152·6

* League of Nations, *Money and Banking*, 1936–7, vol. II, Commercial Banks, p. 149, for years 1928–36.

TABLE XXXVII. DISCOUNT COMPANY BALANCE SHEETS, 31 DECEMBER
(Amounts are stated in £000's)

	Alexanders Discount Co. Ltd.		National Discount Co. Ltd.		Union Discount Co. Ltd.	
	1937	1938	1937	1938	1937	1938
LIABILITIES						
Capital	1,000	1,000	1,000	1,000	2,750	2,750
Reserve	1,000	1,000	1,050	1,100	1,000	1,000
Loans, deposits, etc.	26,683	31,263	37,409	41,201	56,153	51,505
Bills rediscounted	1,375	1,291	16,770	9,020	10,167	9,083
Rebate on bills discounted	153	163	356	—	359	361
Final dividend	—	—	—	—	129	125
Profit and loss	214	217	306	304	203	250
Total liabilities	30,425	34,934	56,891	52,625	70,761	65,074
ASSETS						
Cash	653	674	1,042	1,158	1,563	1,503
Investments	13,951	9,673	12,400	5,200	9,542	6,265
Loans	64	83	251	151	2,206	3,269
Bills discounted	15,387	24,066	43,058	45,964	57,011	53,632
Interest receivable	370	438	40	52	264	230
Union Discount Sub Co.	—	—	—	—	100	100
Premises	—	—	100	100	75	75
Total assets	30,425	34,934	56,891	52,625	70,761	65,074

It is seen that their capital increased from £3·5 millions in 1913 to £6·2 millions in 1929 and £7·8 millions in 1938. The relative importance of the three companies—in spite of certain intermediate fluctuations[1]—did not change to any significant extent. Out of £46·6 millions of deposits on 31 December 1913, the Union accounted for £20·7 millions. The National had £15·8 millions deposits and loans. Alexanders was roughly half of the first at £10·1 millions. At the end of 1937 their respective figures amounted to £56·2, £37·4 and £26·7 millions.[2]

The balance-sheet totals have increased from £66·9 to £140·2 millions in 1929 and to £158·1 millions in 1937; their bill portfolio from £41·8 millions to £81·3 and £104·3 millions, rediscounts

[1] The drop of loan funds of some £7½ millions between 1930 and 1931 was more than accounted for by the shrinkage of deposits of the Union Discount Co. Ltd. The recovery by more than £20 millions the year after, however, swelled the funds of that company again.

[2] The relative position changed in 1938 to £51·5, £41·2 and £31·3 millions. The decline in the Union figure is reported to be due to the withdrawal of foreign deposits during 1938.

from £16·2 millions to £40·3 and £28·3 millions.[1] The most remarkable increase on the asset side, however, is in investments, which have increased from £5 millions in 1913 to £13·5 millions in 1929 and to £35·9 millions in 1937. Since the discount houses sometimes classify as bills short-term obligations of the Government which mature within two years, it is necessary to correct their balance-sheet figures to eliminate the effect of this practice. It has been estimated that if this correction is made for 1937, investments must be increased by not less than £37 millions and bills reduced accordingly. This would reduce the size of the true bill portfolio to roughly £70 millions and increase the security portfolio to £61 millions. An examination of the balance sheets of the three companies shows that they appear to have followed different policies.[2] In 1938 the Union Discount Company Ltd. shows borrowings of £51·5 millions, about thirteen times its capital and reserve of £3,750,000; its rediscount liabilities are £9 millions, bills are shown as £53·6 millions; the bill portfolio therefore is £44·6 millions. Investments are shown as £6·3 millions and loans at £3·3 millions. This has to be corrected for the inclusion under the heading of bills of short-term Government securities.[3] Assuming that the company carries £15 millions worth of these short-term securities, investments would amount to not less than £21 millions, leaving only £28 millions for bills. The change in the policy is striking. The same observation can be made about the National Discount Company. The borrowed funds of this company are twenty times its capital and reserve. In 1938 it records its bill portfolio as £37 millions, but it was believed that bills, excluding short-dated Government securities, did not amount to more than £25 millions as against £17 millions of investments, the latter being over eight times its own capital. Alexander's total engagements remained at fifteen times its capital and reserves.

[1] The relative volume of rediscounts has not changed very much in the case of two of the companies: in 1913 it was £9·0, £5·7 and £1·5 millions for the Union, National and Alexanders respectively; in 1931 it was £9·1, £9·0 and £1·3 millions. The rediscount liability of the National had been as high as £16·8 millions at the end of 1937.

[2] Unfortunately, all analysis is made extremely difficult by the fact that the balance sheets do not reflect accurately the average position of each firm throughout the year. It seems, for example, that the item 'cash' represents an exaggeration of the average holding—which is to be expected, as discount companies seem to have little reason to hold cash. Private information suggests that the distortion is far greater than in the case of the banks. The above considerations are therefore very tentative in character.

[3] See Chairman's speech for 1938, *The Economist*, 28 January 1939, p. 209.

It showed a very much smaller rediscount liability which is presumably due to the fact that it tended to concentrate on dealings in Treasury bills. Its investments were shown (in 1938) in the balance sheets at £9·7 millions, bills discounted at £24 millions, but it was thought that £10 millions worth of short securities were included in the latter item; hence investments seem to have amounted to almost £20 millions which was ten times its capital, whereas bills carried were merely £12·8 millions.

In 1930 bills still amounted to 79·6 per cent of the total assets of the three discount companies. The proportion of investments to total assets was not higher than 16 per cent.[1] The proportion maintained between their own and loan capital was roughly 1 : 12·5. If the hidden reserves are taken into account, the ratio was approximately 1 : 10. It is difficult to calculate the average ratio of the discount companies for the last few years before the war as they have changed considerably: Alexanders increased from 13 to over 15·5, National from 18·7 to over 20·5, whereas the Union decreased from about 15 to about 13 times capital and reserves. The average for all three in 1938—if it has any meaning at all—was only slightly higher than in 1930. But their bill portfolio, which was 75·2 per cent of the total (according to the balance-sheet figures), decreased to not more than some 50 per cent. On the other hand, longer-term bonds have been almost halved in value, falling from £40·7 to £21·2 millions. All these figures are subject to the uncertainty on book-keeping practice referred to above.

(ii) *The Private Firms.* The activities and the balance sheets of the private firms differ from one another even more than those of the public companies. The difficulties in the way of a close analysis are insurmountable. Only one of the private firms, Gillett Brothers Discount Co. Ltd., published a balance sheet up to the 1914–18 war. Even these figures are somewhat uninformative as they include rediscounts under 'deposits, loans and sundry accounts', and this procedure inflates the size of direct commitments by an unknown amount. If we assume that the rediscounts of this firm bear the same ratio to the bill portfolio as those of the Union Discount Co.,[2] an assumption which is quite arbitrary, the direct engagements appear to be just under £10 millions with investments at £1·58

[1] The volume of short-term Government obligations, other than Treasury bills, was very small at that time.

[2] This being between the ratios of the other two.

millions as against a capital of £545,000. The ratio seems to have remained fairly constant except for the year of the acute bill shortage in 1935.

Of the seventeen private firms only six seem to have dealt in trade bills. The ratio of trade bills in their total portfolio does not seem to have exceeded one-eighth (one firm held up to one-quarter) trade bills. Five dealt only in Treasury bills. The rest divided their activities between bank acceptances and Treasury bills. The contingent liability on rediscounts varied considerably. It did not seem to be unusual for a firm to turn over its entire portfolio every three weeks. At the same time the contingent liability was often not more than 20–30 per cent of the portfolio. The smaller firms, as they received relatively a larger share of Treasury bill tenders of the syndicate, appear to have had a quicker turnover, but were nevertheless able to restrict rediscount liabilities to reasonable proportions.

In 1930 Mr Foa, in his evidence before the Macmillan Committee, regarded a 1 : 20 ratio of capital to assets as the maximum theoretical limit of the engagements of the private firms. This theoretical ratio is thought to have ruled in practice up to 1933.[1] After that it was radically modified. The private firms have been forced by the conditions ruling in the market to extend their borrowings relatively to their own capital. It is thought that the larger private firms, that is to say, firms with a capital between £300,000 and £1,000,000, maintained a ratio of loan funds to capital of between 20 and 25 : 1. The smaller firms operated on an even higher ratio of 30–33 : 1. It is understood that most bill brokers considered it safe to carry up to six times their own capital in the form of bonds; considering that even a 10 per cent decline, which in the case of very short-term Government securities would be exceptional and could only be temporary, would leave their capital unimpaired, this limit does not seem to be dangerous, particularly if we assume that at times when bonds would be saleable only at a substantial loss arrangements similar to those made in 1931 would save the bill market from being forced to shoulder its responsibility for rediscount liabilities on bank acceptances. The authorities, however, desired that the endorsements on the bill market should once more be 'made to count' so that the 1931 arrangements should not need to be repeated in a subsequent crisis. Shortly before the 1939–45 war they, therefore, made it clear

[1] Truptil, op. cit. p. 223.

that they would like to see a 'further concentration of capital' in the discount market and also presumably some net increase in its amount. It is not quite clear what they meant by this expression, as it was difficult to see how in the then prevailing circumstances capital could be attracted to the discount market if at the same time the ratio of borrowing to capital was to be reduced. Nor did the proposed steps seem to provide any real additional safeguard against the need to resort to special arrangements in a crisis, for it is difficult to see how the discount market or any part of the financial mechanism of the City could survive if an appreciable proportion of the acceptances of banks was allowed to be dishonoured for any reason whatsoever. This move of the 'Authorities', like many others, seems to show a desire to restore a *status quo* irretrievably lost.

(iii) *Running Brokers.* There have always been a number of firms in the market which act as pure agents, as bill brokers in the proper sense of the word. At the time of the Macmillan Committee their number was eight. Since that time the shrinkage in the discount market and the narrowing of the margin between the money and bill rates and the dealing 'turn' in bill rates (i.e. the difference between the buying and selling rates for bills by the discount companies) caused a drop in their number. The fact that the foreign banks which were the main source of foreign bills restricted their rediscounting—the Australian banks, for example, did no rediscounting at all before 1939—has also limited their activities. Only five or six firms seem to have remained in running brokerage business at the outbreak of the 1939–45 war. One of the banks (the Midland) seems to have employed a running brokerage firm at a fee or salary to acquire bills. Some others acted as agents in bond deals, and one specialized in Indian bills which it sold directly to banks or to discount houses. One of the discount firms (Seccombe, Marshall) acted as agent to the Bank of England and hence to the Exchange Equalization Account. The buying of bills on behalf of the authorities seems to have always been done through the market. The Bank, however, sometimes sold bills directly to the banks. All running broker firms were private and no information is available about the internal character of their businesses.[1]

[1] This refers to the position before the Munich crisis of 1938.

CHAPTER 10. *THE SUPPLY OF BILLS*

DEVELOPMENTS after the 1914–18 war, and even more developments due to the severity of the crisis of 1929–31, have diminished the relative importance of the bill as a credit instrument. In view of the implications of this fact for the future of the discount market—for the purchase and resale of Treasury bills needs no expert knowledge—an attempt is made in this section to examine somewhat more closely the sources from which bills originate and the probable volume available to the market in the years before the 1939–45 war.

The bills dealt in by the discount market can be divided into two main categories with seven subdivisions:

1. *Bills which carry one name only:*
   - (i) British Government Treasury bills.
   - (ii) Promissory notes of local authorities, of other public bodies and of foreign governments (the so-called exotic bills).
2. *Bills on which there are two or more names:*
   - (i) Bank bills accepted by British banks and acceptance houses.
   - (ii) Fine trade bills bearing the name of one or more well-known British firms.
   - (iii) Acceptances of banks which are not regarded by the Bank of England as British.
   - (iv) Foreign agency bills.
   - (v) Ordinary trade bills.
   - (vi) The so-called foreign domiciles, i.e. bills drawn in sterling by foreigners on foreigners and payable in London.

Only bank acceptances and fine trade bills are eligible for rediscount at, or can be used as collateral against an advance by, the Bank of England. These two categories of bills carry in consequence exceptionally low rates of interest.

A. TREASURY BILLS AND OTHER ONE-NAME PAPER

The development of the Treasury bill since its conception by Goschen in 1877 is dealt with in the Appendix below in a special

memorandum prepared by Mr F. W. Paish (Appendix I to Part II, pp. 191–207).

The success and growing importance of the Treasury bills of the British Government gave rise to the creation of similar instruments by other governments, local corporations and other public bodies.[1] The currency of these bills varied from three to twelve months. Their market differed according to the standing of the signatory. They were issued either for the purpose of temporary borrowing or preparatory to the issue of a longer-term loan. In principle they were not rediscountable at the Bank. The Bank also generally refused to take them as collateral for advances.[2] Other lenders were also reluctant to take them as security and only at a higher rate of interest.[3] Foreign Government bills were numerous in the period 1925–30, but have almost wholly disappeared since.[4] The Dominions borrowed in this form during the period of financial stringency and embarrassment while the depression was deepening and before the abandonment of the gold standard; the successful conversion and the incipient revival opened the capital market for their long-term issues in 1933. British Municipal Corporations began to issue bills,[5] after the Local Government Act of 1933 seemed to empower them to do so. Their bills, however, were not prominent in the money market.

The volume of bills belonging to the category under review was not considerable. Mr Foa estimated the volume of all foreign and imperial Government and other exotic bills at only £20 millions. M. Vigreux[6] estimated it at £25 millions in 1928–9 and M. Truptil for the years 1929, 1930 and 1931 at £20, £30 and £25 millions respectively. The higher figure for 1930 includes the emergency borrowing of the Dominions and other Empire Governments referred to above.

[1] Cf. *M.E.* Qu. 1725–31. Mr Foa mentioned the Port of London Authority and the Metropolitan Water Board and foreign Governments such as Chile, Brazil and foreign Municipalities such as Hamburg. For the subsequent history of the latter, cf. below.

[2] For British Corporation bills, cf. below.

[3] *M.E.* Qu. 1731. They can be deposited with the issuing house. Cf. below.

[4] The French Government took several loans by this expedient in 1936. The amount was £40 millions for three months renewable on three occasions. Half was taken by the Clearing Banks. A previous credit (1933) was not secured by bills. It amounted to £30 millions. One half was repaid after three months; the rest was renewed for another three.

[5] Cf. below, p. 150.

[6] *Le Crédit par Acceptation*; see also *League of Nations Monetary Review*, 1938–9, p. 100, footnote 2.

(i) *Government Bills other than British Treasury Bills.* Bills of foreign governments were usually placed through the London bankers to that Government. M. Truptil quotes the following issues:

Hambros Bank:	Greece (£1·5 millions). Finland (£0·5 millions). Norway (£725,000).
Baring:	Argentina[1] (£5 millions).
Rothschild:	Chile (£3 millions). Hungary (£1 million) (in conjunction with Baring Bros. and Schröders).
Schröders:	Hamburg and other German Municipal Corporations.

The 1931 crisis wrought great havoc amongst these bills. The German, Chilean and Hungarian bills were frozen and were taken up from the market. The German municipal bills were first handled by a special arrangement and subsequently merged in the general standstill.[2]

Empire countries usually offered their bills by public tender. Indian Treasury bills used to be sold in terms of rupees with the exchange guaranteed by a bank. During the financial crisis of 1931 India sold 15 millions of sterling bills in London in order to strengthen her foreign exchange reserves.[3] Australia first issued bills in September 1929. The currency of these bills was at first one year; subsequently she was only able to place bills of shorter currency, seven, six, five and in the end three months.[4] According to M. Truptil the volume of these bills outstanding was never below £8 millions between the end of 1929 and 1931. In May and June of the latter year it reached a total of not less than £17,950,000. An issue of New Zealand bills took place in 1931. The amount was £4 millions. Kenya Colony and the Canadian Province of New Brunswick borrowed £1 million and £975,000 respectively. Special circumstances surround the bills of the Government of Northern Ireland which will be dealt with below.[5]

(ii) *Bills of Local Authorities and other Public Corporations.* Even before the Local Government Act was passed in 1933 certain Local Authorities and Public Corporations had successfully promoted legislation which empowered them to issue bills. A list of these

[1] See also *M.E.* Qu. 1729.
[2] For which see pp. 156–7 below.
[3] The exceptionally heavy gold exports after the abandonment of the gold standard have since permitted liquidation.
[4] Truptil, op. cit.
[5] Cf. pp. 152–3.

corporations and the limits of their respective issuing power is given in Table XXXVIII.

It was thought that Local Authorities whose charters had no special clause permitting them to issue bills were prevented from using this method of borrowing. The Treasury, on its part, opposed any extension of these powers to further Local Authorities. In consequence of this opposition specific powers were only rarely granted by Parliament. The Local Government Act of 1933,[1] however, seemed to remove this obstacle in the way of Local Authorities. Consequently a great number of local and other authorities availed themselves of this exceedingly cheap method of finance. Among these were included: the Government of Northern Ireland, the Corporation of Southampton, the Mersey Docks and Harbour Board, the County Councils of Ayr, Lanark and Midlothian. The bills of these authorities had a currency of six or twelve months. In the times when the volume of other bills was relatively small, especially in 1934–5, they enjoyed a great popularity. The Local Authorities placed quite substantial amounts at rates which compared very favourably with the cost of overdrafts on which they had formerly relied. Some of the Local Authorities, like the Central Government itself, began to consider their bill issues as a part of the normal structure of their indebtedness. The volume of these bills increased considerably and may have reached £30–35 millions.

In the autumn of 1938 the central authorities felt themselves obliged to take control of this new development.[2] The Bank of England intimated that it would consider as eligible for rediscount (hence also as collateral for advances) only those Municipal Corporation bills which it had issued itself. This restricted 'eligibility' to corporate borrowers which 'banked' with the Bank of England and there were at that time only five such Corporations, the London County Council, the Port of London Authority, the Metropolitan Water Board and the Cities of Glasgow and Liverpool. As a result

[1] Cf. p. 149. 23 and 24 Geo. 5, part IX, 215 (1): 'A local authority may, *without the consent* of any sanctionary authority, borrow by way of temporary loan or overdraft from a bank *or otherwise* any sums they may temporarily require.' (*a*) For the purpose of defraying expenses pending receipt of revenues, (*b*) expenses intended to be paid subsequently by means of authorized loan to be raised. (The italics are ours.)

[2] Cf. 'Banks and the Bills of Local Authorities', *The Financial Times*, 19 December 1938; 'Local Authorities and their Bill Issues', ibid. 28 March 1939; *The Economist*, 17 December 1938; Circular letter of the Minister of Health to Local Authorities (22 October 1938).

TABLE XXXVIII. INFORMATION SUPPLIED TO THE MACMILLAN COMMITTEE BY H.M. TREASURY IN APRIL 1929.* LOCAL AUTHORITIES WITH POWER TO ISSUE BILLS

Local Authority	Limit to which power may be exercised £	Maximum currency Months
1. England†		
Birkenhead	500,000	12
Birmingham	500,000	12
Blackpool	300,000	12
Bradford	500,000	12
Bristol	500,000	12
Burton-upon-Trent	100,000	12
Derwent Valley Water Board	500,000	12
Halifax	100,000	12
Hull	200,000	12
Leeds	500,000 (bills and promissory notes)	Not prescribed
Leicester	500,000	12
Liverpool	1,000,000	12
London County Council	2,000,000	12
Manchester	1,000,000	12
Metropolitan Water Board	2,000,000	12
Middlesbrough	150,000	12
Nottingham	200,000	12
Plymouth	100,000	12
Port of London Authority‡	3,000,000	12
Sheffield	500,000	12
Southport	100,000	12
2. Scotland§		
Glasgow	2,000,000‖	Not prescribed
Edinburgh	600,000¶	12
Paisley	100,000	Not prescribed

* It is understood that no substantial changes have since taken place.
† Information only available to 31st March 1928.
‡ Including also bonds and moneys received on deposit.
§ Reference may also be made to Clause 78 of the Dundee Corporation Order 1927, authorizing the issue of promissory notes.
‖ The second million requires Treasury consent.
¶ £100,000 as Gas Commissioners.

of this decision the clearing banks refused to accept these bills in parcels eligible for 'bill money'. Consequently several tenders for new bills of this type failed, including one offered by the Government of Northern Ireland. Northern Ireland bills could, therefore, be issued only at 25*s.* per cent, while United Kingdom Treasury bills were sold at $\frac{9}{16}$ per cent. This wide differential, which incidentally gives one indication of the value attaching to the rediscount privilege, caused a storm of protest. The Bank of England relented and announced that it would, until further notice, redis-

count and accept as collateral bills issued under specific and limited powers[1] provided, first, their currency was less than six months and, secondly, that the borrower had no bills at all outstanding during at least two thirty-day periods in each year. Bills issued under the 1933 Act remained ineligible and hence very difficult to negotiate.

This new regulation, though less open to objection than the first restriction, remains arbitrary; it restricts, apparently permanently, the privilege of borrowing upon the most favourable terms to those corporations which happened to have procured specific legislative power to issue bills before a certain date. An examination of the list of the bodies thus privileged does not suggest that they have been selected upon any logical basis. A more equitable solution of what had become a real problem might have given limited borrowing powers to all Corporations whose obligations enjoy the status of a trustee security, the limit being related to rateable value in each case. The trend in the volume of these bills was in the meantime definitely reversed.[2]

B. Bills of Exchange

We have seen that bills of exchange can be divided into:

(i) Bills accepted by British banks and acceptance houses.
(ii) Bills accepted by other banks.
(iii) Fine trade bills.
(iv) Foreign agency bills.
(v) Trade bills.
(vi) Foreign domiciles.

Only those in categories (i) and (iii) are eligible for rediscount or collateral at the Bank of England. We must also distinguish between inland and foreign drawn bills.

(i) *Bankers' Acceptances.*

Prime Bank Bills. The general principles underlying the use of acceptance credits have been discussed at such length in all relevant text-books that it is unnecessary to repeat them here. It

[1] I.e. it excluded bills issued under powers deemed to be conferred by the ambiguous terms of the Local Government Act of 1933 and reverted to the position as it existed at the time of the Macmillan Report. Cf. p. 149 above.

[2] Some of these bills (especially those of Scottish authorities) are dated to fall due on 31 December. Hence they enjoy some popularity as they assist in window-dressing activities.

may, however, be desirable to describe briefly the different kinds of bills which, after acceptance, may find their way into the market.

Fine British bills[1] may be drawn on the basis of credits[2] granted by: (*a*) the banker of a buyer in favour of a seller, (*b*) the banker of a seller for a seller's benefit, (*c*) the banker of a buyer to a buyer (credits of this type are rather exceptional). There are further the more important (*d*) 'reimbursement' credits. These credits are not given directly to customers but to other foreign banks which guarantee their clients to the London bankers. The foreign banker opens the credit for his client and authorizes him to draw on the London acceptor, charging a commission for his guarantee. The commission paid to the London banking house is accordingly smaller.[3] Acceptance credits are granted either against the collateral security of the goods, the transport or holding of which is financed, or without such security (so-called 'clean' credits). In the former case the goods, as represented by documents (bill of lading, warehouse receipts, etc.), remain in the possession of the creditor until the redemption of the bills has been provided for by the debtor. If the debtor fails to pay, the creditor has recourse to the sale of the goods to cover the debt or at least a part of it.[4]

Before the last war the straight acceptance credit granted to merchants and manufacturers predominated. Reimbursement credits were relatively rare except in certain special areas such as Scandinavia and South America.[5] It appears, however, that there was also a substantial volume of finance bills in circulation (accommodation bills or kites) which were drawn, not to finance the movement of goods, but to raise money. Sir R. Kindersley thought[6] that of the £350,000,000 of prime acceptances outstanding in 1913 60 per cent were finance bills. He thought, however (in the beginning of 1930), that in the post (1914) war years a more severe

[1] The rate of interest on fine bank bills is at the moment identical with that on the Treasury bill. Prior to 1931 there was an exceptionally heavy demand for these bills, as certain Central Banks which held substantial reserves in London were precluded by their statutes from purchasing any but two- or three-name paper. Cf. *M.E.* Qu. 1796.

[2] A credit may be granted for a single transaction or it may be a revolving credit under which the client has the right to draw as many times as may be convenient up to a maximum amount.

[3] Kindersley, *M.E.* Qu. 1165.

[4] The portfolios of the Midland Bank (which may not have been quite typical as they specialized in buying commercial bills) originated in 1929 as to 35 per cent from exports and imports out of and into the U.K., as to 24 per cent Empire trade and 41 per cent trade between foreign countries. Hyde, *M.E.* Qu. 947.

[5] *M.E.* Qu. 1175.

[6] *M.E.* Qu. 1273.

scrutiny was exercised and that the proportion of pure finance bills was accordingly lower.

During the latter period reimbursement credits gained considerably in importance. They were thought to be specially safe,[1] and as the foreign banks provided the expert service of scrutinizing names they were more suitable for direct purchase by the joint-stock banks which were now competing actively in this field. The growth of their 'half-commission' credits undoubtedly created a serious problem for the acceptance houses.[2] The controversy between Sir R. Kindersley and Mr McKenna before the Macmillan Committee showed[3] that even before the war the acceptance houses were apprehensive about the repercussions of this competition which reduced the average level of the acceptance commission from over 1 per cent per annum to not much more than ½ per cent. This commission obviously did not permit the accumulation of reserves commensurate with the risks undertaken. And while this was not a serious matter for the joint-stock banks who could accumulate reserves out of their earnings on other business—their acceptances hardly amounted to 50 per cent of their capital and surplus—for the acceptance houses this fall might well have been fatal, for they frequently accepted bills up to four to six times their capital and reserves.[4] That the commission charged in the period 1925–31 was not commensurate with the risks involved has been fully demonstrated by the experiences of big banks and acceptance houses alike during and since the world crisis.

A small commission on acceptance credit is reasonable only if it can be assumed that the risk against which the acceptance insures the holder of a bill is that of the failure or default of an *individual* customer of the acceptor. With first-hand knowledge of his customers, the acceptor is able to take reasonable precautions, and as he deals with many customers in different trades he is able to rely upon the law of averages. But the events of 1931 and of subsequent years have shown that the risk being carried since 1914, at half or even less the price charged in the pre-1914 days, was that of the imposition of embargoes on foreign payments and of exchange controls which blocked payments on commercial debts by many

[1] *M.E.* Qu. 950.
[2] Cf. in the preceding Part.
[3] *M.E.* Qu. 1161–84.
[4] Cf. the Section on Acceptance Houses. Sir R. Kindersley set the limit at three to four times the capital (*M.E.* Qu. 1204). The published balance sheet of one of the great firms suggests that this was not a rigid rule, at any rate not as far as the published capital was concerned.

countries simultaneously, including some of the largest commercial borrowers in London. The foreign exchange devices adopted since 1931 by many countries have involved the immobilization of a very substantial amount of acceptance credits of all kinds. Some £80 millions of short-term credits were frozen in Germany alone. The so-called Stillhalte (moratorium) Agreements were entered into with German debtors whereby the credits were extended[1] and the German representatives succeeded subsequently in obtaining progressively better conditions. Most of the frozen credits before the 1939–45 war no longer represented commercial transactions, and efforts to 'recommercialize' them were not successful and would in any case have been unavailing. The German short-term debt is stated to have diminished through repayments made in the later years of the Stillhalte Agreements and on account of the depreciation of creditor currencies from 13·1 milliard marks in July 1931 to 6·3 milliards in February 1936. Moreover, in an attempt to retain some of their business the English creditors have, under the Stillhalte, allowed some of the unused credit lines to be utilized, and the amounts outstanding on this account have declined only very slowly until the outbreak of hostilities. Most of such decrease as did take place was due to the operation of the so-called 'registered mark' system and special transactions. Under this system blocked marks (primarily accruing from interest) could be sold and utilized for certain prescribed purposes (especially facilitation of additional German exports and tourist trade, the latter being about 60 per cent of the total). Registered marks were quoted at an increasing discount (at the end of 1938 at Rm. 27 against the £ as compared with the official rate of about Rm. 11·70).[2] Not all banking firms suffered a loss of this proportion. Their special deals, involving in most cases a stimulus, if not subsidy, to German exports, enabled them to recoup themselves—at least in part—for their losses. The commission rates charged on these acceptances could not be increased. Most of them were held by the acceptance houses themselves.[3] The policy of individual houses with respect to credits to Germany differed considerably. A few firms liqui-

[1] A more detailed description of the Stillhalte agreements, cf. Harris, *Germany's Foreign Indebtedness*, Royal Institute of International Affairs (1935), pp. 22–31 and 75–82.

[2] In the last two Stillhalte agreements before the war the creditors had to accept an admixture of 'Degomarks' (special Gold-Discount-Bank marks) with the 'registered marks'. These Degomarks were created by the Reichsbank to acquire additional foreign exchange.

[3] Cf. Section on the volume of bills, p. 165.

dated their credits completely. Others hardly reduced their credit lines.

Foreign Agency Bills. The Bank of England excludes from rediscount and collateral privileges any bill which is not accepted by a first-class British name and which does not carry another sound British endorsement. The bills endorsed by agencies of foreign banks, however good their names, are usually discounted at a higher rate of interest than prime British bank bills. The difference used to be about $\frac{1}{16}$ per cent. Brokers sometimes added them to parcels which contain a greater (75 per cent and upwards) proportion of rediscountable paper, in which case they were usually taken at the prime rates. In times of plentiful money, however, these bills were usually discounted at the prime bank bill rate. In the 1930's practically the only foreign agency bills on the market were the acceptances of the London branches of the great American banks. At one time (pre-1914) the German and later the French agency bills played a considerable role in the market.[1]

Bills drawn on banks which, though British, do not comply with the rule of the Bank of England concerning domicile and geographical distribution of assets have the same status as agency bills; they are eligible neither for rediscount nor as collateral. They were usually—and more especially since there was a shortage of bills—treated as British bank acceptances. The most important of these bills were the Far Eastern and Indian bills. These were usually discounted in the market or sold to banks through a running broker specializing in the handling of these bills. The broker would often sell these bills for forward delivery, the market only knowing that the bill will be accepted or endorsed by a certain bank. Discount houses were quite glad to secure a good supply of bills forward. Clearing banks, which often bought agency bills through the running broker without first waiting on their being discounted in the market, usually did not buy forward. Australian and certain other Dominion banks did not as a rule rediscount. They used their London reserves to carry bills which came into their own possession.

(ii) *Fine Trade Bills.*

The acceptances of certain firms other than banks have been admitted by the Bank of England to rediscount and collateral privileges. Bills accepted by these firms rank with prime bank bills. Large merchant and manufacturing companies such as Unilever,

[1] Cf. the reports of Sir Wm. Plender, op. cit.

Imperial Chemical Industries, Lyons and the Union Cold Storage could be quoted as examples.

A subdivision of these bills consisted of the so-called shipbuilding bills drawn by the shipbuilder on the future owner.[1] These bills usually had a currency of six months. They seem to have been rediscountable at the Bank though the Bank was 'not keen' on them.[2] The rate of interest charged on them was ½ per cent above the fine bill rate.

(iii) *Hire-purchase Paper.*

Bills originating in hire-purchase agreements are a new category whose importance grew steadily until the 1939–45 war. While such agreements were not unknown before 1914 and were common, for example, in the finance of privately owned railway rolling stock, a considerable expansion in their volume was experienced in the inter-war period. Very little is known about the methods of finance employed and about the volume of bills arising from it.

It seems that most of the original bills never reached the market at all.[3] Some of the hire-purchase companies were financed directly by insurance companies which have taken an interest in them, while the British subsidiaries of American hire-purchase companies which operate in this country were financed by their parent institution. Others were financed by clearing banks through advances and some by acceptance houses in the form of acceptance credits. In such cases new acceptances are made out, the original bills, signed by or on behalf of the consumer, being deposited as collateral. For some time many banking houses viewed consumers' finance with disfavour, but the public approval given by the Bank of England to the system of hire purchase[4] largely overcame this initial prejudice.

The most important of the hire-purchase firms was the United Dominions Trust. It was registered as a private company in 1922 and became a public company in 1925. Under the management of Mr J. Gibson Jarvie this institution has had a remarkable growth.[5] Its financial policy has been extremely conservative and

[1] Cf. Foa, *M.E.* Qu. 1715–17. [2] *M.E.* Qu. 1722.

[3] This is probably a contributing factor in the growing discrepancy between the total volume of bills stamped, and the volume of bills coming on to the market. Cf. below.

[4] Cf. Part III, p. 301.

[5] Its later initiative in the field of medium-term finance will be dealt with in Part III, 'Other banking institutions'.

it has succeeded in accumulating substantial reserves.[1] It had branches in principal provincial cities and was represented in most industrial centres. In 1930 the Bank of England participated in this concern by taking over £250,000 of £2 shares. The greater part of this holding was sold to the common stockholders in 1936 and 1937. The U.D.T. had (1938) five subsidiary companies.

Two other companies in this field were the Mercantile Credit Co. and Bowmaker Ltd. The former was the result of a merger of several hire-purchase finance companies and continued its expansion by obtaining controlling interests in others. Its capital amounted to £442,800 in 1938; published reserves were £100,000. Bowmaker Ltd. first established itself in Bournemouth. It acquired a London office and branches all over the country. It controlled (1938) three subsidiary companies, one of which operated in the Irish Free State. Its paid-up capital was £1,093,750, and published reserves amounted to £175,000. The consolidated balance sheets of the three groups showed the following items:

Liquid assets of hire-purchase finance firms (in £1000)

	Cash	Hiring agreements and bills	Loans	Total
U.D.T. (30 June 1939*)	1.058	7.902	529	9.764
Mercantile	72	2.974	10	3.056
Bowmaker (31 Oct. 1938)	283	2.654 and 1.123	—	4.268

* Except for U.D.T. Corp. (South Africa) the last balance sheet of which is dated 31 March 1939.

The scope of internal hire-purchase finance was not restricted to durable consumers' goods such as motor cars or radios. Such goods as cinema equipment could also be financed through these companies. They also provided funds for improvements in land and buildings, including private houses. In the past they provided a certain amount of finance for the purchasing of livestock, but this business seems to have been restricted by the legislation controlling hire purchase which came into force on 18 January 1939.[2]

The volume of hire-purchase bills outstanding sold to the discount market was relatively small before the 1939–45 war. It has been estimated at not more than £30 millions. But no estimate is possible of the volume of bankers' acceptance credits granted to

[1] The capital paid up amounted to £1·1 millions of which £500,000 were cumulative preference shares. Reserves reached £1,350,000. A considerable part of this was obtained by an issue of ordinary shares at a premium.

[2] Cf. Chairman's Speech, Bowmaker Ltd. 1938.

hire-purchase finance companies. The Macmillan Committee (paras. 394–5) was satisfied that the facilities for financing hire purchase in the United Kingdom were adequate. The work of the companies which have been referred to above was facilitated by the fact that bill brokers were usually willing to endorse hire-purchase bills, and they in their turn were helped by the existence of the Trade Indemnity Co. with which they frequently reinsured themselves. This company not only guaranteed to make good losses arising in connection with endorsements up to 75 per cent, even in cases of fraud, but also undertook prosecution.

(iv) *Export Credits Guarantee Department.*

A scheme for export credits was first instituted in Great Britain in 1919. It was originally an attempt to foster trade with those countries with which trade had been impossible during the war and provided only for advances to exporters which were to be repaid when they obtained payment from a foreign buyer.

This scheme was modified in 1921 and the first *guarantee* scheme was initiated. Under it the system of advances was discontinued and the Export Credits Department of the Board of Trade was authorized to endorse bills drawn by British exporters on foreign purchasers. The department retained partial recourse against the drawers of bills which it endorsed. In certain cases it also undertook to guarantee other forms of credit. This guarantee took two forms. The department might determine for each exporter the total amount of guarantees which he might have outstanding at any moment in respect of trade with specific countries. Within this limit, the department guaranteed for a fixed period all credit sales by the British exporter to those countries on condition that the duration of the credits should not exceed six months with an option to renew for a further six months. The department did not require any collateral deposit in respect of these credits.

The guarantee might take another form. It might cover specific transactions and not the whole credit business of an exporter. In this case, the department's guarantee usually covered 100 per cent of the face value of the bill of exchange if the length of the credit did not exceed twelve months, and up to 85 per cent of the face value if the credit was for longer than that period.

This scheme also provided for suitable co-operation between the Export Credits Department and private firms conducting similar types of business. The Government, in effect, offered to

reinsure risks undertaken by such institutions in financing foreign trade up to 70 per cent of the face value of the risk. Private institutions, however, refused to co-operate and agreed only to recommend to their clients that they should apply to the department for cover in cases where private firms were unable to give it. This of course left the department with only the worst risks. The losses suffered were rather heavy.

In 1925 a Committee was set up under the chairmanship of the late Major J. W. Hills, M.P., to reconsider the position and to report on the advisability of continuing Government-guaranteed export credits. This committee recommended the maintenance and extension of the existing facilities. The work of the department was completely reorganized in 1926, new methods were adopted, and its name was changed to the Export Credits Guarantee Department. The new scheme provided for a contract (Contract A) between the department and the exporter. The former was thus able to concentrate on specific risks and define the terms under which it was prepared to extend its guarantee. It was not bound by its endorsement on bills. The amount of credit which could be guaranteed to any foreign purchaser was fixed (this the department was able to do because, through the agencies of the Department of Overseas Trade stationed abroad, it could obtain reliable information about the credit standing of foreign importers). Within this limit the department guaranteed all the bills outstanding, and if a bill was not paid on maturity, agreed to pay on demand to the exporter up to 75 per cent of its face value. A variation of this type of contract embodied a clause stating that, in the case of irregularities, the creditor would have to bear responsibility. This latter type of contract was abandoned in 1930 when there was again a reorganization of the work of the department. The drawback of this scheme was that it limited business to transactions financed by bills and to individual transactions.

The work of the department was again reviewed in 1928 by a Committee consisting of Sir Otto Niemeyer, the late Col. the Hon. Sir Sidney Peel and Lord Plender. This Committee reported in favour of continuing what they then still termed an 'experiment' in credit insurance.[1]

[1] On the significance of export guarantees of this type and their development, cf. 'Foreign Trade and Exchange Policy', *Economic Journal*, March 1940 and *Foreign Trade Finance*, Memorandum to a Conference organized by the Joint Committee of Nuffield College Social Survey, the Institute of Statistics, Oxford University, and Foreign Research and Press Section, R.I.I.A., November 1942.

The main features of the schemes in force before the war which were introduced in 1930 may be briefly outlined. Nearly two-thirds of the business done by the department was carried out under the terms of its standard comprehensive policy. This was an agreement whereby an exporter agreed to place all his business with the department. In order to enable the department to quote a premium, the trader was asked to furnish statistics of his trade during recent years and his losses and other relevant information. The applicant for the guarantee could either pay a premium based on the assumption that he would receive from the department 75 per cent of all losses covered by the policy, or a reduced premium in consideration of the exporter bearing a first loss calculated with reference to his past experience, the department being responsible for 75 per cent of all losses in excess of this amount. In either case, the maximum liability of the department was determined by reference to the average annual total turnover of the exporter and was usually large enough to cover all probable contingencies. Further, under this policy the exporter was usually permitted to grant credit without the specific prior approval of the department in order that he might take advantage of urgent orders.

Transfer risks could be insured under a separate policy and the premiums quoted varied for different countries. Payment of 75 per cent of the total amount due was made by the department six months after the debt normally became due, provided that all exchange regulations had been complied with. This cover was only available to exporters who insured the whole of their business under the comprehensive policy. Transfer guarantees were usually granted only for four months, but they were in exceptional cases extended to six months. The premium due was usually recalculated on a three-monthly basis.

Exporters who did not wish to take advantage of the comprehensive policy could obtain guarantees to cover specific transactions, and the rate of premium charged varied with each individual transaction. The guarantee was usually limited to 75 per cent of the total amount.

The Export Credits Guarantee Department also undertook special work in connection with exports to Soviet Russia and to Turkey. The Russian scheme, which was instituted in July 1936, was a departure from the previous practice of the department. Under this scheme the Russian Government agreed to place orders in Britain for purchases of British goods up to a total value of £10

millions. The money was to be obtained by issuing notes of the Soviet Government in sterling at par, bearing interest at 5½ per cent per annum and repayable at par five years after the date of issue. These notes were issued by the Soviet Government to the Export Credits Guarantee Department which endorsed them, thereby placing the guarantee of the British Government on them, and sold them in the London market. The face value of the notes was then paid to the Soviet Government and was used for the purchase of British exports. Any premium obtained on the sale of the notes accrued to the Export Credits Guarantee Department. In connection with this scheme the department guaranteed to pay the British exporters taking advantage of it the full amount of the Russian debt to them within thirty days of shipment, provided that the necessary papers were in order. A similar scheme was instituted with Turkey in 1938.

The department from time to time also undertook to guarantee medium-term credits up to a maximum currency of ten years. The usual period for such credits was about five years, and they did not form a very large part of the department's business. They were, however, of considerable assistance to certain British exporters engaged, for example, in construction work in foreign countries in cases where the work, and consequently the period of payment, extended over a period longer than that normally covered by export credit facilities.

Until 1938 the department was run on a strictly profit-making basis, and it was able to transact business in spite of the existence of private firms because the scale of its operations and the assistance which could be placed at its disposal by the other departments of the Government, and particularly by those which maintained British representatives abroad, permitted it to insure risks which private firms could not touch. In 1938 it was decided that the business of the department should be extended and the limit to the amount of guarantees which might be outstanding at any one time was raised from £26 to £50 millions. It was announced further that the department might in future undertake to assist British exports on terms which were not calculated on a strictly commercial basis. The purpose of this change was to enable credits to be given to certain eastern European countries in an endeavour to build up British trade connections with that area and thus to counter the economic penetration by Germany. This had been undertaken with the help of a combination of expedients such as

the operation of its clearing agreements with those countries, straight export subsidies and a consistent over-valuation of the mark. The new arrangement also permitted guarantees to be made to cover payments in local currency of not more than 25 per cent of the total value of the consignment. At the same time, it was decided to extend the medium-term credit scheme to cover the building of ships in Great Britain for delivery to foreign purchasers, provided that there was reason to suppose that the ship would not be built in Great Britain without the aid of guarantees and that, if it were not built in Great Britain, it would be built elsewhere.

The total value of British exports covered by the guarantees expanded considerably after 1930. In the financial year 1933–4, for example, the total value of British exports covered by the guarantees was about £7½ millions, or less than 2 per cent of the total of British exports, whereas, in the financial year 1936–7, the value of the guaranteed exports was £35 millions, or more than 6½ per cent of the total of British exports.[1] If it failed to counter the threat inherent in collectivist foreign trade methods, this was because it had been called upon for a service which it could not perform.

The export guarantees were used as collateral both for advances and acceptance credits. The discount market also often demanded the deposit of the insurance cover when discounting trade bills. No estimate is possible with respect to the volume of bills negotiated on the basis of such guarantees. The rate of interest (or acceptance commission) was usually lower on credits covered by export guarantees. The increasing influence of the activities of the department indicated a growing realization of the change in foreign trade and thus of the risks connected with it as contrasted with the nineteenth century. The shift in risk-bearing to a public institution, hence ultimately on the Government, did not restore the importance of the bill as an instrument of the finance of foreign trade.

(v) *Trade Bills*

Other trade bills, i.e. bills of exchange which were not accepted by a bank or an important concern, are not eligible at the Bank for rediscount or advances. They were in part directly discounted with clearing banks by their clients in which case they never reached the market.[2] This proportion seems to have been growing in the last

[1] For further details see an article by Mr F. H. Nixon, the General Manager of the Department, in *The Banker*, February 1939.

[2] Especially the Midland Bank. Cf. *M.E.* Qu. 937. It seems that the Midland also bought prime acceptances directly. Cf. previous subsections on the consequences of this practice.

decades. Frequently they were negotiated with certain discount houses and acceptance houses, e.g. Hambros' Bank and William Brandt, specializing in the finance of trades still using this method of raising money. Such trades were, in the last decade, timber (usually four months' bills), wool, leather, rubber, tea and fur (six months' bills). These bills can be divided into wholesale and retail bills. The former, if the firms were well known, carried a rate from about $\frac{1}{8}$ per cent above the rate for fine bills. The others were anything between $1\frac{1}{4}$ and 3 per cent above the fine bills. The rate of interest also depended upon whether the firm discounting it had good connections with, and knowledge of, the market. Timber bills, for example, were usually sold at very favourable rates. To a small extent such bills could be included in parcels sold to banks at the fine rate when there was a bill shortage.[1] On these occasions the billbrokers earned a handsome 'turn'.

(vi) *Foreign Domiciles.*

Foreign 'domiciles' do not properly belong to the material negotiated on the discount market. They are bills drawn on foreign names made payable in London. Before the 1914–18 war[2] such bills were negotiated in London in small quantities. Since then they have not been bought by banks and bankers in London. They were mostly discounted with foreign banks at rates which were very much higher than those current in the market.

CHAPTER 11. *THE VOLUME OF BILLS*

A. Commercial Bills

(i) *General.* No official statistics on the amount of bills of exchange outstanding have been published. Messrs Jessel, Toynbee and Co., however, have evolved an indirect method of estimating the volume of bills of exchange actually drawn.[3] This estimate is based on the fact that all bills have to be stamped and that the Commissioners of Inland Revenue publish separate annual returns of the amount received for stamp duties for inland and for foreign bills. The stamp duty on bills is $\frac{1}{2}$ per mille, and by assuming that

[1] The Westminster, Barclays and the Midland were said to have purchased such bills.

[2] Cf. Truptil, op. cit. p. 257.

[3] The method has been further developed by *The Economist*, 26 March 1938, p. 689, and 14 May, p. 366.

the average currency of all bills stamped is three months, it is possible to estimate from the stamp duty receipts the total volume of bills outstanding.[1] An estimate made on this basis includes promissory notes, instalment paper, etc., as well as purely local bills drawn as collateral, etc. It is therefore not possible to estimate from the figures available the volume of the bills available to the London market. Apart from this the most serious technical objection against the use of this method is that, the duty being by shillings, a bill of £101 attracts the same duty as a bill of £200. This does not, however, detract from the importance of the method in indicating the trend and cyclical fluctuations in the volume of bills outstanding.[2] There are several other drawbacks. A proportion of bills, including even some fine trade bills, have a longer life than three months, which results in further inaccuracy in the opposite direction. For the years 1915–30 a further substantial correction must be made. During these years a substantial volume of a particular type of war debts was outstanding, and it was a condition that it should be collateralled by the deposit of special bills which had to be stamped. The Commissioners for the Inland Revenue have now disclosed the stamp duty paid on these bills, so that by subtracting this amount from the total figures, a better picture can be obtained of the trend of the volume of ordinary bills. The results obtained by these methods are set out in Table XXXIX.

The fluctuations in the volume of stamped commercial bills until 1931 followed closely the cyclical movement of business activity. The trend in terms of nominal sterling value is upwards, with a sharp interruption during the 1914–18 war period. The pre-war peak of 1913–14 was approximately £500 millions. In 1919–20 the volume of bills indicated by this method reached £600 millions, in 1925–6 £633 millions, and in 1928–9 £563 millions. If changes in the general level of prices on the one hand and the increase in banking figures on the other are allowed for,[3] it is seen that the total bill circulation did not recover its former relative importance. 1913–14

[1] The separation was introduced in 1902–3. Gross figures exist since 1848. Small bills of exchange, etc. were stamped differently, the duty varying from 2*d.* for bills under £10 to 9*d.* for bills between £50–70. Such bills, however, formed a small portion of the total as did foreign domiciles (cf. above) which attracted half the ordinary rate.

[2] Professor Clay believes on the basis of 'other indications' that the volume of bills in the London market is about half of the amount indicated by stamp duties. This independent estimate thus confirms the results of the following calculations. Cf. below on some factors tending to increase the discrepancy.

[3] Cf. *League of Nations Monetary Review*, 1938–9, p. 101.

TABLE XXXIX. BILLS OUTSTANDING (YEARLY AVERAGES)
(Amounts are stated in £ millions)

Fiscal years	Inland-drawn bills*	Foreign-drawn bills*	Fiscal years	Inland-drawn bills*	Foreign-drawn bills
1918–19	114	192	1928–29	198	365
1919–20	202	322	1929–30	203	317
1920–21	272	334	1930–31	172	268
1921–22	180	234	1931–32	142	186
1922–23	188	241	1932–33	111	136
1923–24	199	281	1933–34	111	134
1924–25	218	365	1934–35	119	134
1925–26	218	415	1935–36	121	138
1926–27	191	302	1936–37	133	143
1927–28	193	315			

* These bills might be drawn both for export or import purposes. They are not necessarily 'inland bills'. Cf. Part III, p. 230, on the mechanism of acceptance credits.

remains the relative peak year. Taking the figure for this year as 100, the corrected figures for the two post-war peaks in 1925–6 and 1928–9 are both approximately 80. While bills declined in relative importance, deposits at the joint-stock banks increased between 1913 and 1929 from £809 to £1,858 millions. The declining long-term trend of the bill of exchange does not date from 1913–14, however. It was a phenomenon (though then connected mainly with the decay of the internal bill) which originated in the middle of the last century and has continued, with an interruption between 1900 and 1914, ever since. Palgrave[1] estimated that between 1856 and 1876 the increase in the volume of bank deposits was about double that of bills of exchange. King[2] adduces this fact to explain the recurrence of complaints about the prevalence of bad bills which had been too easily placed. This trend continued after 1876. Palgrave thought that the volume of bills had further declined from £300 to £350 millions in 1873 to about £300 millions in 1902. King states that experts put the volume of bills at the outbreak of the war in 1914 at not more than £325–350 millions. The estimates on the basis of the revenue returns suggest, however, that between 1900 and 1914 the volume of both inland- and foreign-drawn bills increased steadily, the former from £127 to £165 millions, the latter from £207 to £335 millions and the total from £334 to £500 millions or almost exactly 50 per cent. The growth of deposits, during the same period, as reported by *The Economist*

[1] Op. cit. [2] Op. cit. p. 288.

in its banking supplements, was from £587 millions to £809 millions, which is only 35 per cent.

The volume of the stamped inland-drawn bills fluctuated relatively little and did not show a sharp drop during the war years, but it did not recover as vigorously as foreign-drawn bills after the war. The great depression of 1929–32 affected the volume of both foreign- and inland-drawn bills, the former far more seriously than the latter. The decline in the nominal value outstanding was more than 50 per cent, and the recovery in trade which in 1937 restored international trade to the pre-depression volume hardly improved the volume of bills. Up to the end of the financial year of 1936–7, the volume of internal bills increased by just 20 per cent and that of foreign-drawn bills by less than 10 per cent. It must not be forgotten, moreover, that the Standstill agreements probably prevented an even greater shrinkage in the volume of nominally outstanding foreign-drawn bills.[1]

(ii) *Bankers' Acceptances.* The great importance of bankers' acceptances renders a special investigation of the fluctuation of their volume advisable. It has been estimated that the total of bankers' acceptances outstanding before 1914 was something like £350 millions. This estimate includes the paper accepted on behalf of Dominion, Colonial and foreign banks (prior to the war the most important German banks had branches or agencies in London and were extremely active in this respect[2]); acceptance credits to Germany at the outbreak of war in 1914 have been estimated at £70 millions, rather more than at the outbreak of the international credit crisis in 1931, when the volume of short-term credits was put at £64 millions, out of which £53 millions were in the form of acceptance credits.[3]

Clearing Banks. No current statistics are published of the total volume of the clearing banks' acceptances. The Macmillan Committee gave figures for the years 1920–30.[4] This series shows a pronounced seasonal variation. The peak is reached in the first few months of each year. The volume then usually declines and

[1] Cf. section on bankers' acceptances. They were not often, however, discounted in the market. Possible reasons for these changes, including such phenomena as the extension of exchange clearing on the one hand and of 'futures' foreign exchange facilities, will be discussed below. Cf. above on the change in the character of the bills outstanding, especially the increase in importance of the clean reimbursement credits after 1925. Cf. also p. 65, n. 2.

[2] Cf. Part I and preceding subsection.

[3] The Hon. R. H. Brand, letter to *The Times*, 22 January 1935.

[4] *M.R.* Appendix I, pp. 284–301. Cf. Table, Appendix II.

the minimum is reached in midsummer. Then it once more increases.

From the high figure of £110·7 millions early in 1920 the volume of acceptances granted by the clearing banks declined to £29·4 millions early in 1921. The next peak was in January 1925 with £78·9 millions, and after a small decline it rose to £86·5 millions early in 1929. By 1931 it had shrunk (again in the month of January) to £50·2 millions.

Only some of the clearing banks differentiate at present between acceptances, confirmed credits and other guarantees on behalf of their customers. Those which do, Lloyds, Martins and the Midland,[1] show very dissimilar movements. M. Truptil attempted to derive an estimate for the clearing banks as a whole by comparing the published figures for total acceptances and engagements with the Macmillan Report figures. He found[2] that for the years analysed in that report acceptances proper amounted to 4 per cent of total engagements on behalf of clients. On that basis he estimated the acceptances of joint-stock banks as shown in Table XL.

TABLE XL. ACCEPTANCES OF JOINT-STOCK BANKS

(Amounts are stated in £000's)

	Ten clearing banks	Six Scottish banks	Total
A. The Macmillan Report statistics			
1927 June	48,650	3,540	52,190
Dec.	53,140	4,320	57,460
1928 June	62,410	3,610	66,120
Dec.	83,350	4,810	88,160
1929 June	74,530	4,640	79,160
Dec.	66,620	4,950	71,570
1930 June	59,310	3,850	63,160
Dec.	51,750	3,930	55,680
1931 Mar.	47,410	3,050	50,460
B. Truptil's estimate for 1931–4			
1931	42,900	4,100	47,000
1932	37,500	4,000	41,500
1933	47,500	5,200	52,700
1934	51,200	7,100	58,300

He thus derived the series (Table XLI) for acceptances granted by joint-stock banks outstanding at the end of each year.

[1] Only in the monthly average statements.
[2] Op. cit. p. 259.

TABLE XLI. BANK ACCEPTANCES

(Amounts are stated in £000's)

	Ten clearing and six Scottish banks	Others	Total
1927	57,500	1,360	58,860
1928	88,200	2,060	90,260
1929	71,600	1,670	73,270
1930	55,700	760	56,460
1931	47,000	700	47,700
1932	41,500	600	42,100
1933	52,700	700	53,400
1934	58,300	2,200	60,500

It is tempting to continue this series. Unfortunately doubts arise as to whether M. Truptil's method gives correct results, even for the years 1931–4. For later years the risk of error becomes almost a certainty. Table XLII shows the evolution in certain years since the publication of the Macmillan Report of the relevant items in the balance sheets of the Big Six banks. This shows clearly that (i) the book-keeping practice is different in different banks, and (ii) that the inclusion of forward exchange transactions[1] makes any estimate of the volume of acceptances which depends upon figures relating to gold-standard days particularly liable to be misleading, for since 1931 forward exchange transactions have increased very much. Nor can we control our estimate of the total volume of acceptance credit granted by the big banks by relying upon the figures of those banks which publish their own acceptance figures separately. There is not sufficient uniformity in these figures to enable us to extrapolate from the figures of the banks which do publish the probable total of all banks. A comparison of the figures of Lloyds and the Midland Banks, both of which publish their acceptances separated out from other engagements, indicates the large degree of difference that may be concealed in the figures of those banks which publish a single figure to include both these items. Between 1929 and 1934 Lloyds' figures for 'other engagements' fell from £46,172,000 to £42,351,000, a fall of approximately 8 per cent.

[1] E.g. the Midland Bank expressly excludes forward exchange transactions (amounting to some £18 millions on 31 December 1930) from its balance sheets. Lloyds Bank apparently includes these contracts. Other banks seem to exclude it, but do not give information on the point. Barclays seems to have changed the book-keeping practice in 1939 (cf. Chairman's speech), which explains the greater part of the substantial increase in the last balance sheet. It is not known whether forward transactions are now included.

The Midland figures fell from £17,604,000 to £6,407,000 or by well over 50 per cent. During the same period the acceptance figures of both banks fell by rather more than 50 per cent. If we

TABLE XLII. BANK ACCEPTANCES

(Amounts are stated in £000's)

Bank	Date	Acceptances	Other engagements	Total deposits
Midland	Dec. 1929	19,741	17,604*	394,897
	Dec. 1931	9,235 (lowest 6,998 June 1932)	10,093 (lowest 5,282 July 1932)	357,560
	Dec. 1934	9,794	6,407	424,746
	Dec. 1936	10,683	7,414	498,922
	Dec. 1938	8,893	8,518	468,261
Barclays	Dec. 1929	22,571		332,576
	Dec. 1931	11,224 (lowest 5,081 August 1932)		333,405
	Dec. 1934	7,111		378,910
	Dec. 1936	9,396		424,295
	Dec. 1938	15,579		429,299
Martins	Dec. 1929	3,618	3,397	81,751
	Dec. 1931	1,381	3,059	75,451
	Dec. 1934	2,229	2,389	81,974
	Dec. 1936	2,486	4,971	93,087
	Dec. 1938	2,902	5,564	99,135
Lloyds	Dec. 1929	8,561	46,172	350,173
	Dec. 1931	2,719	32,492	331,860
	Dec. 1934	3,684	42,351	366,413
	Dec. 1936	3,844	28,581	399,899
	Dec. 1938	2,756	34,557	391,875
National Provincial	Dec. 1929	15,168		266,193
	Dec. 1931	9,119		256,518
	Dec. 1934	5,848		290,197
	Dec. 1936	8,294		315,770
	Dec. 1938	8,284		305,271
Westminster	Dec. 1929	28,346		279,476
	Dec. 1931	18,836		269,195
	Dec. 1934	38,059		300,270
	Dec. 1936	21,536		363,974
	Dec. 1938	26,220		348,388
District	Dec. 1936	6,968		77,559
	Dec. 1938	9,389		82,076

* In the previous month shown as £60·6 millions.

had detailed figures for the Midland, but not those for Lloyds, and attempted to generalize from the former, the conclusion drawn would be wholly erroneous. If we had Lloyds' figures, and based our calculations on those, we should make an even larger error in the opposite direction. The number of banks is so small, however,

that the assumption that errors of this kind would cancel out is unwarranted.

From other evidence it seems clear that M. Truptil's estimate of acceptances by the clearing banks at £57 millions for 1934 may be too high. If we attempt to estimate a figure by using not the Macmillan Report figures and those of the banks' balance sheets but figures for total bills in circulation, which fell by about 50 per cent, we get only £35–40 millions for the acceptances of all clearing banks. In reaching this figure an allowance is made for the important part which reimbursement credits have played in the acceptance business of the clearing banks with foreigners,[1] and for the fact that this kind of business has been even more severely hit than credits granted indirectly. On the other hand, allowance must be made for the fact that the clearing banks seem to have granted relatively more internal acceptance credits than the acceptance houses.[2] By 1937 the volume of their acceptances may have amounted to £40–45 millions. This guess, rather than estimate, is based on the fact that clearing banks in certain cases rediscount for their own customers.

Acceptance Houses. Even the Macmillan Committee did not publish statistics of the total volume of acceptances granted by the acceptance houses. We have, however, statistics of their acceptances granted to foreign customers. M. Truptil arrives at the volume of their total acceptances by assuming that their inland credits were 10–15 per cent of the total. He derives from the published figures the following figures (in £ millions) for total acceptances:[3]

	Acceptances to foreign customers	Total acceptances
1927	108	124
1928	149	170
1929	136	155
1930	125	143

However justified this procedure may be for a period of comparative calm, it seems somewhat precarious for the period after 1930. Since the Great Depression the acceptance houses[4] made

[1] *M.E.* Qu. 760–2, Goodenough's evidence. See also Table 9, Appendix I of the Macmillan Report.

[2] M. Truptil puts the internal credits of the acceptance houses at 10–15 per cent against more than 30 per cent of the clearing banks (*M.R.* Tables 9 and 11).

[3] Truptil, op. cit. p. 160.

[4] Cf. Part III below on this point.

very real efforts to reintroduce the inland bill into the British credit structure. Although these efforts do not seem to have been strikingly successful, it must be remembered that in the period in which they were being made the proportion between stamped foreign- and inland-drawn bills changed from approximately 2 : 3 to approximately 1 : 1 (see Table XXXIX, p. 167). The change in this proportion suggests strongly that there must have been substantial changes in the character of the acceptance business in some parts of the market, and that it is particularly unsafe to rely during this period upon proportional figures deriving from an earlier period.

There are further and even more formidable obstacles in the way of arriving at an estimate of the volume of acceptances outstanding on the basis of the published figures of seven houses (Baring, Hambro, Erlanger, Ruffer, Japhet, London Merchant Bank and Grace). By using these figures M. Truptil continues his series thus (in £ millions):[1]

	Total acceptances of acceptance houses
1931	92
1932	80
1933	79
1934	80

This estimate is not out of keeping with the estimates published on the basis of revenue statistics of the fluctuations in the volume of total bills outstanding and of foreign-drawn bills. But as the balance sheets of those acceptance houses which are bound to publish them show how very different their policies were after the crisis, it becomes increasingly unsafe to rely upon the figures obtained by a further extension of M. Truptil's series through time. Unfortunately, some of those houses which are known to have maintained a large acceptance business even after 1931 (in certain cases not wholly of their own free will) do not publish balance sheets. And it is no longer possible to say whether the 'average acceptance house' behaved like Messrs Baring Brothers whose acceptance credit shrunk from £9·25 millions in 1928 to £1·8 millions in 1931 to recover to £3·4 millions in 1936 and fall back by 1938 to £3·2 millions, or like Hambros whose credits in March 1928, 1933, 1937 and 1938 amounted to £12·5, £7·8, £13·7 and £10·8 millions respectively, thus passing their pre-crisis level in the

[1] Truptil, op. cit. p. 160.

boom of 1937 and being only 20 per cent below it in 1938. There is the further substantial difficulty that two out of the seven acceptance houses which form the basis of M. Truptil's estimate have closed down completely.

If we put the volume of the acceptance credits of the big private firms at somewhere between £70 and £90 millions, those of Anglo-Foreign banks and other banking institutions at somewhere between £25 and £35 millions, against roughly £60 millions before the crisis,[1] we get a total figure of £120–160 millions which may give the upper and lower limits of the total volume of bankers' acceptances outstanding in the period 1937–8. If this figure is at all correct, they remain at approximately 50 per cent of all bills of exchange outstanding.[2]

B. Changes in the Total Supply

We have now considered the different types of bills dealt in by the discount market. In this section we shall attempt to estimate the total supply of bills, including British Treasury bills, which have been available for the market at different periods.

In the financial year 1913–14 the statistics analysed indicated that the average commercial and financial bill circulation was roughly £500 millions. Out of this total £350 millions were bankers' acceptances. Not more than £5·5 millions Treasury bills were outstanding in July 1914. Total deposits of banks in England, Wales and Scotland have been estimated at roughly £960 millions.

The highest figure reached in the inflationary reconstruction period of 1925–9 was in 1926, when the volume of bills stamped is estimated to have been approximately £630 millions. By the eve of the depression in 1929, it appears to have fallen to about £560. The volume of Treasury bills issued by tender fluctuated between £450 and £580 millions, so that the total supply of bills of all kinds appears to have been almost £1,200 millions in the post-war decade or almost double that of 1914. It declined to £725 millions in 1934. In the financial year 1936–7 the volume of commercial and finance bills had shrunk to £275 millions, Treasury bills amounted to £580 millions, £855 millions in all. While these changes in the

[1] The volume of other 'foreign agencies' cannot be determined. At times it may have been important.

[2] This is in a somewhat similar proportion to that which the Macmillan Committee statistics bear to the estimate of the volume of total bills outstanding on the basis of the revenue statistics.

supply of bills had been taking place the total deposits of banks in England, Scotland and Wales had grown from approximately £960 millions to about £2,680 millions.[1]

It is clear that the increase in the total supply of bills has been slower than both that of the total nominal wealth of the country or that of banking funds in general. If allowance is made for the change in level of wholesale prices since 1914, the slight nominal increase in bills available becomes a real fall of some 25 per cent in 1937.

The failure of the reconstruction period dealt a heavy blow to the London bills as a medium of trade finance. The total volume slumped more than 50 per cent and has not appreciably recovered since, while bank deposits have grown by 27 per cent since the crisis and bank advances have just managed to regain their former level.

If we turn from considering the total supply of bills stamped to those believed to be available for the market, the position is even more serious, for there appears to have been a growing discrepancy between the total volume of bills issued and the volume which reached the discount market.[2] There appears to be three main reasons for this:

(1) The practice of direct rediscounting of bills by clearing banks and others has increased in importance.
(2) The gradual withdrawal from the market of bills drawn under the Standstill agreements.
(3) The use of bills as collateral both for advances (e.g. hire-purchase bills) and for acceptance credits.

The consequent narrowing of the market is bound to have considerable influence on the financial structure of the country. First, it reduces the value of the services which discount houses can render as experts in credit risks; secondly, it is likely to lead, if the trend is not reversed, to a change in the whole mechanism of credit control. The decline in the value of the expert services of the market has been accompanied by the establishment of information departments, many of them linked up internationally, by the larger financial institutions, clearing banks and others, which have developed so markedly since 1914. However insufficient they may have been proven by the crisis and the rearmament of Nazi Germany they are much better served than discount houses. The

[1] Cf. Part I on clearing banks.

[2] Cf. p. 65, n. 1.

Government also supplies some information service through the Export Credits Guarantee Department which can rely *inter alia* upon the information obtained by consular and commercial officers overseas. Moreover, the absence of a specific credit risk in Treasury bills (in contrast to the interest risk) has also reduced the need for expert services of the type the money market could provide. It demands a very different type of mind to estimate the probable changes in monetary conditions from that found in general in the bill brokerage community.

The increased importance of the Treasury, as opposed to the commercial, bill must also have important repercussions on the mechanism and automatism of the money market and on Central Bank control. The factors determining the volume of bills (and thus the elasticity of the supply of bills relative to general business conditions) have been completely altered. The volume of bills was formerly closely correlated with the volume of business and with the level of prices; hence its changes tended to strengthen the effectiveness of the credit control through the bank rate of the Bank of England and tended automatically to enforce the tightening and the relaxation of monetary conditions.

The increase in the volume of bills due to the increased turnover of goods at higher prices tended—even if the supply of money was unaltered—to bring about a tightening of the market. In a slump there was a reverse tendency. The mechanism of the gold standard reinforced these effects by inducing the Central Bank to counteract the inflow and outflow of gold. Only a small margin of initiative and choice was left to the authorities—and nothing better was desired by them. After the 1914–18 war, and even more after the depression, the supply of bills depended partly on the budgetary position—which imparted to it a tendency of varying *inversely* with the business cycle[1]—and even more on the policy pursued by the Treasury in managing the internal National Debt.[2] The Central

[1] As far as the international effectiveness of the bank rate is concerned the same effect is noticeable: instead of deterring foreign discounts and influencing the volume of business the variation of the bank rate tended to exhaust itself after the war in short-term capital movements. (Cf. Prof. N. F. Hall, *The Exchange Equalization Account.*) Gold has been taken up by the Equalization Account selling Treasury bills to the market and capital tended to follow the vagaries of confidence (hence to some extent the business cycle). The pre-war pattern is thereby to some extent paralleled—but on an extremely unstable basis. The influence of the Central Bank, freed from the restrictions of the gold standard, was under these conditions supreme in determining the position in the market.

[2] Cf. Part I above.

Bank in its turn was—at least *de jure*—completely freed in its management of the internal credit structure from the restrictions imposed upon it by the obligation of gold redemption (though in practice it has tended to pursue a policy calculated to approximate gold-standard conditions). Even under a system of widespread bill finance there was no *a priori* reason to suppose that the volume of short-term assets created would correspond to the demand for these assets; that is to say that the investment opportunities will correspond to the desires of individual capitalists, entrepreneurs and financial institutions to distribute their assets between different types of liquidity. But the inter-war trend certainly increased the probability of a discrepancy unless the borrowing and funding policy of the Treasury was deliberately designed to produce results similar to those obtained under a perfect commercial bill regime. But—as the Bank of International Settlement[1] pointed out—a Treasury policy of this type may entail such increases in the volume of unfunded Government debt as would be regarded as incompatible with the principles of what is conceived to be by financial and Treasury experts 'sound' Government finance. Unless this attitude changes substantially the strains, to which the market will periodically be exposed, will, in the long run, enforce a substantial change in the structure and technique of the credit system. It will bring about a more direct intervention of the Central Bank in the management of the reserve of the banking system, a direct intervention inimical to the survival of the market even in its modified form of the 1930's.

The Causes of the Decline of the London Bill. The consequences of the declining trend of the importance of the London bill as a means of financing international trade have been discussed above. We shall now have to turn to the explanation of this reversal of the upward trend experienced in the first decade of this century, when the growth of the finance of international trade offset the consequences of the continued decay of the internal bill due to the concentration in banking and the emergence of vast nation-wide branch banking systems.[2]

Some distinction must be made between the two periods—from

[1] *Report* for 1938–9, p. 96.

[2] Some of the factors operating in the period after the 1914–18 war against the acceptance business, such as the increasing use of cash credits coupled with telegraphic transfers, can be discerned already in this period. Their effect was, however, more than offset by the vigorous expansion of the volume of international trade and the rise in prices.

the last war to the world crisis, and the period since. In the first period the factors peculiar to the post-war position of Britain played a more important part. The former almost complete monopoly of the London market was being assailed by the rise of new financial centres. The relative importance of the international acceptance as a method of short-term finance was also tending to decline. This decline, however, was rather slow.

In the latter period—since 1929—London tended to regain its former importance as the centre of the international acceptance business, but the relative and absolute importance of that business declined so sharply as to render the first factor inoperative as far as the supply of bills is concerned. The recovery of international trade did not reverse this trend.

The ultimate causes of the decline of the relative importance of London as a financial centre cannot be discussed in detail in this context. They can be traced to the effects of the war of 1914–18 and of the monetary and economic policies adopted subsequently. The capacity of Britain for capital export was relatively exhausted. The necessity for a continuation of a restrictive monetary policy irrespective of the phases of the trade cycle, was the symptom of the growing lack of balance in Britain's international economic relations. At the same time the rise of the gold exchange standard and the resulting further concentration of huge foreign balances in London enabled the market to sustain its activities on a wider basis than would otherwise have been possible. This resulted, however, in a vulnerability whose threatened liquidation was the main reason for the abandonment of the gold standard in 1931. The subsequent strengthening of Britain's international economic position came too late to permit a restoration of the *status quo*. The crisis having destroyed such remains of the pre-war world economic system, the recovery took place mainly on a *national* basis in which international finance and more particularly acceptance as a medium of international finance had little if any role to play.[1]

In pre-1914 days the London bill represented the only modern banking instrument in most overseas countries on the basis of which credit could be obtained at modest banking cost. The enforced independence of these countries from the London market during the war and the growth of capital resources and banking facilities consequent on their prosperity resulted in a rapid development of

[1] Cf. *Midland Bank Review*, October 1937.

local financing and in an increased intervention (through the rise of reimbursement credits) of their national banks in the international credit business. The stability of exchanges was not restored immediately after the war, and the costs of hedging against fluctuations of the national currency were so heavy in wide areas of the world that the cost of obtaining credit in the main international financial centres rose above the level of the cost of home finance, even though the rate of interest charged by British and American banks and money markets continued to fall. Overseas importers turned to their own banks. In the period between 1925 and 1929, *pari passu* with the restoration of the gold standard, the cost of hedging sterling and dollar credits against national currencies on the forward exchange markets declined. International acceptance business consequently tended to increase.

After 1931 exchange instability once more played an important part in the decline of international credit. There were, however, more important factors at work. They can be discerned operating both from the side of creditors and that of debtors. From the point of view of the creditor, the explanation can be based on the shock to confidence administered by losses suffered through outright defaults, and on the freezing of international credit due to the moratoria and the exchange controls instituted by debtor countries. These controls discouraged new business except in so far as it helped the liquidation of credits granted to those countries. The clearing agreements, moreover, resulted in an increasingly bilateral finance of trade, in which the Central Banks of the clearing partners bear the burden of financing any temporary excess of exports with the complete exclusion of third parties.[1] Viewed from this point, the decay of the international acceptance credit is merely an aspect of the shrinkage of the volume of truly *multilateral international* trade relations, and consequently of international short-term credit business in general.

Yet the experience of creditors with bills as a type of liquid asset in countries other than those which in one way or another imposed moratoria, was very favourable. And the trade, especially internal, of the 'free-currency' countries recovered before the war to the levels which it attained prior to the depression and was far more important in volume than that of the totalitarian countries which pursued a policy of economic and financial autarky. The eager

[1] Cf. The Royal Institute of International Affairs, *South-eastern Europe*. Germany deliberately used this method for obtaining commercial credits.

competitors of London in the acceptance business have, moreover, once more dropped far into the background.

The argument that both before 1914 and in the inflationary reconstruction period many pure finance bills were created,[1] and that the uncertainty and distrust of the 1930's, due to the losses suffered, prevented the recrudescence of this practice may explain a part, but can hardly account for the whole, of the shrinkage and the persistent low level of the volume of non-Government bills.[2] The cost of financing through bills was, moreover, extraordinarily low in the post-crisis period. The banks were constantly searching for liquid and also readily negotiable media of investment. They wanted assets which did not involve the risk of capital depreciation, representing a claim on cash from a debtor of undoubted standing at a short maturity. Long-term Government bonds could not play this role, though they are also readily marketable; but their sale may involve capital losses, especially in periods of tight money, i.e. in periods in which their liquidation might be necessary. Advances (overdrafts), on the other hand, though secure (provided the debtor is well chosen), cannot be liquidated readily and without harmful consequences to business relations. In the bill of exchange an impersonal creditor-debtor relation is created, buttressed by extraordinary legal safeguards for the benefit of the creditor. The explanation based on motives actuating creditors alone can therefore hardly account for the decay of the bill of exchange. We must turn to the debtor to explain the shrinkage of bill finance.

The very advantage of the bill from the point of view of the creditor seems to be the basic reason for the gradual shrinkage of the bill as a medium of finance. The fear of being faced with the necessity of paying a given amount of money at a certain date, however inconvenient for the debtor, must have prejudiced borrowers against the use of credits in the shape of bills, however cheap.[3] The endeavour of certain acceptance houses to render bill finance more elastic by providing facilities both for a premature repayment and an extension of the accommodation according to the need of the debtor, was not successful. Perhaps the basic

[1] Cf. above, p. 154.

[2] Cf. *League of Nations Monetary Review*, 1938–39, p. 111.

[3] This appears to be yet another proof for the belief that cheapness of finance does not seem to be the determining factor of the choice of the borrower. Sir Otto Niemeyer (*M.E.* Qu. 6806) thought that finance through bills was 'good' for the 'morale'—an additional evidence for the disinclination of debtors to be bound by so impersonal a legal relationship.

impersonality of acceptance credit accounts for the distrust of this instrument even after these important improvements. As long as there was a formidable difference in the cost of finance by bank advances and bills, as long as there was in practice no alternative competitive method of finance, the debtor had to put up with these drawbacks. But the war and post-war development in all countries tended not only to provide such an alternative but to render it at times even cheaper than the use of acceptance credits, and in some instances[1] to make it the sole obtainable method of finance. The result was inevitable. The development witnessed in the internal market was repeated in the international sphere.

A number of additional reasons are usually cited. It is said:[2]

(1) That industry has become more integrated, and this reduces the number of stages in the manufacturing process.

(2) That industry in consequence is able and willing to finance itself by long-term capital issues or by accumulated profits, a method of finance which the wholesale merchants, whom this integration of industry eliminated and replaced by agents, would not have been able to use profitably, relying as they did on rapid and fluctuating turnover for their profit.

(3) That the growth of the capital resources and of the banking habit in overseas countries enabled traders, including manufacturers, all over the world to avail themselves of internal banking accommodation and to pay their internal and even their overseas commercial creditors by cable transfers.

(4) That sellers insisted that buyers should obtain credit from a bank and not put the burden of obtaining the discount of a bill on the seller.

These factors merely explain how the debtors were able to dispense with the bills of exchange as a method of financing the movement of goods.[3] But they do not explain why the entrepreneur traders should have been willing to forgo the use of acceptance credits. Acceptance houses were keen to arrange accom-

[1] In case of trade conducted on the basis of clearing agreements. Bills of exchange are used in this case as a form of security and are held by the banks extending the credit.

[2] Cf. *League of Nations Monetary Review*, 1938–39 p. 111, and Foa, *M.E.* Qu. 1764–69.

[3] The last reason is somewhat difficult to accept in view of the intense competition on the part of producers which resulted—especially in the durable consumption goods industries—in the financing of sales by instalment credit.

modation. Finance through bills in creditor countries and in countries whose currency was stabilized on the currency of the creditor nations, was throughout this period cheaper than the other methods of raising capital. This is demonstrated by one of the very arguments attempting to explain the decay of the bills of exchange by the reference to the elimination of the merchant by the manufacturer. The merchant deriving his profit from a narrow trading margin was forced to take into account the actual cost of credit more closely than the manufacturers. If he used acceptance credits on a large scale, this must have been due to their relative cheapness.

What might have played some role in this development was the increase of the power of the joint-stock banks enabling them to enforce the use by their clients of advances and overdrafts, on which earnings are higher. Further and far more detailed field investigation concerning this problem seems urgently needed, as it can hardly be assumed that entrepreneurs were ignorant of the diverse possibilities in finance.[1]

There is no reason to suppose that the force of the factors which have been responsible for the decline of the bill of exchange in general, and the international acceptance credit in particular, will diminish. The consequence of this decline for the money-market mechanism and banking policy which have been discussed in the previous subsection will therefore probably persist, and will force constant attention on the part of the authorities responsible for monetary management.

C. The Size of the London Money Market

It is not possible to estimate directly the volume of funds at the disposal of the money market. Several indirect estimates have been made in the past, and in this section an attempt is made by using information which has been specially obtained about the capital resources and the business policies of different groups of firms in the market to bring these estimates up to date.

(i) *Pre*-1914. An estimate of the size of the discount market on the eve of the war has been made by Lavington.[2] He thought that much the greater part of the short money supplied by the

[1] Cf. the interesting conclusions of a group of economists connected with the University of Oxford on the importance of the price of credit on the policy of entrepreneurs, *Oxford Economic Papers*, vol. I, pp. 1–32.

[2] *The English Capital Market*, 1921, pp. 128, 143, 289.

banks went to the bill brokers either by way of the banks purchasing bills nearing maturity, or in the form of loans at call or for periods not exceeding a week. He corrected the banks' balance-sheet item 'money at call and short notice' from such distortions as arise from window dressing and from temporary borrowing by the market at the Bank of England and arrived at a figure of £104 millions. He accepted Mr E. Sykes's estimates[1] of £81 millions in London and £11 millions in the provinces respectively for the volume of bank loans outstanding for stock exchange transactions. Thus he seems to have assumed that the banks lent to the Stock Exchange firms under headings other than 'money at call' because unless this assumption is made, the much more improbable one must be accepted that by far the largest part of the call money supplied to the discount market was derived from banks or financial institutions other than the English joint-stock banks. Lavington then proceeded to estimate the volume of discounts (which in many of the banks' balance sheets were not distinguished from advances). These, according to him, amounted to 25 per cent of the total of £609 millions, or approximately £150 millions. Adding to this sum the £110 millions of call money, it appeared that the joint-stock banks financed either directly or indirectly some £200–250 millions worth of bills, that is to say, somewhat more than 40 per cent of all bills outstanding at that time.

Lavington did not attempt to estimate the total of the funds of the money market. These must have been considerably larger. Their sources could only partly have been British. The fact that the Bank of England found it repeatedly necessary to have recourse to foreign help to ease the gold position[2] in a period when the volume of foreign-drawn bills (i.e. liquid foreign exchange reserves) fluctuated between £240 and £335 millions cannot be dismissed by reference to the temptation of extending credit at high rates of interest to the United States and elsewhere. It suggests that there must have been important foreign funds in London not wholly covered by the gold reserve and which could be (and were) withdrawn more quickly than the bank-rate action could reduce borrowing in London and mobilize British short-term credits. The London funds of the Russian Government alone were thought to have amounted to £20 millions at one time. The Japanese Government also had important reserves lodged in London. Some of the

[1] *The Journal of the Institute of Bankers*, 1915.
[2] Cf. Sayers, *Bank of England Operations*, Ch. v.

weaker countries and the Empire Governments had also begun to establish Sterling Exchange Reserves. To this has to be added the reserves of foreign private banks. Palgrave's recommendations to increase the gold reserve were based on his knowledge of these facts.[1] Part of these funds must have been lodged in the discount market.

The net discounts of the three discount companies amounted alone to £41·8 millions, their deposits and loans to £46·7 millions. The two other firms publishing balance sheets, Baker and Duncombe and Blydenstein, together accounted for £7·5 millions—assuming that the rediscounts liability of the former bore the same proportion to its total assets as that of the discount companies. If we take into account the known increase in the membership and capitalization of the discount market after the war on the one hand and its known capital resources *after* the increase, and then base our calculation on the working ratio shown in the balance sheet of Messrs Baker and Duncombe, we may very tentatively estimate the capital resources of the market at somewhere about £7 millions (of which £3·5 millions belonged to the Big Three), and the total commitments of the market at somewhere about £110 millions, of which a little more than £55 millions may have been derived from British banks. Sir Charles Addis estimated (in July 1918) that the market was then carrying £300 millions, of which only £100 millions were derived from the banking system.[2]

(ii) *Post*-1918. Two estimates are available for the post-war decade. The first is furnished by the evidence and statistics published by the Macmillan Committee. According to the estimate given in evidence by Sir E. Harvey, the Deputy-Governor of the Bank of England,[3] the clearing banks supplied between 50 and 60 per cent of the market's total loan funds. Using this figure and the yearly average for 1929 of the banks' loans[4] given in Table 3,

[1] The volume of short-term credit extended by London to foreign debtors, however, must have been greater than these foreign deposits (in contrast to the position in 1931). This is shown by the fact that the outbreak of war which caused the withdrawal of the British credits forced the dollar well below parity.

[2] *Edinburgh Review*, quoted by Lavington, ibid. p. 289.

[3] He had opportunities of seeing the detailed balance sheets of the discount firms supplied half yearly to the Bank of England.

[4]

	Clearing banks	Scottish banks
	(£ millions)	
At call	28·9	4·3
At short notice to the money market	76·0	8·9
	104·9	13·2

Appendix I of the Report of the Committee, and assuming in column B that the Scottish banks conform to Sir E. Harvey's estimate and in column A that they do not, we can estimate the total funds at the disposal of the market in 1929 to have been—

TABLE XLIII. DISCOUNT MARKET, 1929
(Amounts are stated in £ millions)

	A		B	
	60%	50%	60%	50%
Estimated loan funds	175	210	195	235
Capital and Reserves	15	15	15	15
Total	190	225	210	250

The three discount companies in 1929 with their own reserves amounting to £6·24 millions held £91·6 millions of loan funds and a total of nearly £100 millions. This is rather more than 50 per cent of the lowest of the above estimates and approximately 40 per cent of the largest of them. Not less than £33 millions nor more than £47 millions of this were obtained from foreign lenders.[1]

The estimates made above are supported by two independent estimates undertaken by M. Truptil. The first is based on the assumption that the private discount firms up to 1932 held 40 per cent and after 1932 45 per cent of the total funds lent to the market. On this basis he arrives at the figures[2] shown in Table XLIV for 1929. The final figure, approximately £246 millions, is £4 millions lower than the largest of our four estimates above.

TABLE XLIV. DISCOUNT MARKET, 1929
(Amounts are stated in £ millions)

	Capital and reserves	Loans and deposits	Total resources
Discount companies	6,860	91,550	98,410
Bill brokers	7,500	140,000	147,500
Total	14,360	231,550	245,910

[1] See Table, Appendix II.

[2] Op. cit. p. 222. He checked these estimates by direct inquiries. These yielded results (ibid. p. 225) for private firms: 1928, £150 millions; 1929, £145 millions; 1930, £158 millions. He believes, though does not give any evidence for this, that the discrepancy between the two estimates can be explained by the effect of window dressing. His figures are erroneous and conflict with his own Appendix V, p. 339, where the resources of the companies are given as £6·91 millions. Actually the capital and reserve amounted to £6·24 millions and undivided profits £836,000.

His second estimate is based on an analysis of the sources of the funds of the money market. He obtained most of his figures from the Report of the Macmillan Committee and estimated subsequent changes—as the clearing banks did not distinguish between short loans to the money market and those to others—on the basis of information given on this point by Mr McKenna of the Midland Bank.[1] On this basis he reaches a figure of £218 millions as the monthly average of all loans granted to the discount market in 1929. The total is made up as follows:

Clearing banks	£106	millions
Scottish ,,	£13	,,
Foreign ,,	£35	,,
Other sources	£64	,,

If the £4 millions of their own resources is added to this figure, the result of £222 millions is still nearer to the higher rather than the lower of our four estimates made above.

There is, therefore, sufficient agreement between our estimates for 1929 and those of M. Truptil to enable us to use his figures with confidence at least for the years immediately preceding and following 1929. M. Truptil has confirmed his estimates by direct inquiry at brokers. He found that prior to 1932 the three public companies took less than 50 per cent of their borrowed funds from this source. After 1932 the continued fall in the bill rate forced the private firms to reduce their borrowing from the clearing banks which, as we have seen, maintained their minimum rates for short loans at 1 per cent when the rate on Treasury bills was below this level. On the basis of this information he assumes that prior to 1932 the clearing banks lent about 45–50 per cent of the total or much the same percentage as that given by Sir Ernest Harvey for 1929. For 1932 he thinks that the share of the banks had fallen to 40 per cent; in 1933 to 33 per cent; that in 1934 it rose to 35 per cent and remained in the first half of 1935 still below 40 per cent. On this basis he arrives at the estimate given in Tables XLV A and B.

Having obtained these results M. Truptil tries to arrive at the disposition of these funds. The investments of the three public discount companies are known[2] from their published balance

[1] Ibid. p. 230.

[2]

£ millions

1927	13·7	1929	19·6	1931	13·7	1933	28·4
1928	17·3	1930	17·2	1932	20·2	1934	35·5

TABLE XLVA. THE UTILIZATION OF MONEY AT CALL AND SHORT NOTICE

(Amounts are stated in £ millions)

	Money at call and short notice	Money at call lent to Stock Exchange	Money at call lent to discount market
1927	140	40	100
1928	154	48	106
1929	148	43	105
1930	142	29	113
1931	121	20	101
1932	116	20	96
1933	102	22	80
1934	134	44	90

TABLE XLVB. TOTAL LOANS TO BROKERS

(Amounts are stated in £ millions)

	Percentage of clearing banks' loans	New estimates	Estimate 2
1927		200–222	211
1928		212–237	211
1929	45–50	210–235	218
1930		226–251	242
1931		202–224	217
1932	40	240	244
1933	33	242	253
1934	35	257	247

TABLE XLVC. TOTAL ASSETS OF MARKET

(Amounts are stated in £ millions)

	Investments	Bills	All Assets
1927	24	202	226
1928	27	199	226
1929	30	203	233
1930	34	223	257
1931	27	205	232
1932	40	219	259
1933	56	212	268
1934	70	192	262

sheets. But those of the bill brokers are not known. M. Truptil thought that up to 1929 they did not hold as investments more than their own capital and reserves or between £7·5 and £10 millions. After that year their holdings increased and reached the level of those of the discount companies. If these assumptions are correct, the total assets of the market can be divided up between bills and investments as shown in Table XLVc.

These estimates yield similar results to those based upon Sir Ernest Harvey's statements for 1929. As far as the calculations for the latter years are concerned M. Truptil's estimates seem to be on the high side. In 1934, for example, we know that the total commercial bill circulation had shrunk to some £250 millions, and that the volume of Treasury bills sold by tender was £473 millions, giving a total bill circulation of some £725 millions. Of this the clearing banks alone held £230 millions. Known sterling assets of certain foreign central banks were almost £400 millions,[1] a large part of which must have been invested in bills. This leaves hardly as much as £173 millions for bills for the money market. Nor is the estimate of £34·5 millions securities for the *private firms alone* quite convincing. M. Truptil's figure for the size of their own capital resources of these firms is certainly too high at £7,100,000, that is to say only £400,000 less in 1934 than in 1929. Blydenstein's alone reduced their capital by some £800,000 in 1931; at the end of 1933 Baker and Duncombe liquidated, which meant a shrinkage of between £250,000 and £280,000. The merger of King and Foa with White and Shaxon seems to have been accompanied by the withdrawal of some £200,000–250,000. These reorganizations alone meant the diminution of the capital resources by over £1·25 millions. In addition, some of the firms which have continued in business withdrew part of their capital from the market. Capital and reserves remaining in the private firms of the discount market by the end of 1934 can hardly therefore have been more than £5·5–5·75 millions. M. Truptil's estimate of their total holdings would give a working ratio of almost 1 : 30 *on the average*, and a ratio of capital to investments of more than 1 : 6, which seems hardly probable.

According to a statement of the Governor of the Bank of England[2] the volume of commercial bills financed in the market (this presumably includes bills held by British banks) declined from £300 millions in 1929 to £200–230 millions in 1931, and to only £130 millions in 1936. As the volume of tender Treasury bills outstanding increased from £523 to £576 millions, the net shrinkage of the volume of other bills held through the market between 1929 and 1936, according to this statement, was £120 millions. The banks, however, *increased* their holdings from £229 millions to £320 millions, i.e. over £90 millions. This means that the market

[1] Cf. *B.I.S. Report* for 1938–9, p. 82.
[2] *League of Nations Monetary Review*, 1937–8, p. 49.

lost over £210 millions. And while foreign holdings of sterling bills may have diminished during this period, it is hardly probable that they should diminish by as much as some £180 millions between 1929 and 1934, which would be necessary to support M. Truptil's estimate that the bill holdings of the discount market proper declined by only £40 millions. Finally, the market must have repaid a considerable amount of loans to clearing banks after 1933, and it is very difficult to believe that most of this money was reborrowed from other sources. Considering all the evidence available, it is difficult not to conclude that the discount market proper had declined substantially by 1934, and that the security holdings of the private firms were not much higher than £25 millions and their bill holdings not much more than £90 millions. The total volume of the market on this basis cannot have been more than some £13 millions capital and reserves, some £220 millions of loans and deposits and £60 millions securities[1] and £173 millions of bills.

(iii) *The Position at the end of* 1938. The volume of the market as a whole in 1938 can only be estimated indirectly. We know that the balance sheets of the three discount companies show:

Capital and reserves	£7,850,000
Loans and deposits	£124,900,000
Total liabilities	£132,750,000
Out of which securities, perhaps	£60,000,000[2]
Bills, perhaps	£70,000,000
Total assets	£130,000,000

Total security holdings of the market (including private firms) appear to be £75 millions. This makes the security holdings of private firms £10–15 millions, or three or four times their capital and reserves. The total book of these firms can be estimated by taking the working ratio of twenty to twenty-five times their capital for the bigger and thirty to thirty-three times for the smaller firms and multiplying their known capital resources. This operation yields as lower and upper limits £85 and £100 millions for the total book of these firms and, subtracting estimated security

[1] Assuming that the discount companies showed *all* short-term securities under the heading of investments.

[2] Some 45 per cent of total assets or almost eight times the capital.

holdings, £70 and £90 millions as the upper and lower limit of the volume of bills carried by them. Hence the total funds of the market can be estimated as follows:

Capital and reserves	£11·5	millions
Loans and deposits	£210–225	
	£220–235	
Of which securities and bills	£70–75	
	£145–155	

These figures imply some increase in the total holdings of the market and a sharp diminution in the security holdings of the private[1] discount firms. These conclusions appear to agree with the observations of experts with first-hand knowledge.

The London discount market—mainly because of the timely increase in the volume of Treasury bills outstanding and the pressing need of the clearing banks to maintain their second liquidity reserve—has not shown a declining trend. From roughly £110 millions in 1914 it has increased to almost £250 millions in 1929. It still remains near that figure. The substance of the market has altered, and with it its character and automatism. Its capacity for earning profits by its pre-war business has been impaired, but it has survived the stresses of the vast monetary and economic changes, and even its relative importance to the total volume of banking funds has not diminished. It has adapted itself to the change of circumstances by extending its operations to the Government bond markets. The discount companies were, before the 1939–45 war, by far the most important gilt-edged jobbers in London.[2] The bond brokerage also considerably expanded. For each year since 1933 profits from bill brokerage and jobbing in most cases did not pay for more than overheads, and in certain periods were not sufficient even to cover them. The largest part of profits, then, was derived from the bond business. Its working was, therefore, based not so much on real economic service as on the feeling that its maintenance enabled not merely the upholding of a tradition but also provided some convenience for the banking system.

[1] Cf. note 2, p. 189.
[2] Especially the Union Discount Co.

*APPENDIX I TO PART II**

THE FLOATING DEBT, 1914–39, AND ITS EFFECT ON THE BRITISH BANKING SYSTEM

By F. W. PAISH

PART I. THE FLOATING DEBT SINCE 1914

§ 1. 1914–19. *The War-time expansion*

ALTHOUGH the Treasury were empowered as early as 1877 to finance the temporary requirements of the Consolidated Fund by the sale at a discount of Treasury bills of up to twelve months' currency, and although in 1902 the power was extended to cover the requirements of the Supply Services, the use made of these powers, up to August 1914, was, by post-war standards, exceedingly small. The highest total of Treasury bills recorded in those years seems to have been £41 millions in April 1910, consisting of £36·7 millions issued by tender to the market and £4·3 millions issued direct to Government departments. In July 1914 the total outstanding was £15·5 millions, of which only £6 millions had been issued by tender.

During the war the floating debt expanded enormously. On 4 January 1919, it stood at £1,545 millions, of which £1,098 millions was in Treasury bills and £447 millions in Ways and Means advances. The very high figure for Ways and Means advances seems to have been due to two causes. In the first place a system had grown up during the war whereby the clearing banks were encouraged to place their surplus cash reserves on interest-bearing deposit account with the Bank of England, which re-lent them to the Treasury on Ways and Means advances. These interest-bearing deposits, which in January 1919 may have amounted to as much as £200 or £250 millions, were not mentioned in the Bank statements, and therefore prevented the obvious emergence of large surplus cash reserves. They could, however, be converted very rapidly into non-interest-bearing bankers' balances, and so gave the banks, in fact, an almost unlimited power of expansion.

The second cause of the high total of Ways and Means advances was the fact that a large part, perhaps as much as £150 millions, of the Government securities then held as backing for the Treasury notes in circulation was apparently in the form of Ways and Means advances.

* Parts of the present Appendix, which was written for the National Institute in June 1939, have subsequently appeared in *Economica* of August 1939 and August 1940, together with Table E and Chart I. It is with the permission of the Editor of *Economica* that the Institute is now republishing this material.

It is impossible to say how much of the Treasury bill total was in the possession of the banks and other non-official holders, and how much in the hands of the Savings Banks and other Government departments and perhaps of the Bank of England, though later developments suggest that official holdings were substantial. During the war the issue of bills by tender was discontinued, first in April 1915, and again, after a brief resumption, in June 1917. Instead, Treasury bills were kept on permanent offer, or on 'tap', to all applicants, official and other, at fixed rates of interest, which were altered only when the demand for bills at the fixed rates became either inadequate or excessive. At the beginning of 1919 bills were available in two currencies, three months and six months, and the rate of interest on each was $3\frac{1}{2}$ per cent per annum.

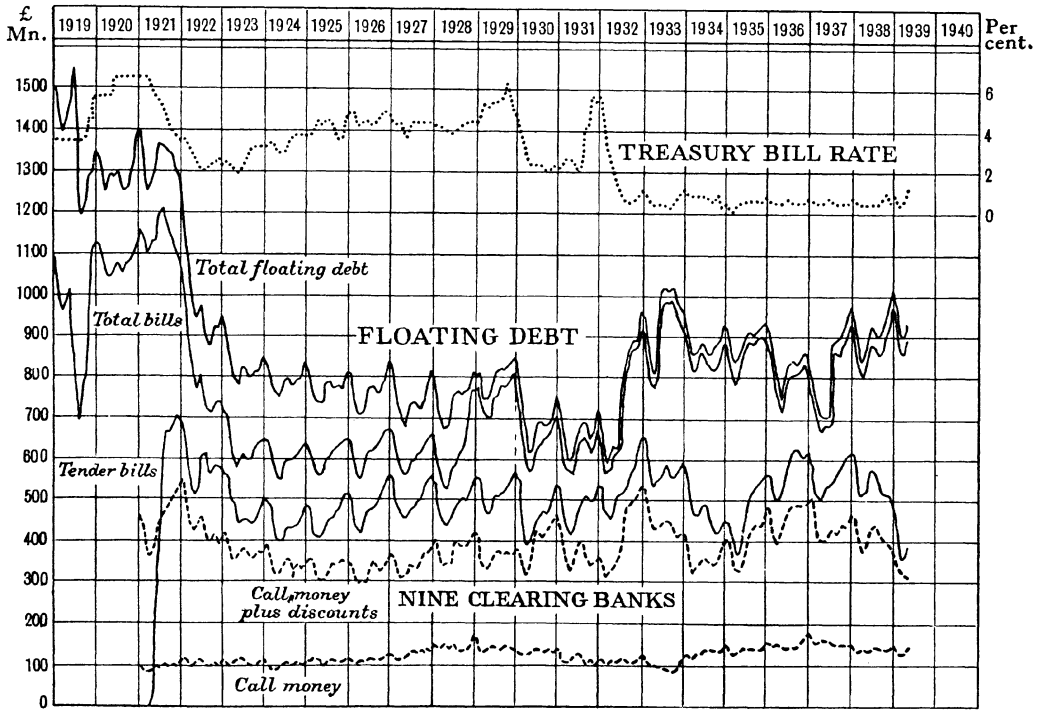
The history of the Floating Debt since 1919 can be divided into three main sections which are plainly discernible in Chart 1. First there is a period of post-war adjustment, from 1919 until about the middle of 1923; then there ensues a period of stability, from 1923 until the departure of sterling from the gold standard in the autumn of 1931; and finally, there is the period of managed currency and the Exchange Equalization Account, from 1931 to date.

§ 2. 1919–23. *The period of adjustment*

During this period the Floating Debt was reduced, partly out of budget surpluses but mainly by funding loans, from a maximum of £1,570 millions at the end of June 1919 to about £1,300 millions in June 1920, £1,000 millions in June 1922, and £800 millions in June 1923. Issues of bills by tender were resumed in April 1921. As the system then inaugurated is that which exists to-day, it is worth while to examine it in some detail.

On each Friday the Treasury announces in the *London Gazette* the total value of the Treasury bills which it will offer for sale by tender on the following Friday. Tenders have to be made on special forms, obtainable from the Bank of England, and must be lodged at the Bank before 1 p.m. on the day on which the bills are offered. The minimum amount for which a tender will be considered is £50,000, and the tenderer has the right to specify on which day or days in the following week he wishes his bills to be dated and paid for. The bills are normally allotted to the highest tenders, and divided proportionately, where necessary, between those submitting equal tenders; but the Treasury is under no obligation to accept any particular tender or to allot the whole of the bills offered. Under-allotment of bills by amounts of from £2 to £5 millions is not infrequent. A preliminary statement, giving the rate of the lowest tenders accepted, and the proportion of applications allotted to those tendering at this price, is issued early on Friday afternoon, and a fuller statement is issued on Saturday morning, giving, in addition, the total amount of applications received, the total of bills allotted, and the average discount rate for the whole issue.

CHART I. BRITISH FLOATING DEBT



NOTE. The figures used in constructing the Floating Debt, Treasury Bills and Treasury Bill Rate curves in this chart are monthly averages of weekly figures. (Taken from *Economica*.)

This system differs from that in use before the war of 1914–18 in three main particulars. First, the minimum tenderable quantity is fixed at the high figure of £50,000, which in effect restricts applicants to banks, discount houses, bill brokers, and other large institutions. Secondly, applicants are allowed to spread the dates of their bills and of their payments over the whole of the following week, or to choose the days which suit them best, instead of having to tender for bills of a given date, and to pay for the whole issue at once. And thirdly, all bills issued by tender are now of three months' date. They follow the same rules for determining the day of payment as do ordinary commercial bills, except that there are no days of grace.

Since all bills are of three months' date, it follows that by totalling the bills issued during thirteen consecutive weeks the total of outstanding bills originally issued by tender can be approximately (and on many dates exactly) determined for the close of business on each Saturday. By calculating a thirteen weeks' moving total, changes in this total can be deduced. Further, since, except at the ends of quarters, the total of Treasury bills outstanding is published for each Saturday, by deducting the calculated total of 'tender' bills from the published bill total, the outstanding amount of bills issued otherwise than by tender can be approximately determined. It should be noted that this method holds good only when the Treasury bill total refers to a Saturday; for we have no means of knowing how much of a week's tenders is dated on each day. When, therefore, the total bill figure is given for the end of the quarter, and not for a Saturday, it cannot be related to the calculated total of tender bills.

The issue of bills by tender was not, at first, the exclusive method of issue to non-official purchasers that it is now. Until the middle of 1921 twelve months' bills continued to be obtainable through the 'tap', and for some years three months' bills, known as 'additional' bills, were available for purchase through the 'tap' at prices fixed slightly above the average rate of the previous week's tender. The issue of these appears to have been gradually restricted by reducing the number of days per week on which this offer was open, until in 1925 it ceased altogether.

Despite the fact that the issue of these 'additional' bills prevents any exact calculation of the volume of bills issued to the public between 1921 and 1925, it seems probable that the amounts involved are not very important, and that the bills issued by tender can be taken as an approximate indication of the total of bills in the hands of the public. If so, it is only to changes in totals of tender bills that attention needs to be paid in discussing the effect of changes in the floating debt upon the position of the commercial banks and the money market.

In the second half of 1921 this total fluctuated seasonally between £660 and £700 millions. During 1922 it was reduced by about £100 millions out of the proceeds of the issue of longer-dated securities and during 1923 by a further £100 millions, so that the total was exactly £500 millions in the middle of December 1923.

§ 3. 1923–31. *The period of stability*

During the next eight years changes, apart from seasonal fluctuations, in the total of tender bills issued were small—not more than £50 millions in either direction. This stability clearly reveals the seasonal fluctuation of about £100 millions, from a minimum at the end of March to a maximum at the end of December, due to the variations in incidence flow of revenue and expenditure. It appears that, in the circumstances then existing, the Treasury considered that the desirable normal limits for the total of its bills in the hands of the market lay between a minimum of about £400 millions and a maximum of about £550 millions.

§ 4. 1931–9. *The period of monetary control and the Exchange Equalization Account*

Since 1931 the movement of Treasury bills has been largely determined by two forces—the purchases and sales of gold by the Exchange Equalization Account and the raising and repayment of longer term loans. The Account was provided with an original borrowing capacity mainly or entirely in the form of sterling Treasury bills, later supplemented by additional issues of similar bills. If it requires to buy gold, its normal procedure seems to be to obtain the necessary sterling by allowing some of its bills to mature, thus obliging the Treasury to issue more bills by tender, and making it unnecessary for the Account to sell into the market bills issued through the 'tap'; while when the Account sells gold, it normally invests the proceeds in new Treasury bills, thus supplying the Treasury with funds and enabling the Treasury to pay off on maturity some bills formerly issued by tender. Thus, in a period of gold acquisition, the total of tender bills tends to rise, and in a period of gold sales to fall.

The period since 1931 shows two main fluctuations in the total of tender bills—a rise from 1931 to 1932, followed by a fall in 1934, and a second rise from 1935 to 1936, followed by a fall in 1938–9. The rise in 1932 seems to have been due, not to an accumulation of gold by the Exchange Account, but largely to an analogous cause—the cost of repaying the foreign credits, raised before September 1931, the sterling receipts from which had enabled the Treasury to dispense with the usual seasonal increase in tender bills in the last quarter of 1931. The repayment of these credits involved a net loss of certainly £40 millions, and perhaps nearly £50 millions, which was temporarily financed out of the issue of additional bills.

During 1933 the Exchange Account is believed to have bought a large quantity of gold, but this was prevented from raising the tender bill issue, partly by large resales of gold to the Bank of England (in which case only the difference between the market price and the Bank's statutory buying price needed to be financed on bills) and partly by issue of a conversion loan in the autumn which eliminated the usual

seasonal expansion. In effect, therefore, the gold bought during the year was financed partly by an expansion of credit and partly on long-term. The effect of this was seen in the following year, when a heavy outflow of capital occurred and the Account was obliged to sell a substantial amount of gold. As it reinvested the proceeds in 'tap' Treasury bills, the Treasury was enabled to redeem tender bills, the total of which fell, with the seasonal fall in the first quarter of 1935, to an exceptionally low level. It was this decline which gave rise to the celebrated 'bill famine' of 1934–5.

After the first quarter of 1935, a resumption of large gold purchases by the Account caused the issue of tender bills to recover to a normal December level of £565 millions, and a continuation of the same movement in 1936 raised the total in the third quarter of that year to well over £600 millions. Thereafter, although the Account continued to gain gold until early in 1938, further rises in the issue of bills by tender were prevented by the issue of periodical conversion loans. Thus of the great bulk of the funds, estimated at over £450 millions, which had to be borrowed between 1932 and 1938 to finance the purchase and sterilization of gold, not much more than £50 millions was borrowed on Treasury bills and something like £400 millions on long-term loans.

The results of this conservative financing were seen during the period of heavy gold sales between March 1938 and April 1939. The proceeds of the gold sold during 1938–9 were sufficient, not only to cover the excess of £40 millions in the cost of rearmament over the loan of £80 millions raised to meet it, but in addition to reduce the issue of tender bills by about £150 millions to the lowest figure on record. Since the beginning of the 1939–40 financial year, sales of gold have apparently been small, while the cost of rearmament has greatly increased, with the result that issues of tender bills are again rising rapidly. But even at the present enormous rate of expenditure, the outstanding total of bills issued by tender is not likely to reach a normal level before the autumn. Thus, in effect, during the past and present years, the cost of rearmament has been largely met out of the proceeds of the sale of gold which was originally purchased by means of long-term loans.

PART II. THE FLOATING DEBT AND THE BRITISH BANKS

§ 1. *The* 1914–18 *expansion in Bank Assets*

It is not possible to make any accurate comparison of the position of the British commercial banks as it was in 1914 and as it is now, or even as it was at any time after the 1914–18 war. Before July 1914 the banks published statements of their position only half-yearly, and the description and classification of assets varied from bank to bank. Of the nineteen principal banks then existing, two did not distinguish between advances and discounts. It is only by assuming that the assets of the

banks which did not differentiate them were distributed on the average in the same way as those of the banks which did, that it is possible to make any estimate of the aggregate position of the banks. Even then substantial differences of description remain. There is, for instance, no item for 'Balances with other Banks and Items in Course of Collection' in the pre-war returns. It is probable that some banks at least included this item in the figures for cash. Nevertheless, in spite of all the reservations which are necessary, the changes between the pre-war and post-war returns are so marked that a comparison of them may not be entirely misleading. The dates selected for comparison are 30 June 1914, the latest available pre-war date, 30 June 1927, during the period of stability of the Floating Debt, and 30 June 1938, the most recent date for which comparable figures are available (Table A).

TABLE A. AMALGAMATED RETURNS OF BRITISH COMMERCIAL BANKS

	19 banks 30 June 1914		9 clearing banks 30 June 1927		11 clearing banks 30 June 1938	
	£ millions	% of deposits	£ millions	% of deposits	£ millions	% of deposits
Capital and reserves	70·4	9·5	125·6	7·3	138·6	6·0
Deposits	743·0	100·0	1,710·7	100·0	2,331·3	100·0
Cash	113·4	15·3	216·8	12·7	266·5	11·4
Money at call and short notice	98·5	13·3	139·9	8·2	164·3	7·1
Discounts	109·5	14·7	186·8	10·9	266·6	11·4
Total liquid assets	321·4	43·3	543·5	31·8	697·4	29·9
Advances	365·4	49·1	933·5	54·6	998·9	42·9
Investments	114·3	15·4	236·4	13·8	629·9	27·1
	801·1	107·8	1,713·4	100·2	2,326·2	99·9
Balances with other banks and items in transit	—	—	66·5	3·9	77·2	3·3
	801·1	107·8	1,779·9	104·1	2,403·4	103·2

All the three half-yearly returns contain a substantial amount of window dressing. In recent years the half-yearly totals of cash have been as much as £20 or £30 millions above the monthly averages, and the monthly averages themselves are window-dressed to an appreciable extent—perhaps £15 to £20 millions—by the individual banks making up their weekly accounts on different days, and calling from the market in turn. The total of cash shown on 30 June may therefore be anything over £35 millions higher than the total aggregate normally held by the banks. The items which are correspondingly lowered are mainly discounts and probably to some extent call money. Clues to the amount of window dressing in any particular half-year are given, first by com-

paring the half-yearly totals with the average monthly totals; and secondly by observing the increase in discount and advances (or in earlier years in other securities) in the Bank of England's statement and/or the rise in the Treasury's Ways and Means advances from the Bank of England. For the pre-war figures only the first method is, of course, practicable. An examination of these figures suggests that the total of cash was thus inflated by about £40 millions in both June 1927 and June 1938, and by about £16 millions in June 1914. What proportion of these totals should be added to call money and discounts respectively cannot be determined, but it seems likely that the reduction on discounts is greater than that in call money. If we allot three-quarters of the increase to discounts and one-quarter to call money, we obtain the amended results shown in Table B.

TABLE B. SUGGESTED AMENDED FIGURES FOR BANKS, CASH, CALL MONEY, AND DISCOUNTS

	30 June 1914		30 June 1927		30 June 1938	
	£ millions	% of deposits	£ millions	% of deposits	£ millions	% of deposits
Cash	97	13·2	177	10·3	226	9·7
Money at call and short notice	103	13·8	150	8·8	174	7·5
Discounts	121	16·3	217	12·7	297	12·7
Total	321	43·3	544	31·8	697	29·9

Whether we have regard to the actual or to the suggested amended figures, it is clear that the great expansion in bank deposits which has taken place since before the 1914–18 war has necessitated a heavy reduction in the ratios of liquid assets to deposits. But for the great increase in the issue of Treasury bills to the market, it seems almost certain, either that the ratios of liquid assets to deposits would have been less or the

TABLE C. MACMILLAN REPORT ANALYSIS OF MONEY AT CALL AND SHORT NOTICE AND DISCOUNTS (JUNE 1927)

(Amounts are stated in £ millions)

Money at call		23·7	
Money at short notice:			
To the money market	78·9		
To the Stock Exchange	41·4		
		120·3	
			144·0
Discounts:			
Treasury bills		93·5	
Commercial bills		96·2	
			189·7
			333·7

total of deposits smaller. It seems possible, indeed, that, owing to the dwindling importance of the commercial bill, the total of these held by the banks, either as discounts or as security for money lent at call or short notice, was actually smaller in 1927 than in 1914. The figures quoted in the Macmillan Report, for June 1927, which are closely, though not exactly, comparable with those given above, are as shown in Table C.

These figures show that, on that particular date, nearly half the banks' discounts consisted of Treasury bills and that the banks' holding of commercial bills discounted was lower than the comparable total of nearly £110 millions in 1914. If we assume that, of loans at call and of money lent at short notice to the money market, three-quarters were secured on both dates by deposits of bills, and if we further assume that the same proportion of these bills as of bills discounted consisted of Treasury bills, we arrive at a figure, naturally very hypothetical, of £52 millions for the value of the commercial bills financed by the banks at call and short notice. If the proportions of Stock Exchange loans and of short loans against the security of bonds are assumed to have been the same in 1914 as in 1927, the corresponding figure for 1914 would have been about £60 millions, making a grand total of commercial bills held or financed by the banks of about £170 millions in 1914, as against under £150 millions in 1927. The probable errors in the above estimates are too large to make it possible to say that there was an actual decline between 1914 and 1927 in the banks' holdings of commercial bills; but at least it seems unlikely that there was any appreciable increase. It may therefore be said, broadly speaking, that the whole of the increase in the banks' liquid assets other than cash was due to their holdings of Treasury bills. This conclusion finds some confirmation in the estimates which have been made of the total of commercial bills in circulation in Great Britain. These show £165 millions of inland bills plus £336 millions of foreign bills in 1913–14, and £191 millions of inland bills plus £302 millions of foreign bills in 1926–7. Thus the total of commercial bills in circulation was apparently approximately the same in 1927 as it had been in 1914.

§ 2. *Treasury Bills and Changes in Clearing Banks' Discounts*

As Chart 1 clearly shows, fluctuations in the total of clearing bank discounts closely followed in most years the fluctuations in the outstanding amount of Treasury bills issued by tender. The closeness of the similarity between the short-period fluctuations of the two series has tended on the whole to increase. From 1919 until the end of the first quarter of 1931 we can follow the fluctuations in the banks' holdings of Treasury bills with the aid of Table I of the Macmillan Report. Since 1931 similar statistics have continued to be compiled for private circulation, but have been published by only two banks, Lloyds and (since 1934) Midland. The clearing bank figures are for the end of each month,

and the Treasury bill figures for the last available Saturday in each month. The error involved by the difference in dates does not seem likely to be important, except on occasion at the ends of half-years, when the discount figures may be fictitiously low.

These figures confirm the impression, given by Chart 1, that a more than proportionate share of the decline in the total issue of tender bills between 1921 and 1923 was borne by the discounts of the clearing banks. Between July 1921 and July 1923 total tender bills fell from £660 to £450 millions, or by 32 per cent. Clearing bank discounts of Treasury bills fell from £253 to £145 millions, or by 43 per cent, while other holdings of tender Treasury bills fell from £407 to £305 millions, or by only 25 per cent. Though in the following year total tender bills fell only slightly, by July 1924 clearing bank discounts had fallen by a further £36 to £109 millions, while the tender bills otherwise held rose by £21 to £326 millions. During the two years, 1924–6, there was a rise of over £50 millions in the average level of tender bills, but little of the increase was reflected in the banks' discounts, which until the end of 1928 remained at only slightly above the 1924 level. Meanwhile the total of tender Treasury bills otherwise held rose by about £50 millions. Some part of this increase may have been due to the increase in the banks' loans at call and to the money market at short notice, which, according to the Macmillan Report, rose from £82 millions in July 1923 to £110 millions in July 1928. That is to say, the banks may have preferred to hold fewer Treasury bills directly, but more as security for the more liquid loans to the market. But this can account for only a part of the increase in Treasury bills not discounted by the banks, and it seems likely that both the relatively smaller fall in these from 1921 to 1923 and the rise in them from 1923 to 1928 was due to the urgent demand for a safe investment by the owners of the increasing volume of foreign short-term funds in London. The banks were unable to make good their lower holdings of Treasury bills by increasing their holdings of commercial bills, which stood at about the same level in July 1928 as they had in July 1921, after being frequently lower in the intervening years.

The years 1929, 1930 and 1931 offer interesting contrasts. In the second half of 1929 Treasury bills discounted failed to show their usual seasonal rise, while those otherwise held rose to an exceptionally high figure. These movements are clearly due to the banks' reluctance to buy bills in the effort to maintain their cash reserves, and are therefore associated with a rise in the rate of discount. In 1930 the easier cash position of the banks caused them to bid freely for bills, so that by the end of the year their holdings of Treasury bills were nearly £100 millions higher than twelve months before, while tender Treasury bills otherwise held showed a corresponding decline, and interest rates fell sharply. In 1931 the movement of 1929 total discounts was repeated, and though the figures of Treasury bills discounted are not available after March, there can be little doubt that they also showed a movement closely similar to

that of 1929, for the same reason and with the same effect on interest rates.

Since 1931 the combined total of the clearing banks' loans at call and short notice and discounts have closely paralleled the movements in the total of tender bills issued, with certain interesting exceptions. From Chart 1, it will be seen that the gap between the two curves widens in 1933, narrows in 1934, widens again from 1935 to 1937, and narrows once more in 1938–9. It seems clear that these movements are directly connected with the volume of foreign short-term funds in London. A proportion of these is apparently invested directly in Treasury bills, thus providing a market for part of the additional tender bills issued by the Treasury to finance the purchase of gold. It should be noticed that in this case a widening of the gap is not accompanied by any tendency for bill rates to rise, for it is due, not to any unwillingness of the banks to buy bills, but to an increased demand by outside buyers. If the whole of short-term capital entering London were invested in this way, it would provide an automatic means of financing the Treasury's purchases of gold, and would therefore exercise no effect on the banking system. Only in so far as it is either invested in less liquid form or held on deposit at the banks is the banking system affected by the consequential changes in the Treasury bill issue.

Part III. The Treasury Bill Rate

§ 1. *Supply Conditions*

The supply of Treasury bills issued by tender is determined by the needs and policy of the Treasury. Among the criteria which the Treasury presumably takes into account in determining how much to borrow on bills, the rate at which the bills are sold does not seem to play any obvious part in the short run. It is true, of course, that no simple relationship between the supply of Treasury bills and the discount rate could be looked for. When the short-term rate is lowest, and its margin below the long-term rate greatest, the long-term rate itself usually stands at a lower level than is expected to be maintained indefinitely. It is quite possible, therefore, that the moment when the temporary advantage of borrowing on short-term is greatest is also the wisest moment, on a longer view, for converting short-term debt into long-term debt, for at such a moment the present long-term rate may be lower than the expected average short-term rate over the duration of the long-term loan. Further, the Treasury might prefer to incur some *probable* additional interest cost as an insurance against the *possibility* of a future very large and sudden rise in short-term rates. (See Sir Otto Niemeyer's evidence before the Colwyn Committee, Minute of Evidence, vol. II, p. 122.) In addition, the Treasury must consider the complicated

effects of changes in the size of the Treasury bill issue upon the position of the banking system. Nevertheless, it is a little surprising to observe that, apart from one or two minor and temporary exceptions, the tender bill issue has been kept since 1922 within the limits £400 to £600 millions. Since the normal seasonal movement is about £100 millions, this means a fluctuation due to non-seasonal causes of not more than £50 millions on either side of an average of £500 millions. During these seventeen years the discount rate has fluctuated from over 6 per cent to under ¼ per cent, and the difference between the discount rate and the long-term rate of interest from about −3 per cent to about +1¼ per cent. It would therefore seem that we must regard the supply of Treasury bills to the market as being almost wholly independent of the discount rate.

§ 2. *Demand Conditions*

(*a*) *Elasticity of Demand.* There is some evidence to show that, at least until a few years ago, the price of Treasury bills depended to some extent on their supply—or in other words, that the elasticity of the demand was less than infinite.

On at least two occasions, in 1922 and in 1930, a fall in the rate was accompanied, and may have been accelerated, by a reduction in the tender bill issue, while the collapse of the rate at the end of 1934 was undoubtedly a result of the 'bill famine'. There are also signs in the years 1923–8 of slight seasonal movements in the price of bills. In general, however, it seems that changes in the supply of Treasury bills have been a minor factor in determining the bill rate. In part this may have been due to the fact that Treasury bills form only a portion of the total supply of bills in the market and that it is to variations in the total supply rather than in a sectional supply that we must look for an explanation of changes of rate in a market which is to a large extent common to all types of bills. Thus the fall in discount rates from 1921 to 1922, when the total of Treasury bills issued to the market was probably rising, may well have been due in part to the estimated fall of over £100 millions in the volume of commercial bills during the same period. Again, the rise in discount rates from 1923 to 1925, while the issue of Treasury bills was hardly changed, was accompanied by a rise of more than 100 millions in the estimated total of commercial bills, and the very low discount rates since 1932 have occurred during a period when the supply of commercial bills has also been exceptionally low.

It is even more difficult to make any estimate of the elasticities of the different types of demand as a whole. The principal demand for tender bills can be broadly classified into five groups. (1) The money market proper, comprising the discount houses, bill brokers and United Kingdom banks. (2) The London offices and agents of overseas commercial banks. (3) The Bank of England, acting as agent for overseas central banks. (4) The Bank of England, acting on its own behalf, or on behalf of

the Treasury or of the Exchange Equalization Account. (5) Outside investors, such as insurance companies and other large institutions.

The demand from the last two groups is likely to be non-continuous. The Bank of England presumably buys tender bills for itself or for the Exchange Account only for the purpose of rapidly replenishing or expanding the clearing banks' cash reserves as a part of its general monetary policy. Such action is most likely to be taken at times when a depletion of the banks' reserves is tending to raise the market rate of discount, and the Bank of England's demand might therefore possibly be described as having a positive elasticity. The outside demand, on the other hand, is likely to be greatest when the opportunities of profitable investment elsewhere are least, that is to say, when discount rates are low. This increase in outside demand is, however, due to a change in the whole set of conditions, changing the whole form and position of the demand schedule, and not merely to the fall in discount rates with which it coincides.

TABLE D. ESTIMATED AVERAGE BILL CIRCULATION IN GREAT BRITAIN

(Amounts are stated in £ millions)

Year (April to March)	Commercial bills		Treasury bills		
	Inland	Foreign	Treasury bills issued by tender	Total	Average Treasury bill rate %
1922–3	188	241	490	919	2·3
1923–4	199	281	466	946	2·9
1924–5	218	365	456	1,039	3·6
1925–6	218	415	466	1,099	4·3
1926–7	191	302	501	994	4·5
1927–8	193	315	502	1,010	4·2
1928–9	198	365	505	1,068	4·3
1929–30	202	317	512	1,031	5·0
1930–1	172	268	467	907	2·3
1931–2	142	186	485	813	4·0
1932–3	111	136	571	818	0·9
1933–4	111	134	558	803	0·6
1934–5	119	134	443	696	0·6
1935–6	121	138	505	764	0·6
1936–7	133	143	580	856	0·6

The regular demand for bills comes on the one hand from British banks, discount houses, and bill brokers, and on the other from overseas banks, both central and commercial. Before 1931, when Britain was on the gold standard, the demand from both of these groups probably showed considerable sensitiveness to changes in the discount rate in London only; for when the possibility of exchange fluctuations and restrictions is remote, both British and foreign funds are sensitive to relative changes in short-term interest rates in different centres. Since 1932, however, the elasticities of the demand of the two groups seem to

have changed in opposite directions. Foreign funds are now held in London, not for the sake of maximizing interest yields, but for reasons of convenience, policy or safety. Being here, they will be invested in suitable short-term investments, and it seems probable that, for a given amount of foreign funds in London, the foreign demand for bills is now highly inelastic; that is to say, the proportion which it is desired to invest in bills is fixed without much reference to the rate.

On the other hand, the British demand for bills has been made much more elastic by rate-fixing agreements between the banks and the different discount firms. The first of these agreements was reached in September 1933, when the Treasury bill rate had fallen to about $\frac{1}{4}$ per cent per annum. As the banks were still charging a minimum of 1 per cent for short advance against bills, it is not surprising to find that the total of money at call and short notice fell below £100 millions. Only the etiquette of the City can have prevented it from falling further. In an effort to restore this, the second line of defence among their assets, to its normal level of about £140 millions, the banks came to an agreement among themselves to raise their buying rates for Treasury bills by stages to above 1 per cent. The move was at first successful, but during 1934 the increasing scarcity of bills forced the banks to offer gradually higher prices. By February 1935, the rate had again fallen back to under $\frac{1}{4}$ per cent, and the banks' short loans to the discount market were again showing signs of a decline. The banks then came to a new agreement. They agreed to stop tendering for Treasury bills and to obtain their bills only by purchase from existing holders at rates not below $\frac{1}{2}$ per cent, while they also reduced their minimum rate for loans to the discount market against the security of bills to $\frac{1}{2}$ per cent. The withdrawal of direct competition by the banks enabled the discount houses and bill brokers to form a syndicate to fix a common rate for their tenders and to allocate the bills allotted among the individual members. Since that date the syndicate has succeeded in keeping the Treasury bill rate above $\frac{1}{2}$ per cent, thus preventing the business of carrying bills on bank money from involving an actual loss, though at times only at the cost of obtaining very small allotments. It is understood that the amount tendered for by the syndicate is £30 millions each week, and the allotments during the past few months have varied from little more than 20 to over 70 per cent.

Despite the inelasticity of the foreign demand, the syndicate has kept bill rates extremely stable for the past four years, the only variations having been the regular small temporary increases at the half years (when the demand for bills is temporarily restricted by window-dressing requirements), and the almost equally temporary rises during the international crises in September–October 1938 and March–April 1939. In maintaining this stability the syndicate has, of course, been greatly helped by the fact mentioned above (see p. 200) that hitherto increases in Treasury bills issued by tender have been accompanied by an inflow of funds to London and an increased demand for bills on foreign account, and decreased issues of bills by decreased foreign demand.

(*b*) *Changes in Demand Schedules.* A more important effect upon the discount rate than the changes in the supply of bills has been the changes which have taken place in the demand. Before 1931, especially after the return to the gold standard in 1925, the London discount market was merely a part, though a very important part, of the world market, and rates could not depart very widely from rates elsewhere if the gold standard was to be maintained. On the whole, the rather weak tendency of sterling during most of this period necessitated keeping the London rate at a level sufficiently above that ruling in other centres, and especially in New York, to attract and keep an adequate supply of foreign short-term funds. Since 1931 the instability of exchange rates and the growth of restrictions upon exchange transactions and capital movements have increasingly tended to isolate capital markets. To-day, short-term rates in London are controlled more by Treasury and Bank of England policy than by any external developments.

Under gold-standard conditions, an inflow of foreign funds automatically increases the cash ratios of the clearing banks and brings a fall in discount rates, while an outflow of funds brings a fall in cash ratios and a rise in discount rates. Under the present Exchange Account system of offsetting the effects of such movements, both on the exchange rates and on the banking system, the effects are far more complex. Under this system the immediate result of an inflow of funds from abroad is that the Treasury, through the Exchange Account, has to borrow sterling in order to buy foreign exchange or gold. If, as it normally does, it borrows initially on Treasury bills, there are three possible types of investor to whom it can sell them. It may be able to sell them to the owners of the newly transferred foreign funds. In this case the ultimate position is that the Account has the foreign exchange formerly owned by the foreigners, and the foreigners have the additional bills issued to pay for it. There is no effect on the banking system and there need be no effect on the discount rate. Secondly, it may persuade existing holders of bank balances to buy the bills. In this case the ultimate result is that, without an increase in the total of bank deposits, there is a transfer of bank deposits from the previous holders, who now hold bills, to the foreign owners of the newly transferred funds. This process will be accompanied by whatever rise in the discount rate is necessary to persuade the former holders of bank balances to buy the bills. Thirdly, it may be possible to sell the bills to the banks, or to market firms financed by the banks. In this case there is an increase in clearing banks' discounts or short advances and also in deposits, the increase in deposits being equal to the funds transferred from abroad. In other words, additional deposits are created for foreigners to hold.

There is some uncertainty as to the effect of this process on interest rates. The obvious result would be that the offer of additional bills for sale to the banks would depress their price and raise the discount rates. But if the discount rate is already being held by the syndicate at above the competitive level, a substantial additional amount of bills can be absorbed without a change in the discount rate. How much the rate

fixed by the syndicate is in fact above the competitive rate will depend largely upon the banks' cash positions. If they have an appreciable excess of cash above their normal minimum ratios, they could absorb a considerable quantity of additional bills without a rise in the rate. The Bank of England, in collaboration with the Exchange Account and the Treasury, can always, if it wishes, buy gold or securities, thus increasing the banks' cash ratios and placing them in a position to buy more bills if they so desire.

There is also some reason for believing that, in certain conditions, an increase in the sale of Treasury bills to the banks may not only not raise short-term rates but may lower long-term rates. It is argued that the banks, in considering the ideal distribution of their assets, have regard to their ratios, not only of cash to deposits, but also of all quick assets—i.e. cash plus money at call and short notice plus discounts—to deposits. If this last ratio falls below about 30 per cent, it is said that the banks may feel obliged to attempt to restore it by reducing their investments or advances. Thus a shortage of bills may have an effect on long-term rates similar to that caused by a shortage of cash.

This argument clearly depends upon two assumptions: first, that the banks have a cash ratio above the customary minimum; and secondly, that they abide by an agreement not to bid the price of bills up to beyond a certain level. In the absence of such an agreement, rather than sell £2 worth of assets yielding 3 per cent or more in order to remedy each £1 deficiency in bills, the banks would bid up the price of bills until the rate fell to zero or even became negative. At some point the demand of other holders of bills would presumably become elastic, and so enable the banks to obtain a larger share of a given supply. Further, the argument applies most clearly to the case where the ratio of quick assets to liabilities is already below the customary minimum. In these circumstances it is possible that an increase in the total of Treasury bills in the market may enable the banks to retain their investments and so help to prevent a rise in the long-term rate of interest.

It cannot, however, be argued from these premises that an increase above the customary level in the banks' ratio of quick assets to deposits will necessarily cause the banks to increase the totals of their advances and investments. Whether or not they decided to do so would depend on the attractiveness of the investment opportunities open to them. As the excess cash reserves of the banks in the United States show, no bank is willing to lose money merely because it has unused investing capacity. When the business outlook is uncertain, and the long-term interest rate is likely to rise, the banks may prefer to allow their quick-assets ratio to rise well above the minimum. If in such conditions the Treasury wished the banks to increase their holdings of securities, it would itself have to assume a larger share of the risk by issuing securities with early dates of maturity.

London, June 1939

TABLE E. BRITISH TREASURY BILLS

Treasury Bills issued by Tender

Weeks	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27
Years																											
1921																											
1922	690	690	690	680	655	630	610	600	580	565	555	550	543	528	513	498	496	511	526	546	561	584	597	611	617	614	616
1923	562	556	561	561	561	557	549	543	530	515	500	485	489	479	470	458	451	452	452	450	451	452	457	461	464	459	459
1924	495	495	497	497	492	492	485	475	461	447	433	424	413	408	403	395	389	394	392	396	400	402	412	417	427	432	426
1925	495	495	492	482	477	472	462	451	446	431	421	411	411	411	411	408	413	418	418	421	430	434	444	446	449	454	449
1926	516	516	517	512	498	488	475	460	454	448	436	430	426	425	417	419	424	434	439	449	459	464	471	479	480	481	482
1927	557	557	557	552	547	537	522	512	502	495	485	477	473	473	466	456	454	454	454	459	464	469	471	476	481	481	476
1928	553	550	543	533	518	508	493	488	480	470	458	448	443	436	436	441	446	446	451	461	466	469	474	481	484	484	486
1929	560	560	555	560	560	560	547	529	514	504	489	482	477	477	472	477	472	472	467	470	478	493	503	513	515	519	514
1930	573	563	548	531	516	498	479	464	449	434	418	405	395	390	390	388	390	390	393	402	402	407	422	433	441	446	446
1931	545	548	540	530	515	505	495	485	470	460	445	430	415	415	413	416	421	431	436	439	444	449	459	474	479	489	489
1932	540	538	531	518	504	489	476	464	454	449	444	449	454	459	465	477	490	499	504	512	514	514	519	523	520	517	515
1933	666	661	657	652	642	632	622	607	592	582	577	569	556	542	534	530	536	543	550	559	560	557	562	567	572	580	589
1934	592	577	562	547	537	526	516	506	496	483	470	463	458	458	466	474	484	488	494	494	494	499	500	499	492	487	482
1935	451	447	441	434	422	411	403	396	381	368	358	361	361	361	373	383	393	405	416	427	437	452	465	475	480	485	490
1936	565	556	550	545	540	535	525	515	505	505	505	503	498	493	498	508	518	528	538	548	558	568	573	578	583	595	605
1937	609	599	588	575	560	550	540	530	520	510	505	500	500	497	500	505	515	525	530	530	530	530	535	535	540	545	553
1938	622	622	612	597	587	572	557	542	532	522	517	512	512	512	512	522	532	545	560	570	570	570	575	580	585	583	578
1939	474	449	426	411	396	381	366	351	346	351	356	366	376	387	394	402	402	419	429	439	449	459	464	469	479	484	489

Weeks	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53
Years																										
1921		660	660	670	670	670	670	655	660	670	675	680	680	685	685	695	705	705	705	700	695	695	690	690	690	
1922	616	616	603	588	578	578	568	565	567	568	567	577	585	590	585	585	585	584	577	577	581	581	581	581	567	
1923	451	448	450	444	441	443	443	446	451	452	454	454	459	467	470	475	480	483	488	493	497	496	500	499	495	
1924	426	429	433	433	435	435	431	429	429	434	434	434	440	450	455	457	457	457	457	455	465	480	485	490	490	
1925	447	451	452	452	457	464	469	470	470	473	470	470	475	482	486	490	494	499	502	509	510	509	513	518	516	
1926	485	480	480	480	485	490	495	500	503	503	507	512	512	517	527	532	537	542	547	547	552	554	559	558	557	
1927	478	483	485	490	495	500	500	499	499	499	505	514	519	527	530	535	535	540	545	555	556	561	566	566	561	556
1928	486	488	493	503	503	501	501	501	501	501	503	508	513	518	518	518	523	523	530	535	540	545	555	560	560	
1929	514	514	514	514	519	524	529	524	519	519	524	525	530	535	540	545	545	550	555	560	565	570	573	573	573	
1930	446	453	458	468	473	473	476	476	466	466	466	471	476	476	481	486	491	496	501	508	518	528	535	545	550	
1931	493	495	500	505	510	512	512	512	507	502	507	501	496	496	499	499	494	499	504	509	519	524	529	529	535	
1932	516	516	521	530	535	540	555	565	565	566	569	573	578	578	583	584	585	595	605	610	625	640	650	655	659	661
1933	594	596	593	586	579	570	569	572	567	562	560	560	560	563	568	570	575	580	585	585	585	590	595	597	597	
1934	476	470	461	457	454	450	445	435	431	427	424	424	424	424	423	424	424	422	423	425	435	441	449	451	451	
1935	490	495	500	505	510	515	520	520	525	530	535	540	545	549	550	550	550	550	555	560	565	565	565	565	565	
1936	615	620	625	630	630	630	630	630	625	621	621	619	619	619	615	608	603	603	603	603	608	613	617	617	614	
1937	552	548	543	543	548	558	568	573	573	573	573	573	573	581	595	610	612	612	612	612	612	617	622	622	622	
1938	573	568	568	565	560	555	555	555	550	545	537	526	521	521	526	526	522	517	517	522	522	517	507	500	493	488
1939	494	499	504																							

Treasury Bills issued otherwise than by Tender (Tap Bills)

Weeks	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27
Years																											
1921																											
1922	378	374	371	359	357	360	365	357	353	454	341	344	*	298	287	269	263	253	245	236	210	212	206	200	194	*	161
1923	152	153	154	154	153	159	160	155	143	140	141	146	127	151	138	135	138	133	136	140	141	156	156	148	156	145	145
1924	153	152	153	154	155	157	155	153	154	154	155	155	*	154	155	156	156	152	147	158	165	168	168	167	167	*	167
1925	154	156	155	151	154	154	153	154	146	149	150	148	*	*	152	156	150	141	143	147	145	148	148	148	149	*	153
1926	*	128	134	135	141	140	138	137	138	129	132	131	*	*	124	125	126	122	123	126	126	132	133	135	135	*	*
1927	*	115	118	119	124	135	127	127	126	122	118	115	*	*	110	112	113	110	111	110	110	110	115	126	116	*	*
1928	94	92	91	90	89	89	89	88	85	85	84	84	84	84	84	84	85	82	84	86	87	93	94	95	96	97	98
1929	224	220	208	199	221	231	227	224	225	223	223	218	223	231	235	232	234	232	235	232	230	235	243	244	241	238	243
1930	227	222	210	208	203	201	199	194	197	195	197	194	*	185	181	179	180	184	182	183	175	175	185	185	182	*	184
1931	164	158	157	157	157	163	151	142	136	138	142	138	*	146	146	145	140	131	136	132	131	138	147	149	147	*	154
1932	*	135	122	108	100	101	98	98	99	116	132	126	*	*	134	135	132	126	117	105	97	88	102	105	102	*	*
1933	269	265	246	238	227	223	211	217	213	208	199	208	*	227	234	234	224	219	214	404	394	411	409	419	417	*	404
1934	348	351	343	346	348	347	342	344	343	343	341	346	342	354	340	356	359	365	370	372	370	362	362	361	360	361	363
1935	458	445	429	433	433	421	409	401	397	402	430	430	438	446	440	441	439	435	427	420	415	405	405	406	403	392	393
1936	332	339	328	321	311	284	271	268	269	259	257	259	*	204	197	226	227	225	219	212	208	202	214	215	210	*	198
1937	*	175	164	158	155	170	167	159	159	172	173	172	*	*	187	176	171	157	154	145	141	151	135	140	141	132	*
1938	*	312	309	301	292	282	277	276	273	282	284	289	*	*	305	307	296	289	282	278	276	281	309	311	303	306	*
1939	524	525	524	518	520	502	499	500	510	503	506	502	*	511	512	498	499	513	510	506	506	535	539	542	540	*	563

Weeks	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53
Years																										
1921		547	542	532	521	507	496	496	492	494	493	*	482	465	434	429	422	417	415	408	405	396	394	398	370	
1922	161	149	152	153	149	144	147	148	147	148	147	147	144	143	152	155	156	158	152	155	155	153	152	153	152	
1923	146	149	152	153	155	156	160	162	165	172	175	172	171	169	164	160	157	155	154	153	149	150	149	150	*	
1924	166	166	166	165	163	161	161	162	163	163	163	*	163	162	161	162	161	157	159	167	159	148	148	154	*	
1925	153	153	152	152	151	153	155	155	155	156	156	*	155	154	150	147	143	142	140	137	137	136	133	131	*	
1926	138	133	133	130	131	131	135	137	136	136	133	*	*	135	133	129	126	125	121	119	118	118	115	119	*	
1927	115	117	119	117	117	117	116	116	114	114	112	114	*	112	111	109	105	104	103	102	101	100	99	98	*	95
1928	99	100	101	103	106	109	111	113	118	121	124	128	132	136	145	155	169	180	190	204	206	212	224	226	*	
1929	243	244	242	251	256	252	248	247	252	253	244	*	244	252	253	249	248	245	237	229	232	240	232	232	*	
1930	187	183	180	176	175	175	165	166	179	183	183	*	187	180	181	177	178	178	171	167	164	172	171	168	*	
1931	150	146	143	152	148	143	139	133	144	154	138	*	*	104	109	111	119	127	122	117	119	144	153	154	157	
1932	234	232	227	231	230	229	268	261	258	288	295	292	*	290	289	282	273	261	245	261	254	238	247	276	278	267
1933	397	391	396	397	406	416	421	420	424	432	437	428	426	410	404	383	381	377	358	357	329	336	342	346	342	
1934	365	367	370	371	378	381	373	383	392	398	401	399	405	407	409	413	422	428	427	431	435	438	440	441	*	
1935	397	394	390	383	385	365	359	359	359	363	359	*	358	353	348	347	351	350	346	341	341	343	333	333	*	
1936	191	186	182	176	178	173	168	165	176	188	191	*	*	214	224	224	228	235	235	223	220	203	205	202	*	
1937	316	308	308	315	314	303	285	283	289	291	291	296	*	297	299	278	283	290	290	290	287	302	305	317	320	
1938	298	302	304	309	320	303	296	294	317	324	335	346	*	379	384	379	386	405	407	404	404	445	465	474	495	498
1939	563																									

* Not published.

APPENDIX II TO PART II

LONDON CLEARING BANKS AND BANK OF ENGLAND. DEPOSITS AND STERLING BILLS HELD, AND (CLEARING BANKS ONLY) ACCEPTANCES OUTSTANDING, ON ACCOUNT OF FOREIGN CUSTOMERS

(Amounts are stated in £000's)

	1927		1928		1929		1930		1931		
	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	31 Jan.	28 Feb.	31 Mar.
Deposits held on account of:											
Banks with head offices abroad	80,624	68,109	83,504	82,977	69,335	70,594	123,220	122,026	109,762	110,858	105,804
Foreign governments	16,983	19,897	19,531	25,534	26,493	19,307	13,500	11,133	11,039	10,316	9,174
Other foreign customers	20,998	21,979	22,149	22,990	23,274	21,530	25,000	21,118	21,475	20,129	20,333
Total deposits	118,605	109,985	125,184	131,501	119,102	111,431	161,720	154,277	142,276	141,303	135,311
Sterling bills held on account of:											
Banks with head offices abroad	111,205	133,382	134,169	172,267	160,356	163,238	122,584	118,918	112,768	113,863	108,660
Foreign governments	13,121	22,923	19,955	13,790	19,276	26,293	17,159	16,817	16,305	18,420	19,521
Other foreign customers	4,216	5,150	4,107	8,471	9,608	9,923	7,862	8,740	7,088	7,952	8,482
Total sterling bills	128,542	161,455	158,231	194,528	189,240	199,454	147,605	144,475	136,161	140,235	136,663
Total deposits and bills	247,147	271,440	283,415	326,029	308,342	310,885	309,325	298,752	278,437	281,538	271,974
Acceptances outstanding on account of:											
Banks with head offices abroad	27,693	27,084	34,787	46,994	46,158	34,823	39,690	31,557	30,828	30,369	28,770
Foreign governments	338	838	—	250	462	626	100	50	75	113	100
Other foreign customers	3,086	3,296	3,124	3,180	3,614	3,744	2,630	3,219	3,150	3,319	2,727
Total acceptances	31,117	31,218	37,911	50,424	50,234	39,193	42,420	34,826	34,053	33,801	31,597

SCOTTISH BANKS.* DEPOSITS AND STERLING BILLS HELD, AND ACCEPTANCES OUTSTANDING, ON ACCOUNT OF FOREIGN CUSTOMERS

(Amounts are stated in £000's)

	1927		1928		1929		1930		1931		
	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	31 Jan.	28 Feb.	31 Mar.
Deposits held on account of:											
Banks with head offices abroad	2,256	4,462	4,060	5,025	4,526	4,234	6,815	7,648	7,875	7,696	8,192
Foreign governments	18	19	20	20	21	21	63	2	1	—	—
Other foreign customers	2,366	2,350	2,784	2,885	2,717	2,604	2,802	2,682	2,575	2,568	2,661
Total deposits	4,640	6,831	6,864	7,930	7,264	6,859	9,680	10,332	10,451	10,264	10,853
Sterling bills held on account of:											
Banks with head offices abroad	440	159	231	762	753	733	195	203	191	160	142
Other foreign customers	14	5	7	23	6	39	22	47	9	8	9
Total sterling bills	454	164	238	785	759	772	217	250	200	168	151
Total deposits and bills	5,094	6,995	7,102	8,715	8,023	7,631	9,897	10,582	10,651	10,432	11,004
Acceptances outstanding on account of:											
Banks with head offices abroad	196	171	410	491	544	285	297	255	225	209	215
Other foreign customers	132	289	146	363	837	500	448	586	521	458	489
Total acceptances	328	460	556	854	1,381	785	745	841	746	667	704

* The figures relate to six banks only.

Deposits and Sterling Bills held in London on Foreign Account and Sterling Bills accepted on Foreign Account

(Amounts are stated in £000's)

	1927		1928		1929		1930		1931		
	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	30 June	31 Dec.	31 Jan.	28 Feb.	31 Mar.
Deposits with:											
Bank of England, clearing banks, and Scottish banks	123,245	116,816	132,048	139,431	126,366	118,290	171,400	164,609	152,727	151,567	146,164
Accepting houses	76,055	89,321	96,373	104,331	86,426	79,183	86,490	82,112	76,527	75,821	81,019
Total deposits	199,300	206,137	228,421	243,762	212,792	197,473	257,890	246,721	229,254	227,388	227,183
Sterling bills held through:											
Bank of England, clearing banks and Scottish banks	128,996	161,619	158,469	195,313	189,999	200,226	147,822	144,725	136,361	140,403	136,814
Accepting houses	9,432	13,115	9,147	16,863	14,466	19,379	8,647	8,040	6,744	7,043	7,380
Total bills	138,428	174,734	167,616	212,176	204,465	219,605	156,469	152,765	143,105	147,446	144,194
Advances to discount market by:											
Banks with head offices abroad	33,405	35,560	43,050	43,425	32,965	30,535	41,070	33,625	35,846	38,956	33,619
Other foreign customers	4,920	2,815	4,270	3,585	3,500	3,435	1,190	1,475	2,065	1,897	2,056
Total advances	38,325	38,375	47,320	47,010	36,465	33,970	42,260	35,100	37,911	40,853	35,675
Total deposits, bills and advances	376,053	419,246	443,357	502,948	453,722	451,048	456,619	434,586	410,270	415,687	407,052
Acceptances on foreign account by:											
Clearing banks and Scottish banks	31,445	31,678	38,467	51,278	51,615	39,978	43,165	35,667	34,799	34,468	32,301
Accepting houses	91,504	107,954	126,907	149,231	150,883	135,699	132,111	125,282	120,846	120,942	120,616
Total acceptances	122,949	139,632	165,374	200,509	202,498	175,677	175,276	160,949	155,645	155,410	152,917

LONDON CLEARING BANKS. SUMMARY OF THE MONTHLY AVERAGES (12 MONTHS)

(Amounts are stated in £ millions)

Year	Cash in hand	Balance at Bank of England	Money at call	Money at short notice		Treasury bills discounted	Commercial bills discounted	Investments	Advances (i.e. loans and overdrafts)	Current accounts	Deposit accounts	Total deposits	Acceptances outstanding
				To the money market	To the Stock Exchange								
1919	112·4	103·9	22·9	90·9	17·7	159·2	106·8	351·4	579·6	1,015·9	494·8	1,510·7	61·5
1920	105·8	83·7	23·8	54·3	22·0	115·6	144·2	367·7	831·6	1,097·6	622·1	1,719·7	75·8
1921	110·7	96·1	27·2	54·8	18·0	224·6	134·1	348·8	790·2	1,024·8	728·9	1,753·7	39·4
1922	107·5	92·9	29·7	58·8	23·4	208·0	113·3	420·6	711·8	998·3	709·1	1,707·4	36·5
1923	103·8	87·3	24·8	60·2	24·5	146·1	119·8	377·6	729·5	965·6	648·5	1,614·1	44·7
1924	103·8	88·3	24·6	57·2	22·8	104·8	125·5	364·7	774·2	950·0	665·7	1,615·7	54·5
1925	103·7	86·2	24·8	61·1	30·6	91·0	127·6	305·4	821·6	922·5	680·2	1,602·7	60·5
1926	103·1	86·1	25·0	63·1	32·1	100·9	107·8	284·5	858·0	921·4	687·5	1,608·9	52·1
1927	105·1	85·3	25·2	75·4	39·5	112·6	98·4	272·6	899·2	932·1	726·5	1,658·6	49·5
1928	104·5	83·6	28·4	77·7	48·0	107·7	118·2	275·3	923·6	953·7	755·2	1,708·9	65·3
1929	104·4	82·9	28·9	76·0	43·4	98·3	122·9	275·0	964·0	940·2	797·9	1,738·1	73·6
1930	103·6	84·5	33·1	80·1	28·5	128·6	127·2	281·5	933·4	920·8	820·0	1,740·8	58·0

SCOTTISH BANKS. SUMMARY OF THE MONTHLY AVERAGES (12 MONTHS)

(Amounts are stated in £ millions)

Year	Cash in hand	Balance at Bank of England	Money at call	Money at short notice		Treasury bills discounted	Commercial bills discounted	Investments	Advances (i.e. loans and overdrafts)	Current accounts	Deposit accounts	Total deposits	Acceptances outstanding
				To the money market	To the Stock Exchange								
1919	10·8	2·0	·7	3·8	·2	19·6	3·6	39·0	26·8	28·7	59·3	88·0	2·4
1920	17·4	1·0	2·1	8·5	·6	20·8	11·8	58·3	61·8	48·6	103·8	152·4	3·2
1921	21·8	1·0	4·4	10·9	·7	41·5	13·3	75·2	75·9	57·3	150·0	207·3	3·1
1922	19·3	·9	4·0	9·8	·9	28·3	11·6	99·5	66·0	56·4	148·1	204·5	3·2
1923	18·4	1·0	3·6	9·8	·7	13·4	11·7	88·5	68·7	56·8	124·1	180·9	3·2
1924	18·0	·9	4·1	9·4	·6	12·1	10·6	84·0	72·3	58·7	116·7	175·4	3·6
1925	17·7	·9	3·4	8·3	·9	10·1	9·7	78·7	79·0	58·8	112·3	171·1	3·7
1926	17·0	·9	3·9	7·9	1·0	10·5	8·4	74·4	82·7	58·4	109·6	168·0	3·7
1927	17·0	·9	4·1	8·4	1·3	9·3	7·9	73·2	86·0	61·2	107·4	168·6	3·8
1928	17·3	·9	4·4	8·1	1·4	8·1	8·8	69·9	92·6	64·1	107·3	171·4	4·2
1929	17·0	·8	4·3	8·9	1·4	10·8	9·0	65·4	97·1	62·4	110·7	173·1	4·8
1930	16·9	·9	5·1	10·0	·8	8·8	7·9	69·1	97·7	65·4	109·6	175·0	4·0

APPENDIX III TO PART II

THE LONDON GOLD AND SILVER MARKETS

By PAUL BAREAU

(*a*) *The London Gold Market*

Origins of the Market. The origins of the London gold market are lost in the early relics of British banking. It was on the foundation of dealings in coins and financing of merchandise transactions that English banking was built. The term 'goldsmith' symbolizes that process. The gold market in London developed very gradually. During the seventeenth and eighteenth centuries it disputed the supremacy with Amsterdam, but since the end of that period its foremost position as an international market has never been challenged. The reasons for its growth may be summarized as follows:

(1) all the factors which made for the growth of international banking in London—specially the immunity from invasion;

(2) Great Britain was the first country to base its currency on the gold standard;

(3) the Bank of England ever since 1844 (barring the short suspension periods) was a ready buyer and seller of gold at fixed prices. This may be contrasted with the obstacles which were placed by such central banks as the Bank of France on the free sale of gold at times of special pressure;

(4) since the 1860's most of the newly mined gold has come from the Empire—Australia, South Africa, West Africa and Canada;

(5) over the same period most of the non-monetary demand for gold has also come from the Empire, particularly from India, which between 1870 and 1931 absorbed on balance nearly £700 millions of gold and since then has disgorged over £250 millions of that total.

In orthodox gold-standard days the gold market was much less important than it became in the 1930's. Before the war of 1914–18 gold fixing was a very minor affair—held as a modest sequel to the fixing of silver, which was then the more important and profitable function.

Organization of the Market. The organization of the London gold market was comparatively simple. Business was handled by six firms each of which remains an authorized dealer in to-day's controlled market. These firms were:

(1) N. M. Rothschild and Sons, who combined several functions: agents for the Bank of England and the Exchange Equalization Account; representatives of the South African producers (which became virtually synonymous with the preceding function when the South African gold

was automatically purchased by the Exchange Equalization Account); brokers with an important domestic and foreign clientele; refiners operating the Royal Mint refinery (so-called because of its situation in Royal Mint Street and not because it operates under Government aegis).

(2) Samuel Montagu and Co., who combined two functions: bullion brokers with a specially important foreign clientele; dealers in gold, in which capacity they were greatly helped by their combination of bullion broking with the business of bankers and foreign exchange dealers.

(3) Mocatta and Goldsmid, bullion brokers.

(4) Pixley and Abell, bullion brokers.

(5) Sharps and Wilkins, bullion brokers.

(6) Johnston Matthey, refiners, combining dealing in unrefined metal and coins with their refining operations and acting as buyers for the trade.

Representatives of these six firms met at 11 a.m. in the offices of Rothschild and Sons and there 'fixed' the price of gold. This process, quite briefly, was achieved by bringing together all orders for buying and selling which these firms had on their own and for clients' account, and finding the figure at which these orders would balance. But before looking more closely at this interesting function let us investigate some of the more fundamental aspects of the gold position and the anchors to which the sterling price of gold was fixed. We shall then appreciate better the process of 'fixing' at which the gold market took corporate and specific shape day by day.

Basis for Gold Price. Before 1914 and in the period 1925–31 the anchor to which the open-market sterling price for gold was attached was the statutory price of the Bank of England. The Bank bought standard gold, i.e. $\frac{11}{12}$ fine, at 77*s.* 9*d.* per ounce and sold at 77*s.* 10½*d.*, and the market price inevitably fluctuated within the narrow margin separating these two prices. Until September 1919, the market quoted gold in terms of standard ounces. Thereafter the quotation came to apply to fine ounces. Between September 1919, when a free market in gold was resumed, and April 1925, when we returned to the gold standard, the price of gold was related to the prevailing dollar, guilder, or Swiss franc exchange—each of these three currencies being on a full gold standard. Between 1925 and 1931 the anchor was once more the statutory price of the Bank of England. Then, with our departure from the gold standard, the sterling price for gold had once more to become attached to the statutory price which one or more foreign central banks were prepared to pay for gold. These alternative supporting parities—dollars, guilders, French and Swiss francs and belgas—dwindled as the currencies in question themselves left gold, and between September 1936 and the outbreak of the war it was left to the United States dollar and the belga to provide the sole supporting parities. Of these the dollar parity was by far the more important, since the international trend of gold movements was

naturally directed towards the United States and therefore arbitrage interest in gold was largely focused on this currency.

The Dollar Parity. This dollar parity was based on the readiness of the U.S. Treasury to pay $35 per ounce of fine gold. Admittedly the United States were—and still are—on a '24 hours' gold standard', and the official price can be changed from day to day on Presidential initiative. But this price has remained unchanged since 1933 and thus acquired sufficient appearance of permanence to make it an effective basis for arbitrage shipments of gold to New York. The incompatibility between a 24 hours' standard and the fact that it took at least a week to complete a gold arbitrage operation with New York became apparent whenever the permanence of this dollar price for gold came under suspicion, as it did in the gold scare of 1937 when arbitrage shipments of gold to the United States came to a stop although the sterling price of gold fell to the altogether abnormal discount of 2*s.* under the dollar parity.

This parity was not a straight exchange equivalent. To take a simple example, if the U.S. Treasury paid $35 an ounce for gold and the dollar sterling rate was $5 to the £, the parity in London would not be $\frac{35}{5}$ = £7 an ounce. The parity was the shipping parity, i.e. the price at which it just paid to buy gold in London, ship it to New York, sell it at the official price to the U.S. Treasury and convert the dollar proceeds back into sterling. In exchange parlance, it was the gold export point. The expenses to be reckoned in arriving at this parity were the handling charge in New York (a big item of $\frac{1}{4}$ per cent); commission to brokers in London (saved if a brokerage firm handled the arbitrage), freight and insurance, packing, interest on the money locked up during the shipment (usually ignored during the cheap-money period), and the cost of the appropriate forward exchange operation. If, as was usually the case, forward dollars were at a premium, this item was not a debit but a credit in the cost calculation. Until the approach of the war began to play havoc with war-risk insurance costs, it was reckoned that the expenses of shipping gold from London to New York would be about covered if gold could be bought here at a price which, converted into dollars at the prevailing rate of exchange, gave an equivalent of $34·77 per fine ounce. If dollars could be sold at $4·68, the parity for the London gold price would on this basis have been: 34·77/4·68 = 148*s.* 7*d.* As soon as the price approached this parity, arbitrage buying of gold immediately occurred. If the price fell appreciably below the parity, one could assume that something abnormal was afoot. It occurred when the permanence of the American buying price for gold was brought into question during 1937; again in September 1938, when the international crisis caused a temporary breakdown in the machinery for insuring gold across the Atlantic; on isolated occasions it occurred when the flow of gold across the Atlantic assumed such proportions that all the shipping facilities acceptable to insurers were exhausted.

The dollar parity was thus a basic minimum sterling price for gold.

That price could and on many occasions did rise above this figure. For example, if there was a strong hoarding demand for gold, buyers were prepared to pay over the parity; or if sterling was bid in the foreign exchange market and the Exchange Equalization Account was acquiring gold, there was a natural tendency for the sterling price of gold to rise above the export point. The gold import point could be reckoned as being 1*s.* 9*d.* above the dollar parity, i.e. above the export point. Theoretically, therefore, the sterling gold price could rise to a premium of as much as 1*s.* 9*d.* over the dollar parity. The import point, however, was rather in the nature of a theoretical abstraction, since the U.S. Treasury only allows gold to leave America if the metal is destined for a central bank operating the gold standard and would certainly refuse to sell gold for disposal on an open market. The upper gold point in the sterling price of gold was, however, observed and made effective as a result of official intervention by the Exchange Equalization Account. If the premium reached a level approaching the import point, it paid the Exchange Equalization Account to buy dollars which had become cheap in relation to gold, to earmark gold in New York against those dollars and to sell an equivalent amount of gold in London out of its stocks. Official arbitrage of this kind could be depended upon to keep the sterling price of gold below the theoretical import point on the comparatively few occasions when it showed a tendency to rise towards that point.

The normal state of affairs was the persistence in the sterling price of gold of a small premium of $\frac{1}{2}d.$ to 1*d.* over the shipping parity. In practice the export point at which well-placed arbitrage operators began to ship gold to New York at a small profit stood slightly above the theoretical parity. There were several reasons for this. Some arbitrage operators could save brokerage charges here; others, such as the American banks, saved various charges in New York. For an extended period certain wide-awake operators had found a way of shipping gold to the United States by using the parcel post facilities of the French Post Office and thus saving a considerable amount on freight. Again, the persistence of a premium on forward dollars introduced an item in arbitrage transactions which tended to make it possible to ship at a profit when gold was bought above the theoretical parity—and paradoxically which made the profit increase with the length of the voyage (since the return on the forward sale of dollars was usually larger than the cost of interest on financing the shipment). Finally, a good deal of gold arbitrage partook of the nature of short-term exchange speculation—using that term in the sense in which it must apply to most adept exchange dealing —by buying gold at a certain moment and waiting to cover the corresponding sale of dollars—or vice versa, by selling dollars in anticipation of a gold arbitrage operation. If the view thus taken proved correct, arbitrage could take place with the sterling price of gold slightly above the theoretical parity—calculated as it was on the rate of exchange prevailing at the moment of fixing. In any case it should be remembered

that the dollar parity was not the only effective parity in the pre-war period. At certain times the belga provided the effective parity, and arbitrage purchases of gold at prices well above the dollar parity were on occasion destined for shipment to Brussels.

What Market Dealt In. Gold to be good delivery in the London market had to be in bars of 350–430 ounces assaying at least 995 per mille fine. The customary bar weighed about 400 ounces. Bars consisting of melted Continental coin, and thus 899–901 fine, or melted sovereigns, and thus 915½–917 fine, were also good delivery. These bars were a relic of the days of gold currency. All bars had to bear the stamp of a recognized assayer or refiner. Formerly, each bar was accompanied by a weight note and assay certificate, but this became less customary recently, the assay stamp on the bar being accepted as sufficient evidence of fineness, while one weight note covering all bars included in a transaction was normally drawn up.

Bars departing from the norm were accepted in the market, but only at a discount sufficient to cover the expense of refining or remelting.

A comparatively recent innovation in the stock in trade of the market was the so-called 'baby bar'. Small bars of 2, 5 and 10 ounces and of 1 kg. attained considerable popularity at the height of the gold-hoarding movement. They were made to meet the requirements of the small Continental hoarder who could not afford the 400-ounce bar. The price charged for these bars was that of their bullion content plus melting cost if they were sold to the public and minus that cost if repurchased from the public.

The gold market also did an important business in coins. This developed considerably during 1935–7 as a result of the flight from certain Continental currencies and of the hoarding of gold which went hand in hand with this movement. In view of the character of the demand for coins these were normally quoted at a premium on their bullion value. Dealings in coins in the London market at over their bullion value was at one time forbidden by the authorities on the theory that they encouraged the flight from the currency of friendly countries such as France.

The Fixing. Having cleared up these various features of the gold-market position, and in particular the basis of arbitrage operations, we can now view the daily procedure which was known as 'fixing' with more appreciative interest.

During the morning orders to buy and sell gold had reached the brokers' offices by mail, cable, and phone from the whole world over. These included newly mined metal arriving in this country (other than the South African, which went direct to the Exchange Equalization Account); some of the orders were for the trade, while in more recent years the successive waves of gold hoarding and dehoarding provided the market with one of the principal contributory factors in its turnover. Most of these were firm orders placed largely independently of the price to be fixed.

In addition to these orders, however, dealers in gold—banks and some of the bullion brokers—had been watching the trend of the exchange markets carefully and deciding whether they would be buyers or sellers of gold on their own account. The final decision on this score had of course to be postponed to the last possible moment.

The 'firm' orders to buy and sell reaching each firm were 'married', i.e. the sales offset against the purchases, and only the balance was taken to the fixing. This took place at 11 a.m. (10.30 on Saturdays) at the offices of Rothschilds. Each representative of the five visiting firms had a private telephone line from the fixing room to his office, while Rothschilds' representative was in touch with the Bank of England.

The position and trend of events can best be described by giving a hypothetical case. Let us assume that on the day in question there were 50 bars of newly mined gold for sale in the market. On the other hand, the Continent was hoarding gold and there were orders for about 100 bars from that quarter. The dollar on the day in question was quoted around $\$4.68\frac{1}{4}$ and looked like going firmer—if it did, the sterling price of gold would rise with it. If dollars could be sold at around $\$4.68\frac{1}{4}$ the dollar parity for the sterling price of gold should be just about 148*s.* 6*d.* If gold could be got at this price, there would be a good demand for it by arbitrage houses. The fixing was usually started by Rothschilds' representative suggesting a price as the beginning of negotiations. This would probably be the dollar parity, 148*s.* 6*d.* (the Bank of England dealers operating for the Exchange Equalization Account generally attempted to hold the dollar rate fairly stable during the few minutes normally taken by fixing so as to simplify the procedure). At 148*s.* 6*d.* there was an arbitrage demand for 300 bars of gold. This demand might come directly from firms represented at the fixing whose representative was instructed to bid by his dealer at the other end of the telephone wire. Or it might come from London banks or Continental operators who were in direct telephone communication with one or other of the brokerage firms while fixing was proceeding.

At 148*s.* 6*d.* therefore it was found that there was a net demand for 350 bars of gold—say £260,000. The supplier, 'if he would play', must be the Exchange Equalization Account. At that price, however, official quarters were unwilling on that day to sell gold—it may not have suited their current exchange operations to allow that much gold to be taken for arbitrage to New York on that particular day and for the corresponding sales of dollars to come on the market. As demand was greater than the available supply, the price had to go up. In view of the size of the unsatisfied margin, it probably went up by 1*d.*, though steps of $\frac{1}{2}d.$ were more usual. At 148*s.* 7*d.* notes were again compared. The position was broadly unchanged. The firm net demand for 50 bars was still there, while arbitrageurs could still work at 1*d.* premium over the nominal dollar parity. So the price moved again, this time to 148*s.* $7\frac{1}{2}d.$ At this point 200 bars of the arbitrage demand disappeared while a fresh selling order of 50 bars arrived from the Continent. It must not

be forgotten that during these few minutes the market position was in a constant state of flux, new orders coming in, old limits to buy or sell becoming effective, while exchange movements would play their part in altering the underlying conditions. The position with gold at 148*s.* 7½*d.* was that there was a net demand for 100 bars. The Exchange Equalization Account being willing to supply this amount, supply and demand met at this price. 'Fixed!' rang the cry round every dealing room connected with Rothschilds and the price was flashed by phone and cable to every part of the globe.

There was not always this hectic atmosphere. The process of fixing could be perfectly simple and straightforward and concluded in two or three minutes at the very first price suggested.

Instead of adjusting demand and supply by the orthodox method of varying the price, the authorities might decide to fix gold at a low price which suited their other operations in the exchange market, or their inter-central bank gold dealings, and to ration buyers. There was increasing resort to this procedure during the last few months preceding the outbreak of the 1939–45 war.

After the fixing was over, information was collected regarding the turnover. This included not merely the transactions brought to the fixing by each firm but also the orders married by them beforehand. The dollar 'parity' premium or discount was then calculated—in this case 1½*d.* premium—and the official announcement of turnover and price published. If, as sometimes happened, the dollar parity was temporarily ineffective, the announcement stated that the price had been fixed on a supply and demand basis and made no reference to the discount or premium on the parity.

There remained the routine arrangements for delivery of the gold bought and sold at the fixing. The rule of the London market was that both delivery and payment were for the same day as that on which the gold was dealt in, except on Saturdays, when the following Monday was the due date.

With the completion of fixing, the curtain had by no means fallen on the gold market for the day. In any case, dealings in coins were never taken at the fixing and these at times assumed exceptional importance. Moreover, the market in gold bars continued to function between the various dealers in London and the international market and did so 'the clock round', since dealings took place with America and the Far East. Prices in these post-fixing operations shifted with movements of the exchange rates. At times the post-fixing activity was exceptional and exceeded the amounts dealt in at fixing. On occasion the magnitude of the gold market after the fixing made recourse to the Exchange Equalization Account necessary, though the authorities usually showed some reluctance in dealing with the market after the fixing.

The Forward Market. A forward market in gold, which at times assumed considerable importance, developed after 1931. Any forward market in gold is obviously the product of currency and exchange

instability. There can be no basis for such a market when the price of gold is fixed by statute. After sterling's departure from the gold standard, certain gold producers began to sell their output forward in order to make sure of that part of the gold price exceeding 85*s.* an ounce which, because it was referred to as the 'premium', seemed to have about it an appearance of impermanence. By far the more important factor in the development of a forward gold market was not the offering of, but the demand for, gold. Forward purchases of the metal were effected for many reasons. Most important was the buying of forward gold as a hedge against general currency depreciation and in particular as cover against liabilities expressed in terms of dollars. The forward gold market's facilities were also used to provide cover against the invoicing of foreign trade operations in terms of gold (a much more common occurrence than was generally supposed in the pre-war period). Finally, forward gold purchases were effected as out and out speculative operations, the counterpart being the currency most vulnerable at the time. As a parallel to the speculative forward gold market certain attempts were even made in 1938 to develop an option market in gold, but this never attained much importance.

This forward market was operated to a negligible extent only by the 'marriage' of buying and selling orders. This was because when the market was really active it was always expanding in one direction—a general demand for forward gold occurring when currency scares prevailed and being followed by reselling of this gold if gold came under suspicion—as it did during the gold scare of 1937 and again when the increasing risk of war conjured up visions of gold sequestration. The forward market in gold was therefore almost entirely based on corresponding operations in the spot market, and on the rate for loans secured by gold for the period of the forward deal. When gold was bought forward, the seller in the market covered himself by buying gold spot and financing the metal during the currency of the operation. Thus if gold was bought three months forward when the spot price was 148*s.* and the rate for a three months' loan against gold was $2\frac{1}{2}$ per cent, the forward price would be slightly over 148*s.* 11*d.*

The forward gold market was never a free market, partly because it always tended to be a one-way market and because of the paucity in the number of firms handling such operations. In this lack of freedom it offered a curious antithesis to the spot market which provided an almost classical example of a free and elastic market. Thus when forward positions in gold were being 'undone' it was generally at the prevailing spot price, though fresh buyers of forward gold at the time would probably have had to pay the premium indicated by the appropriate interest rate.

The forward market was subjected to an official ban in 1935 at the request of members of the then harassed 'gold bloc' countries whose currencies were being hard pressed by forward gold speculation. The ban was removed in the spring of 1938, but reimposed again in January

1939, owing to the development of speculative attacks against sterling. Commercial operations in forward gold were, however, exempted from the ban.

Exchange Equalization Account and Gold Market. In gold-standard days it was the Bank of England which provided the ultimate buyer or seller in the gold market. After 1932 that position was taken by the Exchange Equalization Account. The authorities were always ready to buy or sell gold—at a price. These official operations were co-ordinated with the tripartite agreement machinery which made gold the ultimate instrument of exchange control, even in the days of shifting gold prices and parities. The Exchange Equalization Account seemed to welcome the role which it could play in the open gold market, as its operations in that market allowed it to intervene with a maximum of effectiveness in the foreign exchange market. If sterling required some support at the level temporarily chosen for it by the authorities, the 'control' would sell gold in the market at a price which would make arbitrage with New York possible. The sales of dollars by the arbitrage operators (selling the dollars they would obtain for the gold shipped to the United States) would provide the necessary support for sterling. Why, it may be asked, did the authorities not sell dollars directly in the market against unearmarking of gold in New York? The answer seems to be that the machinery of the open gold market, though it was indirect and involved giving an arbitrage profit to banking houses, proved by experience to be more efficient than direct official intervention in the exchange market. Direct official sales of dollars were too obvious and concentrated to have as great an effect on the market as a similar amount of dollars liquidated by several gold arbitrage houses whose sales would be well diffused and would percolate to the market from all points of the compass.

The gold market could not, however, always be depended upon by the authorities to provide the channel for their intervention in the foreign exchanges. There were times when pressure on sterling was too great to be countered by sales of gold in the open market. There are fairly rigid limits to the amounts of gold which private arbitrage can carry at any particular moment. These limits are determined by the capacity of the shipping and insurance markets and by the natural restrictions which any particular firm must place on its open commitments of a particular character. At certain times extraneous events such as war scares interfered so much with the free functioning of the arbitrage machinery (by removing marine insurance facilities, for example) that, just at a time when the authorities had perhaps to give special assistance to sterling, the open gold market ceased to be effectively available for their purpose. These, however, were the exceptions. Over the greater part of the 1932–9 period the London gold market was playing an unsuspectedly important role in the machinery of our foreign exchange control.

(*b*) *The London Silver Market*

Growth of the Market. The London silver market evolved gradually during the course of the nineteenth century, and by the beginning of this century it was functioning on lines very much akin to those which it follows to-day. The reasons for its growth are to be found in the usual combination of political and geographical factors. The main users and buyers of silver were to be found in the countries of the Far East. The main output of new silver came from North and Central America. Our strong trading and banking representation in India and China made us the obvious channel through which silver should reach those countries. Our geographical position helped to make us an equally obvious link between the supplies of silver coming from the New World and the ultimate absorption of the metal in the East. With every important Eastern bank and trading concern directly represented in London and with smelters in America establishing direct contact with London firms of bullion brokers, our market acquired a dominance which was never challenged except after the initiation of United States silver policy in 1934—of which more anon. Until then the price for silver which the London market fixed was in fact the world price, and though since 1935 this price may have been anchored to the buying price for imported silver decreed by the U.S. Treasury, it is interesting to note that it was still through the London market and its fixed price that the new American anchor for silver found its expression as an effective world quotation.

Organization. The organization of the London silver market is extremely simple. The whole business is concentrated in the hands of four firms of bullion brokers, each of them also members of the gold market. They are Mocatta and Goldsmid, Samuel Montagu and Co., Pixley and Abell, and Sharps and Wilkins. Although intermediaries, in the sense that they make their profit by charging a brokerage, and not by quoting differential buying and selling prices, these firms in fact act as principals. There is no 'passing of names', i.e. ultimate buyers and sellers are not put into direct touch with one another and the brokers take the full risk for the due fulfilment of the contracts which pass through their hands.

The market deals in bars of silver which vary in weight from 900 to 1,250 ounces and which assay between 996/1,000 and 999/1,000. Although the metal dealt in is of this high degree of fineness, the price quoted is that for standard silver, i.e. $\frac{11}{12}$ or 925/1,000 fine. This is a relic of the days of the sterling silver pound, which was of this fineness. Brokerage is paid by the buyer only. It amounts to $\frac{1}{8}$ per cent when the price is over 21*d.* per standard ounce and £1. 2*s.* per 10,000 ounces when the price does not exceed this figure.

The Fixing. The process of 'fixing' dates from the closing decades of the nineteenth century. Before then with silver tied to the Chinese and rupee exchanges, and with remnants of the bi-metallic system still maintaining a fairly rigid ratio between the prices of silver and gold,

the price of the former moved within such small margins that the operation of fixing was carried out by an informal interchange of notes between the offices of the brokerage firms. Thereafter a more formal meeting was held on days when the 'packets' bringing silver from America arrived. Since the beginning of this century the fixing has been a daily proceeding. The orders to buy and sell silver which have been reaching the offices of the four firms of brokers during the morning are taken to a meeting of the partners held at the offices of Sharps and Wilkins. Before the war this meeting was held at 2.15 p.m. Since then it has been advanced to 12.45 p.m. in accordance with the shortening of banking hours.

At this meeting the total of buying and selling orders are compared, and in the light of the limits which are appended to them a price is found at which the closest balance between demand and supply is reached. The 'fixing' of silver is not complicated as was that of gold by the existence of a highly sensitive arbitrage machinery which continued to move with alterations of rates of exchange while fixing was actually proceeding. The state of the silver market may continue to change while fixing is in progress, and orders which are received by bullion brokers are transmitted to the representatives. But the contact between the partners attending the fixing ceremony and their offices works only 'one way'. Orders can be transmitted from the offices, but there must be no intimation back to the offices of the way in which fixing is proceeding.

Cash and Forward. The meeting fixes two prices. One is the spot or cash price, business at which must be completed, at the seller's option, within seven days. The other price is that for forward delivery which is exactly two calendar months from the day on which the business is transacted. This period of two months is an unusual one in futures markets. It seems to have originated from the practice of silver smelters to sell forward the silver contents of the ore they purchased. It took about two months for this silver to reach London, and thus was established a tradition which has endured—as so many traditions have done—long after their causal factors had disappeared.

The forward market in silver is very free and active, and from this point of view contrasts very pointedly with the former forward market in gold. It is a two-way market fed by genuine commercial transactions as well as by hedging and speculative operations. Until the United States came to absorb most of the newly mined silver, much of that metal was sold forward for disposal on the London market. The hedging operations in the silver market have diminished in recent years and particularly since China demonetized silver. Before November 1935, when the final break with silver was made, the rate of the Chinese dollar and of silver tended to move together, and the forward silver market was thus the main channel through which Chinese exchange risks were hedged. If an exporter was due to receive payment in Chinese currency at some future date, he hedged his risk by selling silver forward. Simi-

larly, if a bank had discounted bills payable in terms of Chinese dollars, the operation could be similarly hedged by the appropriate forward sale of silver. In addition, the forward market is fed by a steady stream of speculative orders facilitated by the fact that a margin of 15 per cent only has to be maintained against forward operations. Finally, this forward market derives flexibility from the existence in London of substantial stocks held by the Indian Government and therefore available for swap or 'budla' operations, as they are known in silver, whenever the margin between spot and forward prices makes such deals attractive.

It used to be a rule of the London market that a price *must* be fixed at which all offerings would be absorbed. This rule had to be suspended in 1935 when India was unloading silver in large amounts following the break in the American purchasing programme which began in 1934. The weight of metal coming on the market and the unwillingness of the American official buyer on certain days to take up the silver thus sold made it impossible for silver to be fixed. When the rules of the market were revised in 1936 this provision was left out, and it is now open to the market to leave selling orders unfulfilled or to ration them.

The procedure of fixing does not exhaust the activities of the silver market for the day. Dealings continue after fixing at prices varying with the relative trend of supply and demand.

Silver's Anchorage. The anchors to which the sterling price of silver has been tied have varied considerably in the past. Up to 1873, when most Continental countries still adhered to a bimetallic currency standard, the silver price was determined by the ratio first of 15 : 1 then of 16 : 1 as against gold. This meant a comparatively narrow range of prices around the mean of 60*d.* which lasted until 1873, when the demonetization of silver in Germany led to the first serious break in the price of the metal. Until 1893, however, silver remained the currency standard in India as well as China (which was only to abandon it in 1935). The rupee and later the Chinese exchanges therefore provided some kind of anchor for the sterling price of silver—though not so rigid an anchor as that provided for the price of gold by the interplay of gold parities and arbitrage. Neither in India up to 1893 nor in China up to 1935 were there issuing authorities prepared to pay a currency price for silver or conversely to sell silver at a statutory figure. The link between their exchanges and the price of silver had to be maintained ultimately by the much more laborious process of metal going into or coming out of circulation, though this process was to some extent accelerated by the bullion and exchange operations of the important Far Eastern banks. Beyond these currency links the price of silver appeared to maintain a loose connection with the general level of commodity prices. When the level of prices rose—whether as the result of war or for some other reason —the price of silver tended to follow. In part this was due to the influence on the silver market of the purchasing power of the Indian peasant, whose purchasing power and predilection for silver hoarding tended to increase as the prices of his produce rose.

U.S. Silver Policy. The whole silver position was revolutionized by the silver policy of the United States which began to take form with the Thomas amendment to the Agricultural Adjustment Act and which was finally enshrined in the Silver Purchase Act of 1934. This is not the place to deal in detail with the abysmal fallacies and misconceptions which underlay the policy launched by these measures. Suffice it to say that measures which were intended to 'ensure greater stability in the price of silver' were followed by the most chaotic fluctuations the silver market has ever known; that a policy which was intended to 'rehabilitate silver as monetary metal' was in fact the direct cause of the abandonment of the silver standard by China, the only country which then remained on the silver standard. The aggressive American buying of silver and the speculative orgy to which it led raised the world price of the metal so high and the consequent appreciation in the Chinese dollar wrought such havoc with Chinese export trade that silver had to be demonetized in China. The silver programme as embodied in the Silver Purchase Act aimed at building up a silver reserve which would equal one-third of the gold held by the United States. Since that Act was passed the U.S. Treasury has bought some 2,000 million ounces of silver; and yet owing to the even greater growth of the gold reserve the goal of a 1 : 3 ratio between silver and gold in the metallic reserves of the United States is further from attainment to-day than it was in 1934 when the silver programme started.

From the point of view of silver market mechanics the important feature of the silver programme has been the price quoted by the U.S. Treasury for imported metal. Since China's departure from the silver standard this price has in fact been the anchor of the world price for the metal. There has been no semblance of fixity about this price. Since the beginning of 1938, for example, it has dropped from 45 to 35 cents per fine ounce. But the changes have on the whole been concentrated in short periods, and there have been sufficient periods of stability to provide the basis for silver arbitrage operations between the London and New York markets. Most of this arbitrage has been effected on a covered basis, i.e. the operators—mostly American banks—have dealt on the basis of a stock of silver in New York which has been sold to the Treasury as it was being reconstituted by shipments from London. In addition there has been a fair amount of American trade buying of silver in the London market. All domestic newly mined silver in the United States is taken by the Treasury at a highly preferential price, and the trade in the United States is therefore compelled to depend upon supplies of imported metal if it is to buy at the world price. By this two-fold influence of arbitrage operations and trade buying the sterling price for silver has on the whole been held very close to the shipping parity to New York.

There have, however, been fairly important deviations from this parity. For example, the initial burst of speculative optimism let loose by the start of the U.S. purchasing programme caused the sterling price

to soar far in advance of the price at which the Treasury at Washington was prepared to buy. Again in the summer and autumn of 1939 the existence of an important bear position in the London market, coupled with the imposition of sterling exchange control, served to keep the London price at an appreciable premium over the dollar parity. With the imposition of the ban on the import of silver into this country the sterling price for silver became temporarily divorced from any external parity.

In addition to normal London delivery business the London market has at times handled important business for account of the Indian Government in respect of silver which has never come to this country. When selling silver to Indian operators the Indian Government chose for a long time to do so almost exclusively through the London market. The general rule was to make such silver available at the Bombay Mint on the basis of the London price plus the equivalent of shipping costs from London to Bombay. It is this type of business which provided the London market with the bulk of its activity since the imposition of the embargo on silver imports. Now, however, it has been decided that such business might as well be done direct through the Bombay office of the Reserve Bank of India, and London will thereby lose a fairly important source of revenue. This development will emphasize the loss in stature which the London silver market will have suffered from the restrictions which have been placed on the free movement of the metal.

PART III. OTHER BANKING AND FINANCE FIRMS IN LONDON

CHAPTER 12. *INTRODUCTORY*

THERE are several difficulties in the way of an exhaustive description of the work of that very important group of financial institutions which is in some ways the most characteristic feature of the City of London. The group is, primarily, made up of the international banking and issue houses such as Barings and Rothschilds. But one of those old London private banks which are original members of the Clearing House and are therefore 'clearing banks' has not built up a great chain of branches. It therefore carries on business of a different type from that of the clearing banks. This banking house, Glyn, Mills and Co., should also be counted in the group to be considered in this part of our study.[1] The rest consist of finance houses of widely different character and purpose established mainly after the last war.

The variety of their business and the differences in their importance make it difficult to find a satisfactory term for this group of banking and finance firms as a whole. Many do acceptance business, and the group is sometimes referred to as 'the acceptance houses'. But not all of them do this business. The same group is sometimes referred to as 'the issue houses', but again not all of them participate in that business. If we call them merchant banks, partly to describe the origins from which many of them have grown and partly to differentiate them from the clearing banks, we also incur the charge of inaccuracy, for not all of them have grown out of merchant firms, and one, at least, of the clearing banks belongs to this group. If, as is frequently done, we call them 'private banks' there is the objection that some of the most influential amongst them are to-day public limited companies. What does distinguish them from the rest of the British banking system is that they do not offer banking services for the average depositor, and therefore they do not possess nation-wide branch systems.

The character of this group of firms is as much a direct consequence of the peculiar development of banking in England as was the formation of nation-wide branch banks. The rise of the

[1] This was written prior to the purchase of Glyn, Mills by the Royal Bank of Scotland. It is not probable that that transaction will change the policy of the former.

banking habit and the adoption of the cheque as the most important medium of payment determined the structure of deposit banking. The capacity for attracting deposits, i.e. conducting banking business, became dependent after the turn of the last century not so much on the rate of interest allowed on deposits as on the safety, efficiency, and cheapness of the service of effecting payments and other routine banking business for the depositor. Those institutions which could not adapt their organization to this main function could not continue in any business dependent on deposits. This is the reason why among the existing independent financial institutions only one English private banking house remains.[1] With the growth of nation-wide banking chains they have disappeared as they could not in general find any adequate substitute for their normal banking activities. Their resistance to the admission of the joint-stock banks to the London Clearing was futile. As the plans elaborated by the management of the Westminster Bank under the leadership of Gilbart show,[2] a continued refusal would merely have led to the establishment of a rival to their clearing centre and possibly to their even quicker and less smooth elimination from what is conventionally termed the 'classical' banking business. As it was, the English private bankers combined into powerful joint-stock companies—like Lloyds and Barclays—which then competed on equal terms with their rivals, the growing joint-stock banks. Indeed, they not only were able to survive but they absorbed lesser joint-stock banks. Those who did not succeed in preserving their entity in this manner were absorbed by the joint-stock banks. The fact that private banks in London were members of the Clearing House was an additional stimulus to provincial banks to try to affiliate with them. And if the 'private bankers' in most cases lost their corporate identity (though, in the case of some, the absorbing banks assumed their name—e.g. Martins—and in others were left their independence—e.g. Grindlay, Williams Deacon's, and Coutts[3]), the social prestige and the connections which the families owning these private banking firms enjoyed, in many cases secured them a very powerful voice on the board and management of the bigger institutions.

The growing tradition of deposit or clearing banking, however, demanded abstinence from long-term financing, if such financing was at all likely to conflict with liquidity of the assets. There was

[1] Cf. footnote 1 on p. 227.
[2] Cf. Gregory, op. cit.
[3] Cf. footnote 1 on p. 227.

further the necessity of maintaining a vast network of branches and entrusting the management of the day-to-day business to officials educated in the tradition of caution. These two factors created a void in the financial structure previously filled by the private banker. This void was the vast and indefinable field of special finance, of expert advice, of reorganizations, in short the field of banking and financial business requiring the attention and capacity and the power of decision of principals untrammelled by boards and committees, by set rules and regulations. Before the 1914–18 war the time was not ripe, however, for the English private banker to grasp this opportunity. The scope in internal British business was insufficient to maintain powerful organizations. The reasons for this are discussed below. As they did not find a temporary field for operation, they almost completely disappeared.

But meanwhile another group of financial institutions had established itself in London, in the main transferred from foreign centres. Some of them came for the sake of political security during the Napoleonic wars; some grew into financial institutions after they had established themselves primarily as merchant houses; others were attracted by the unrivalled opportunities in trade, banking and finance which London offered in the last century. As England became the most powerful industrial country, London became the financial centre of the world.

The oldest of these firms still surviving is the firm of Baring Brothers. It was established in the eighteenth century in London and Exeter. At first it specialized in the woollen trade. Its close connection with the most important Dutch firm of the day, Hope and Co., later resulted in its ceasing to trade and wholly concentrating on (foreign) banking business. Rothschilds, on the other hand, is an example of the transference to London of a firm already established as an international banking house, as an agent for foreign Governments and for the financial counsel of powerful clients rather than of a 'merchant' banker; this assumes that dealing in precious metals is regarded as finance rather than trading. One of the latest important firms of this last type to establish itself in London was Higginson and Co. (1907). These foreign firms, with their international connections and their then unrivalled opportunities for obtaining promptly reliable information about business conditions throughout the world, were responsible for the increasing internationalization of the banking and other financial business of London, during the period in which the

original private banking firms in the City, who mainly relied on internal business, were increasingly feeling the detrimental effect of the competition of the growing deposit banks. Neither group could hope to accumulate banking resources on the same scale as those banks. The international banking houses found profitable business in the fifty years preceding the 1914–18 war in both short- and long-term foreign financing. The deposit banks, although they gradually extended their operations into important parts of this business, were not able or willing to compete for or oust them from their leadership.

This historical development explains the present structure of the 'City' banking firms. The English private banks, especially the 'country' banker, could not find a new profitable business outlet unmolested by the competition of the growing clearing banks. They therefore disappeared from the scene long before the last war. The originally 'foreign' firms (and English firms which consciously modelled themselves on their example) not only survived, but were at the zenith of their power and success at that time. They became, both with respect to personnel and traditions, the most aristocratically English of all City groups. When their position in turn was assailed by the clearing banks in the post-war period, the change in the technical and financial structure of home industry and the insatiable demand for credit by foreign countries provided them with a new field of activity which, if it was not as stable nor as profitable as their pre-war activities, was sufficient for survival. Their existence was much more threatened after 1931, and the outbreak of the 1939–45 war, with its adverse repercussions on the non-clearing banks, seems to have merely accentuated the decline in their influence and affluence already noticeable earlier.

CHAPTER 13. *THE PRE-1914 BUSINESS OF THE GREAT CITY INSTITUTIONS*

A. Acceptance Credits

WHILE the British clearing banks made a profit upon their capital by attracting deposits at a relatively low rate of interest through offering services and employing the money at remunerative rates, the private institutions in London were securing a somewhat similar gearing of loan capacity to capital by developing an acceptance business.

They charged their clients a fee for endorsing their bills, and they made it possible for them to borrow in the London money market at rates far more attractive than those at which they could have obtained advances from the clearing banks, if they—especially the foreign clients—could have obtained credits at all directly in the formative period of the clearing banks. The steady canalization of international liquid funds through London resulted in a growing demand for safe short-term investments. The acceptance houses, with their extensive connections, were able to carry the risk of accepting bills. Once they gave their acceptance the bill was transformed into a first class short-term asset. To a considerable extent, therefore, the growth of the volume of business of the two groups was complementary. The acceptance houses obtained the advantage of a high gearing of acceptance business to capital,[1] the clearing banks that of deposits to capital. The business of each was to a large extent dependent upon that of the other, and the whole was linked together by the relatively smooth functioning of the discount market. For reasons which have been explained in the previous sections acceptance business became increasingly international in the generation preceding the 1914–18 war. Thus, after the decline of the inland bill, sterling bills payable in London, mostly on behalf of foreign clients of London acceptance houses, came to form the second-line reserve of the British banking system. The existence of this fund of short-term claims on a great variety of countries, secured in principle by documents embodying the ownership of the commodities under transhipment or in warehouses, served, incidentally, as the second line of monetary reserve of the country. England permitted the less wealthy foreigners to carry its gold reserve and obtained interest payments on it.[2] As the foremost creditor and banker she could dispense with the costly holding of actual international cash. The only flaw in this harmonious structure was the possibility of such sudden heavy drains of foreign funds accompanied by tempting bids for new credits as could not be quickly enough countered by a recalling of the credits through an increase of the bank rate. On such occasions internal finance and banking were adversely affected, provided foreign help was not used to permit the neutralization of the drain. On balance

[1] The usually accepted proportion is 1 : 3 or 1 : 4 (Kindersley, *M.E.* Qu. 1204). It is obvious from published balance sheets and other statistics that this limit was not always strictly or prudently observed.

[2] Cf. Goschen, *Essays and Addresses on Economic Questions* (1885), p. 119. Cf. below, however, on the changes in the last decade before the last war.

Britain probably profited heavily from this system. The activity of the international banking firms provided England with a direct foreign income which before the last war must have amounted to tens of millions annually. It also gave rise to further foreign income of not lesser proportions. It strengthened (as it was strengthened by) the paramount position which Britain assumed in the export trade in general and in the entrepot trade in particular. Given the uncontested creditor position of the country, the increase in business fluctuations in contrast with, for example, those experienced by France was not so considerable as to offset these advantages.[1]

The volume of the total commitments[2] of acceptance houses prior to 1914 is not known. What we do know is only the stamp revenue indicated on the average total volume of foreign-drawn bills which in 1913–14 amounted to £335·8 millions. In the same period stamps were paid on £165·2 millions inland bills outstanding on the average.[3] By far the largest proportion of the total must have been accepted by acceptance houses, as the competition of the cheque clearing banks in this field had as yet hardly begun.

B. The Finance of Foreign Governments and other Overseas Borrowers

The international acceptance business provided these banking houses with other remunerative business. Their close connections with foreign countries, acquired in the course of financing trade, made them the natural channel through which the Governments and other large borrowers approached the British capital market. As acceptance business requires a certain amount of geographical specialization on the part of the different houses, their relations with foreign Governments tended to show the same specialization. Baring, Lazards, Hambros and Rothschilds became in different degrees bankers in London to foreign countries and corporations, arranging all their financial business for them through the various stages by which temporary accommodations slowly matured until

[1] Given the greater dependence on foreign trade (and more particularly on the export of capital funds) the sensitiveness of British business activity to changes in prosperity abroad was in any case greater. On the other hand, a very much higher standard of consumption could be secured by concentrating on highly productive activities.

[2] That their commitments did not substantially increase after the period of their greatest prosperity is suggested by the fact that as early as 1890 the liabilities of Barings at their reconstruction were as high as £21 millions, a figure not surpassed since. Cf. Andreades, ibid. p. 368.

[3] Cf. previous section on the volume of acceptances.

a long-term loan could be sold on the London and other international markets. The amount of business undertaken was frequently substantial. If foreign Governments were thus able to obtain capital, the London house acquired access to Governments and other important factors in foreign countries, which was not without use in their activities of granting acceptance and commercial credits.

The importance of private banking houses in providing in London a close institutional link between public and private, short- and long-term borrowing on foreign account, is shown by the magnitude of the issues they sponsored. It has been estimated that between 1870 and 1914 out of a total of £3,600 millions invested abroad by Britain on long-term not less than £1,350 millions were placed through them.[1]

C. Large Deposits and Foreign Exchange Business

Both acceptance business and the finance of Government and private issues gave rise to foreign deposits in London.[2] It was a usual practice to require a client who was given a line of credit for acceptance to maintain a minimum balance in proportion to his availments; and considerable sums were necessarily held in London

[1] According to a Report prepared for the National Bureau by Professor W. A. Brown as quoted by *The Economist* (Nov. 20, 1937), the channels of British investment abroad between 1870–1914 were as follows (in £ millions):

Period	Official and semi-official agencies	Private banks	Joint-stock banks	Overseas banks and agencies	Companies *via* their bankers	Other media*	Total
1870–74	7·1	207·4	17·0	37·5	70·9	50·7	390·6
1875–79	21·6	54·4	1·2	36·9	19·4	15·7	149·2
1880–84	23·8	136·8	11·9	50·0	94·8	38·0	355·3
1885–89	47·2	210·3	25·5	35·4	125·0	35·8	479·2
1890–94	36·5	162·2	31·3	30·8	68·7	20·1	349·6
1895–99	30·1	90·9	40·0	73·2	91·1	34·3	359·6
1900–04	71·0	49·4	46·0	37·1	43·1	11·6	258·2
1905–09	52·4	166·7	62·0	114·4	95·3	19·1	509·9
1910–14	64·9	275·8	135·9	147·2	137·3	22·9	783·8
Totals	355	1354	371	562	746	248*	3636

* Comprising: (*a*) Investment trusts, £23 millions. (*b*) Finance, land and property companies, £18 millions. (*c*) Special purpose syndicates, £41 millions. (*d*) Issue houses with stock exchange connections, £22 millions. (*e*) Companies as their own issuers, £13 millions, and (*f*) miscellaneous issuers, £131 millions.

[2] Kindersley, *M.E.* Qu. 1247.

for this purpose. The handling of the issue and other financial business of foreign Governments and private firms also required the maintenance of London deposits which might be highly variable in amount. All these deposits tended to accumulate in the hands of the banking institutions, which granted the acceptance credit or acted as agents for the foreign loan. In this way they obtained a substantial addition to their own resources and were able to maintain a higher gearing of business to capital.

The administration of these deposits involved purchases and sales of foreign exchange and, when the occasion required, of bullion. The banking houses had to develop this business and, until 1914, dealing in foreign exchanges and gold remained their exclusive domain. But the sterling acceptances were then so widely used that business, even business between foreign countries, was often conducted in sterling. The bill through which payments for imports were made would be drawn upon the importer in sterling, and the acceptor of the bill would be responsible for acquiring the exchange. Exports were also mostly quoted in sterling. Under these circumstances there was relatively little regular foreign exchange business for the ordinary banks to do directly on behalf of their customers. The decline in the use of the sterling bill since the last war has changed this and has made a very large breach in the monopoly which the acceptance houses formerly enjoyed in the foreign exchange market.

D. Investment Advice

The special influential connections which the city banking houses built up all over the world, in every branch of industry and commerce, made their advice and information on long-term investment highly thought of. More and more clients, including financial and banking institutions, came to rely on it and to use it by entrusting London houses with the management of their affairs and investments. To some extent—as the U.S.A. experience in the twenties shows—this function seems incompatible with their role as issuing houses. In practice some firms succeeded in combining these two activities and a few, as we shall see, have specialized in the former.

The combination of a strong capital basis with all, or some, of these activities gave these houses a prestige and financial power which opened further opportunities in the field of general financial operations; these are scarcely capable of definition nor can the

types of deals be enumerated, as they are so manifold. Reorganization of big companies, financial reform in debtor countries, became as much their domain as were special transactions such as the placing of big blocks of shares.

It must not be supposed, however, that all private banks attempted to combine all these functions or that they could attempt to do so. Most of them were able to exercise at least several of these functions, with the acceptance business providing the bulk of the 'bread and butter' business. But the structure of each private bank was, and remains, widely different from the others, the result of an organic development in which origin, family ties, friendships, the personality and ability of the partners, and chance, have exerted their varying influence. Some of them dropped their banking activities altogether and specialized on finance and investment advice. Some of them retained departments dealing with the precious metals, others handle gold only as far as it may be necessary in connection with their foreign exchange dealings. On these developments M. Truptil's book gives valuable information which cannot be recapitulated here, and a few examples must suffice.

Barings (London, 1717–1763) had important early family connections with the United States and, through Hope and Co., with the Continent. It became the agent of the Imperial Family and the Government of Russia. Its commercial and financial activities led to important connections with Governments in South America (its commitments in Argentina were to cause the crisis of the firm in 1890 and its reorganization as a public limited liability company, the first of all international banking firms to assume this status). In the post-war period it participated in the issue of loans to Germany and the Central European countries together with Rothschilds and Schröder. It maintained its relations with the Argentine. In 1938 one of its directors was a member of the Court of the Bank of England; another was on the board of one of the joint-stock banks. It retained throughout the inter-war period substantial pre-revolutionary Russian balances.

Rothschilds was from its inception closely connected with Government finance. The London branch was established to act as the agent of several minor European sovereigns. During the last phase of the Napoleonic wars they were entrusted with the transfer of subsidies and payments to the British expeditionary forces. They continued to deal in gold and foreign exchange and operated the Royal Mint Refinery. The fixing of the gold price continued to take

place at their office (another acceptance house which is very active in precious metal dealings and foreign exchange—especially Far Eastern—is Samuel Montagu). Rothschilds participated in the formation of the Alliance Assurance and retain a representative on its board. Their activity as an issue house before the last war was phenomenal: according to M. Truptil, they issued and participated in issues of over £1,300 millions loans. Together with their Paris, Frankfurt and Vienna houses they were a decisive factor in the pre-1914 foreign Government finance. After the last war their activity was centred in France (railroads), Central Europe, Chile, and Brazil. In consequence they suffered very great losses after 1931. Their acceptance business was always of rather secondary importance.

J. Henry Schröder (1804) belongs to the type of firm which developed from a merchant business. They imported wheat from Russia. It is said that their acceptance credits exceeded £15 millions in 1928–9. Their issuing activity arose in connection with their commercial business. They floated Russian railroad issues, South American issues (Sao Paulo, Santos), and also participated in nitrate finance (Chile). They had close relations with Germany and especially after the 1914–18 war, when the German banks did not reopen their agencies, seem to have represented them (as did Japhets to a lesser extent prior to 1933). One of their directors was a member of the Court of the Bank of England and played an important role in the Standstill negotiations with Germany before the 1939–45 war.

Hambros Bank (1839) represented Scandinavian interests from its inception, and floated loans for Denmark. It established relations also with Italy and Greece. In 1920 it amalgamated with the British Bank of Northern Commerce. After the last war it participated in the issue of loans to central and south-eastern Europe as well as Scandinavia. It has an extensive acceptance business. Since the crisis it has repeatedly joined forces with Erlangers and Philip Hill in making new industrial issues. One of its directors was (1938) a member of the Court of the Bank.

Lazard Brothers and Co. (1877) was formed as a branch of the Franco-American firm, Lazard Frères. It became a private limited company in 1919 and the majority of the shares passed into British hands. It is closely associated with the Pearson family (Whitehall Trust). After the war it was very active, both as an acceptance and as an issue house. Lately, issuing activity was further developed

in home industries (especially electricity). The firm has one of the most active foreign exchange departments and it seems to have a very active investment business. It arranged the credits of the French Government in 1936 and 1937 and acted as their agent. One of its senior partners was (1938) on the Court of the Bank and another on the Board of Lloyds Bank.

Morgan, Grenfell and Co. Ltd. (1838) is the parent company of J. P. Morgan and Co. of New York. It was established by G. Peabody, and the senior J. P. Morgan's father entered it in 1854. Its acceptance business is relatively small. The issue business was very important after the American Civil War and also in South America. In the last war it took a leading part in financial arrangements of the British Government in U.S.A. It has intimate connections with India, and is supposed to act as financial adviser to important clients there. One of its managing directors was on the Court of the Bank of England (1938).

Erlangers Ltd (1870) was mainly active as an acceptance house after the war. Since the crisis it has tried (as have others) to restore the internal bill. It also entered the home industrial finance field.

Brown, Shipley and Co.; *Kleinwort, Sons and Co.*; and *S. Montagu* are firms mainly interested in acceptance business (the last also in foreign exchange and precious metals).[1]

CHAPTER 14. *OTHER INTERNATIONAL BANKING INSTITUTIONS IN LONDON, PRE*-1914

THE rapid rise and great prosperity of the private banking houses which specialized in international finance and the growing importance of London as a financial centre attracted other English and foreign private firms to embark on the same business and establish themselves in London. After 1860, when the principle of limited liability had been generally accepted, two kinds of joint-stock banking companies entered the field of international short- and long-term finance in London. These were: (1) British-owned companies established mainly with the view of providing specialized finance of international trade with one particular country or a group of countries forming a geographical unit. These companies

[1] Unfortunately no adequate history exists of the various firms and their influence on affairs.

generally took their business titles from the countries where they operated. Their headquarters were located in London and they were British-owned, though most of their regular banking business was done abroad. (ii) The rise of London as an international centre compelled the most important banks in other countries to open branches in London, to establish banking companies controlled by them, or to appoint representatives in order to have direct access to the facilities offered by the London market.

The first group can be subdivided into those banks which operated mainly in the British Empire, and those which operated in other countries. The latter group can be divided similarly into the branches of Empire banks and those of foreign banks. Only a few of these international banks were 'British' banks under the rules of the Bank of England. The majority were treated as foreign banks, and their acceptances therefore ranked as agency bills.

There were marked differences between the character of the business and functions of these banks and of the acceptance houses. Acceptance houses, though they may have more intimate contacts in certain countries and in certain trades than in others, nevertheless usually had world-wide business relations of the most varied kinds. They (and to a lesser degree, and more recently, the joint-stock banks) were the points of contact of the London market with customers overseas. The function of international joint-stock banking companies, on the contrary, can rather be described as representing the foreign customers in London. The international joint-stock banks (even those which were not branches or agencies of powerful commercial banks exercising the functions of the British clearing banks in their respective countries) did not in general attempt to go outside their special geographical field in their business. Both the private and clearing banks and these international banking companies acted as channels through which London extended credits overseas and accepted deposits and provided other investment outlets for liquid funds of foreign countries. Their functions were complementary rather than competitive.

The establishment of these joint-stock banking companies dates mainly from the period after 1850 and more especially after 1862 when international financial activity suddenly expanded. The Bank of Australasia (1835), the English, Scottish, and Australian Bank (1852) and the Union Bank of Australia (1837), the National Bank of New Zealand (1872), the Standard Bank of South Africa (1862), the National Bank of South Africa, the Anglo-Egyptian Bank

(1836) and the Bank of British West Africa (1894) are the most important examples of Anglo-Dominion banks established in London but operating mainly in the Empire. The so-called 'Exchange Banks' are banks operating in India and the Far East. They represented, prior to the war, the greater part of the foreign exchange market in London. They remained important as suppliers of commercial bills.[1] Apart from the three original central banks of the three main Indian presidencies (Bengal, Bombay and Madras), which were amalgamated into the Imperial Bank of India in 1920, the Exchange banks did not restrict their business to India alone. The Hong Kong and Shanghai Banking Corporation (1867) was domiciled in Hong Kong and had powers of note issue in Hong Kong dollars. It was mainly operating in the Far East, but had world-wide connections. The Chartered Bank of India, Australia, and China (1853) operated in India and the Far East. The National Bank of India (1866) extended its operations to Eastern Africa; the Eastern Bank (1909) to Iraq.

The boom in foreign issues[2] led also to the establishment of banking institutions for the development of business outside the Empire. Very many of these companies were mushroom growths managed on speculative lines and did not survive for any length of time. But there were also Anglo-Foreign banks which fulfilled useful functions and became more firmly established. The Ionian Bank founded as early as 1839, the Imperial Bank of Persia (1899), which received the exclusive privilege of note issue against a payment of 6 per cent of its profits to the Persian Government, the National Bank of Egypt, the Jewish Colonial Trust (1899) and the Anglo-Palestine Bank (1902) were the most important in Near Eastern business. The Ottoman Bank, though it had a London Office and board of Directors, was controlled by French interests.

The financial connections with South America were more important, and the strongest British banks were found in that area in pre-1914 days in spite of the intimate connections which the international private banking firms maintained with that continent. The Mercantile Bank of the River Plate, the London and River Plate Bank, the London and Brazilian Bank (the former passed under the control of Lloyds Bank in 1919 and on amalgamation with the latter altered its name to Bank of London and South America), the Anglo-South American Bank and the British Bank

[1] Cf. above 'Running brokers'.
[2] Cf. Giffen, *Essays in Finance* (1882), vol. I, pp. 107–32.

of South America could, before the crisis, maintain themselves in spite of this competition. They actively engaged in business in South America.

Practically all great commercial banks operating in the Empire established one or more branches in London. Before the 1914–18 war, when no central banks were operating in the Dominions, the liquid funds of those institutions, placed in the London market, constituted the first-line defence of the currency of their respective countries and determined banking policy. This function did not altogether cease, even after the 1914–18 war and after Central Banks were established. The most important of these banks were the Australian banks: Bank of Adelaide (1865), Bank of New South Wales (1817), Commercial Bank of Australia (1866), Commercial Banking Company of Sydney (1834), Commonwealth Bank of Australia (1911), National Bank of Australasia (1858), Queensland National Bank (1872). One bank was operating in New Zealand, whose head office was not situated in London, the Bank of New Zealand, established in 1861. The two important banks operating in South Africa have their head offices in London. The National Bank of Egypt, the issuing bank of Egypt (1898), has its head office in Cairo.

Canada has always maintained close financial contact with the United States. Its currency is not based on the pound, which prevented the establishment of the same relation between London and Canada as developed between London and the other British Dominions. There is only one English-owned bank operating in Canada (Barclays Bank, Canada). The great Canadian banks therefore are in a special position with respect to London business. But all of them have branches in London.

The French banks were among the first of the *foreign* banks to establish branches in London. The first was the Comptoir National d'Escompte in 1865, followed by the Société Générale in 1872, the Crédit Lyonnais in 1873, and the Crédit Industriel et Commercial in 1895. The Banque de Paris established itself in 1873. The Germans established offices in London after the victorious war with France which opened a period of rapid economic development. The Deutsche Bank established itself in 1873, the Dresdner Bank in 1895, the Disconto Gesellschaft in 1900. They were undoubtedly the most active and important of the foreign banks in London. Two Austrian banks established branches in this country in 1864 and 1871 respectively. The Russian Bank for Foreign Trade also

opened in the 1870's, the Yokohama Specie Bank in 1884, the National Bank of China in 1892. There can be little doubt[1] that the Germans were probably the most active agencies in the London market, at any rate as far as acceptance business was concerned, whereas the Russian and Japanese banks[2] were more important in placing funds on the market. In the main these banks restricted their operations to arranging acceptance credits, acted as traders in foreign acceptances, issued loans, and placed their surplus funds in the London market with its unrivalled facilities for short-term investments. Their role and influence has of course never been as strong as that of the international private bankers, but they fulfilled a useful function, and enabled the full development of the facilities of the London market.

CHAPTER 15. *THE WAR OF* 1914 *AND ITS CONSEQUENCES*

THERE is perhaps no part of the financial structure where the impact of the last war was quite so marked as in this field.

A. SHORT-TERM BUSINESS

The first, and ominous, development was the expansion of the joint-stock deposit and clearing banks to dimensions where their very size involved them in the field of international credit. The Midland Bank opened this new era by establishing a foreign exchange department in 1905, though it was exposed to a violent barrage of hostile criticism.[3] Their intrusion into the acceptance business, if it occurred at all, was not very serious at this time.[4]

The financial repercussions at the outbreak of the war brought home to the City the magnitude of the risk inherent in banking business conducted beyond the confines of a single sovereignty. This risk was not that of the bankruptcy of a single debtor due to

[1] Cf. the report of Sir William Plender (Cd. 8430, 1917). Up till 30 September 1916 at least £20 millions were collected by the custodians of enemy banks in cash alone.

[2] Cf. King, op. cit. [3] Crick and Wadsworth, op. cit. p. 442.

[4] Cf. balance sheets of the clearing banks for 1913, Part I. Sir R. Kindersley, on the contrary (*M.E.* Qu. 1177), thought that two to three years prior to the war the competition of the joint-stock banks had been an unfavourable factor depressing acceptance commissions to unduly low levels.

the mismanagement of his affairs, but a cessation of all payments from one or more foreign countries as a matter of deliberate policy of the Government of that country due to economic or political reasons. It is a risk familiar in the history of all earlier money markets, though in the wars of previous centuries private payments to enemy countries were usually not proscribed. It had been dormant for such a long period during the nineteenth century that its incidence had been wholly disregarded. At the outbreak of war not only the enemy, but other (even allied) debtors of the acceptance houses[1] were unable to remit funds to London to meet their bills as they matured. The acceptance houses had to answer for the bills which they had made their own direct obligations in return for a very small commission, and to an amount several times greater than their own capital. The closing of the Stock Exchange and the tight position of the clearing banks, moreover, prevented a mobilization of their other resources, even if these had been sufficient for the purpose. It became necessary to proclaim three exceptional Bank Holidays immediately after the outbreak of hostilities while the City prepared to make the necessary adjustments. A special moratorium on bills[2] was declared on 2 August 1914. This was supplemented by a more general measure on 6 August. These measures allowed the postponement of all—except for certain specified—payments until 4 September. This period was subsequently extended to 4 November. On 13 August the Bank of England was authorized to discount bills drawn prior to the moratorium, waiving recourse against the holder. The Government guaranteed the Bank against any loss which might arise in this connection. Finally, in September the Government empowered the Bank[3] to take these acceptances into 'cold storage' until a year after the end of the war. In November a somewhat similar scheme was elaborated for non-banking creditors unable to recover their obligations due from foreigners. In this scheme the joint-stock banks were already active participants.[4] The acceptance houses, whose interests could be safeguarded in the peace treaties, were enabled to weather the crisis without serious losses.

[1] Cf. Part II on the acceptances on the volume of German commitments.

[2] The measures taken will be discussed briefly. Cf. Brand, *War and National Finance, the Foreign Exchanges.* Also Cmd. 7633, 7689 and 7863, 1914.

[3] Statement to the Press on 5 September; letter of the Chancellor to the Bank of England on 30 September 1914.

[4] It is noteworthy (cf. Cmd. 9049) also that the joint-stock banks were called upon to assist in the arrangement of a Swiss credit.

This was the first warning to the international banking community of what their position would necessarily be if any major disturbance occurred in the system of international payments. A further and perhaps even more significant development was the appointment of a Departmental Committee of the Board of Trade on Financial Facilities[1] and later a Joint Committee of the Treasury and of the Ministry of Reconstruction.[2] Both recommended the establishment of new institutions to grant what one may call medium-term credit facilities to aid British exports. The result was the passing of the Trade Facilities Act, and the establishment of the Export Credits Department, which later developed into the Export Credits Guarantee Department in its present form. The fact that the establishment of a State Department to help the export trade by providing financial assistance or facilities was thought to be necessary[3] shows, perhaps, not so much the inadequacy of *existing* credit facilities as such, but rather that new and different conditions had arisen where risks existed which could not be dealt with, or were not covered by, facilities offered by private institutions. The fact that the purely commercial side[4] of the Export Credits Guarantee Department has been not only self-supporting (as contrasted with its predecessor), but has been able to accumulate substantial reserves,[5] showed that these new risks were of a special character. They are not normally perhaps very great. But they are accompanied by very high uncertainty and the possibility of a sudden total loss. The insurance of such risks on an actuarial basis is not possible, for in many cases they arise out of transfer difficulties, and in the post-war period many of them have been the product of political rather than of economic causes. In consequence, they are of a character which cannot be borne by private firms.

The final implications of these permanent changes in the world economic and financial structure caused by the last war, and by the economic and monetary policies which most countries indulged in subsequently, were by no means immediately realized. The recommendations of experts show some perception of the fact that

[1] Cmd. 8346, 1916. [2] Cmd. 9227, 1918.

[3] The opinion of the war-time Committees was reaffirmed by Hill's Committee, 1925, and by a Special Committee of Sir O. Niemeyer, the late Col. the Hon. Sir S. Peel and Lord Plender. Cf. above, Part II.

[4] As contrasted with the new schemes to provide assistance to certain countries for reasons which are not necessarily economic under the Export Guarantee Bills (1938 and 1939). [5] Cf. above pp. 160–4.

changes had occurred and that new measures and institutions were needed to deal with them. But apart from partial, incomplete measures the post-war policy disregarded these changes, and it may perhaps be argued that the very lack of realization, the failure to analyse the new position and to draw the logical conclusions when determining post-war policies, contributed to intensify and to render these changes really permanent. However that may be, it is clear that in the sphere of international finance the first and overwhelming impulse after the war ended was to re-establish the pre-war position. The return to the gold standard sponsored by Anglo-Saxon financial opinion was the most notable of the steps calculated with this end in view.

The all-pervasive optimism on the outlook for international trade led to the establishment of numerous new institutions in this field. All except one of the big clearing banks established banking affiliates concerned with international finance. Other international banking concerns were formed under quasi-official initiative, such as the British Overseas Bank and the Anglo-Italian Bank, both of which possessed several foreign affiliates. Both British and foreign interests participated in the establishment of several other joint-stock institutions with a view to participating in international finance.[1] The war had eliminated the competition of the London agencies of the great German banks[2] which had been increasingly active before 1914 and which were not re-established after the war. As we see, however, the international private banking firms had to face new British competition. This was made formidable by the entry of the clearing banks themselves into the field of international acceptance and other short-term credit.

The controversy between Sir Robert Kindersley and Mr McKenna[3] at the hearing before the Macmillan Committee leaves no doubt about the opinion of the acceptance houses on this point. They regarded the entry of the clearing banks into a field which hitherto had been their practically exclusive domain as the most important factor[4] in the post-war development of international short-term finance. They did not consider the competition of New

[1] Cf. M. Truptil, op. cit. Examples: Anglo-French Banking Co., Anglo-Portuguese Colonial and Overseas Bank, the London and Eastern Trade Bank and the British and Continental Banking Co., Ltd.

[2] It is said that Schröders and Japhets took over the role of representing the German banks.

[3] *M.E.* Qu. 1161–84. Cf. above, p. 155.

[4] Though Kindersley said the clearing banks' acceptance business was necessary for the London money market (*M.E.* Qu. 1208–10).

York and Paris as menacing the supremacy of London, although the former did actively compete at times.[1] The average level of the commission on acceptance, which prior to the war seems generally to have amounted to between 1 and 1½ per cent per annum,[2] and in certain less safe lines 2 per cent, fell rather sharply to ½–1 per cent per annum. This is an astonishing development considering the experiences which the acceptance houses had had at the outbreak of the war. This should have warned all concerned that the risk of default was higher, rather than lower, than it had been thought to be prior to the war. And the persistence of the troubled monetary and economic conditions should have given a warning of the increase of the post-war, as compared with the pre-war, risk. If the acceptance houses had any misgivings—and Sir Robert Kindersley's evidence shows that some, at any rate, had—they were unable to enforce their views against the optimism of the clearing banks. The cut in acceptance commissions did little to increase the volume of business except in finance bills. There was no compensation for the loss caused by the entry of the new element of competition into the business.[3]

The nature of the acceptance credits was also undergoing a considerable and rather unfavourable change. Direct credits to merchants and manufacturers abroad were to some extent replaced by reimbursement credits, i.e. credits negotiated through overseas banks which guaranteed their clients. Superficially this intervention of a foreign bank seemed to increase the security of the credits, and was used as an argument for cutting the acceptance commission to ½ per cent per annum.[4] As it turned out it was a development which, far from strengthening, rather undermined the security and changed the character of these loans. Nor could it help in diminishing the 'transfer' risk. The expert knowledge of the trade and the firm which was required when granting direct acceptance credits, was obviously not needed if a foreign bank of standing

[1] Kindersley (*M.E.* Qu. 1219–22), Foa (ibid. Qu. 1798–9), Hyde (ibid. Qu. 963–4) and Goodenough (ibid. Qu. 555–67). The New York charge for acceptance was also cut to between ½ and 1 per cent per annum (Kindersley, ibid. Qu. 1168).

[2] According to Kindersley (*M.E.* Qu. 1166), certain reimbursement credits which seem to have been used (especially in Scandinavian and South American business) were done at ½ per cent even prior to the war, if not by Lazards (ibid. Qu. 1176) by the joint-stock banks (McKenna, ibid. Qu. 1175–77).

[3] Kindersley, *M.E.* Qu. 1211–12. Several attempts at agreement failed, ibid. Qu. 1210.

[4] Cf. Part II. According to Goodenough the fall in the acceptance commission came at a rather later date (*M.E.* Qu. 760).

accepted a contingent or direct liability for the credit. But with the decline of specialized expert knowledge, there was a growing danger of overlending and of the reappearance of accommodation credits[1] under a new guise; for the specific business conditions under which these credits were granted and which could have been used to supply criteria for checking their soundness, were known only to a decreasing degree. General economic investigations which under the new conditions would have had to serve as a substitute for the detailed practical knowledge which was adequate in pre-war days, were not undertaken.[2] The pooling of information about the size of engagements of foreign banks was also far from complete. The eagerness of the competition in international lending, both British and foreign—especially on the part of the institutions newly entering this field—seriously increased this danger. Nor was it reduced by the fact that the so-called 'clean' credits, not secured by documents actually in the control of the lender, increased in importance *pari passu* with the spread of the new methods of granting acceptance credits.

All attempts made by the acceptance houses to reach agreement amongst themselves to pool information failed,[3] and it was practically impossible during the post-war period for anyone to know with any degree of accuracy the magnitude of the liability which London was shouldering. Even the efforts of the Macmillan Committee to assess the position of the market proved to be very incomplete,[4] yet the Governor of the Bank of England thought before the crisis that he had all the statistical information which he needed. He said that he disbelieved in elaboration and preferred to arrive at his own conclusions independently and then to test them only afterwards by appropriate inquiry.[5] At the end of the period under review, however, considerably more elaborate statistical information seemed to be at the disposal of the Bank of England, but it has never been published.[6]

[1] This was denied for a long time (cf. *M.E.* Qu. 1273). It is now generally admitted.

[2] Only one of the acceptance houses seems to have had an economic research department, the others seem to have relied on their 'connections' which were mainly interested parties, i.e. foreign bankers desirous of obtaining accommodation, partly people with little if any political knowledge. Cf. however, Mr Nixon's article (op. cit.) on the importance attributed to general economic investigations by the Export Credits Guarantee Department.

[3] Kindersley, *M.E.* Qu. 1214–17.

[4] Cf. Keynes, *Lloyds Bank Review*, April 1932, pp. 148–9.

[5] Norman, *M.E.* Qu. 9174–6.

[6] This was demanded at that time by the Deputy-Governor of the Bank

It has been argued[1] that it was a desire to reduce the risks which they were running that caused several of the firms engaged in international business to abandon the simple form of partnership in which they had operated in pre-war days and to become instead, either limited liability companies or a still more complicated legal entity, in which the partners themselves became limited companies, thus limiting their liability although they remained formally partners in an unlimited concern. The latter type of development in which the individual partner rather than the concern itself changed its legal status, suggests that the real reason for these changes has been the desire to escape as much as possible the influence of high taxation, and more particularly death duties, on the continuity of old-established business houses, and not the wish to hedge against risks by resorting to legal subtleties. A further indication which points to this explanation is found in the behaviour of a number of individuals and family groups which in and after 1931 met out of their private fortunes obligations which could not be enforced against them personally.[2] So long as this tradition persists there can be little doubt that all the reserves that the individual members could mobilize would be used to fulfil the obligations of these firms, whose stock in trade is their names and their long business experience. It is possible, looking back, to say that these firms might have been wiser to have paid more attention to the risks that they were running in doing acceptance business internationally in the late twenties, but such facts as are available suggest that while the absolute volume of London acceptances had recovered its pre-war level by 1929, the proportion of the business done by the City houses had declined and that of the clearing banks greatly increased.

As far as their deposit business is concerned there seems little doubt[3] that foreign deposits—always rather large in London—sensibly increased after the war. Sir R. Kindersley stated[4] that his firm's foreign deposits—and the 'great majority' of his deposits were foreign deposits—were about equal to his acceptance credits. The reports of Sir W. Plender and the balance sheets of Barings, Hambros and Erlangers, show that this could not have been the

(cf. Harvey, *M.E.* Qu. 1763–8, 8874–7), and his views were endorsed by Kindersley (ibid. Qu. 1236, 1246–7).

[1] Cf. Truptil, op. cit. p. 135.

[2] Cf. Andreades, op. cit., on the behaviour of the Baring family in 1890. One of the retired partners put his assets at the disposal of the creditors of the firm and participated in the reconstruction.

[3] Cf. Part II on the demand for bills for the statistical material.

[4] *M.E.* Qu. 1147, 1157–9.

case before the war. The statistics for the acceptance houses as a whole[1] show that foreign deposits amounted roughly to about two-thirds of the acceptance credits outstanding for foreigners in the books of all acceptance houses.[2] Contrasting these global figures with the published balance sheets of certain larger firms, this ratio would seem to indicate that the smaller firms—as one would expect—had relatively less deposits than the large houses.

In the foreign exchange and bullion business the houses which specialized in these fields seem to have held their own, but the increase in the volume of business due to the instability of foreign exchanges in the period under review seems to have gone mostly to the clearing banks.

B. Long-term Business

The post-war period saw a vigorous revival of the foreign issue business of London, and in this sphere the international banking houses remained dominant.

Before the war perhaps one-sixth of the national income was available for net capital accumulation,[3] and of this perhaps one-half to one-third, in 1908–10 an average of £130 millions per annum, was invested abroad.[4] The proportion of issues made on the London capital market on behalf of foreign countries was very high because internal investment was largely effected without the agency of the organized capital market. In the years between 1910 and 1913 not less than 81 per cent of all issues was on behalf of foreign debtors.[5]

[1] *M.R.* Appendix I, Table II, p. 301.

[2] But it is most significant that the clearing banks and the Bank of England held up to twice as many foreign deposits as the acceptance houses and granted only one-third to one-quarter as much acceptance credits. Cf. the table quoted. It is possible (though not probable) that it is the inclusion of the Bank of England into the clearing banks which is responsible for this picture. Otherwise this relation, too, would show the great competitive power of the clearing banks in international relations. On the competition of the clearing banks and the methods used in attracting foreign deposits cf. Part I.

[3] Sir A. Flux's estimate, *Census of Production*, Final report, 1907. Cf. below. On the importance of the nineteenth-century pattern of foreign loans for the relatively smooth transfer of the loans, their interest service and amortization, cf. my paper 'Some theoretical problems of post-war foreign investment policy', *Oxford Economic Papers*, 1945. On the great advantages to creditor countries of granting such development loans (in so far as they are likely to turn the terms of trade in their favour either by increasing the imperfection of the debtor's markets or by an increase in the productivity in the industries producing goods which the creditor needs), cf. 'A note on the economics of retaliation', *The Review of Economic Studies*, 1944, p. 88.

[4] C. K. Hobson, *The Export of Capital* (1914); also Lavington, op. cit. p. 276.

[5] K. Zweig, 'Die internationale Kapitalwanderungen vor und nach dem Kriege', *Weltwirtschaftliches Archiv*, 1928.

TABLE XLVI A. ANALYSIS OF NEW CAPITAL ISSUES IN THE UNITED KINGDOM BY DESTINATION AND CLASS OF BORROWER

(Amounts are stated in £000's)

	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928
Home:										
Public bodies	—	—	—	—	—	—	—	—	29,830	17,566
Production	—	—	—	—	—	—	—	—	53,542	86,474
Trade	—	—	—	—	—	—	—	—	20,414	43,051
Transport	—	—	—	—	—	—	—	—	28,750	8,211
Finance	—	—	—	—	—	—	—	—	43,507	63,833
Total	187,670	324,552	100,073	100,469	67,584	89,323	132,099	140,862	176,043	219,135
% of all issues	79·0	84·5	46·4	42·6	33·2	39·9	60·1	55·6	55·9	60·5
India and Ceylon:										
Public bodies	—	—	—	—	—	—	—	—	—	6,863
Companies	—	—	—	—	—	—	—	—	—	885
Total	1,454	3,514	29,563	38,118	25,391	2,610	3,426	2,061	1,363	7,748
% of all issues	0·6	0·9	13·7	15·4	12·5	1·2	1·6	0·8	0·4	2·1
Other British countries:										
Public bodies	—	—	—	—	—	—	—	—	56,921	45,203
Companies	—	—	—	—	—	—	—	—	29,460	33,159
Total	28,882	37,059	61,268	39,399	62,186	70,892	53,978	49,949	86,381	78,362
% of all issues	12·2	9·6	28·4	16·7	30·5	31·7	24·5	19·7	27·5	21·6
Foreign countries:										
Public bodies	—	—	—	—	—	—	—	—	19,884	19,759
Companies	—	—	—	—	—	—	—	—	31,043	37,515
Total	19,535	19,086	24,891	59,683	48,599	60,721	30,394	60,394	50,927	57,274
% of all issues	8·2	5·0	11·5	25·3	23·8	27·2	13·8	23·9	16·2	15·8
Total overseas	49,871	59,659	115,722	135,200	136,176	134,223	87,798	112,404	138,671	143,384
% of all issues	21·0	15·5	53·6	57·4	66·8	60·1	39·9	44·4	44·1	39·5
All issues	237,541	384,211	215,795	235,669	203,760	223,546	219,879	253,266	314,714	362,519

TABLE XLVI A. ANALYSIS OF NEW CAPITAL ISSUES IN THE UNITED KINGDOM BY DESTINATION AND CLASS OF BORROWER (*cont.*)

(Amounts are stated in £000's)

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Home:										
Public bodies	3,553	46,022	10,307	32,612	34,477	34,308	24,577	48,119	34,740	27,563
Production	80,093	34,867	16,259	25,315	34,470	41,657	62,239	73,076	57,830	48,289
Trade	27,078	10,311	4,684	11,432	16,559	18,642	26,309	16,834	17,954	10,992
Transport	3,696	20,225	4,263	8,932	3,689	2,657	32,561	33,054	11,183	473
Finance	44,982	15,931	7,075	5,526	5,864	9,477	16,248	19,725	17,061	5,429
Total	159,402	127,356	42,588	83,817	95,059	106,741	161,934	190,808	138 768	92,746
% of all issues	62·8	53·9	48·0	74·1	71·5	71·1	88·6	87·8	81·2	78·5
India and Ceylon:										
Public bodies	9,100	27,770	21,640	4,532	4,745	—	—	—	—	—
Companies	1,032	891	829	1,858	273	1,133	828	1,090	1,634	458
Total	10,132	28,661	22,469	6,390	5,018	1,133	828	1,090	1,634	458
% of all issues	4·0	12·2	25·4	5·7	3·8	0·8	0·4	0·5	1·0	0·4
Other British countries:										
Public bodies	21,518	28,257	8,932	21,166	20,232	11,035	2,907	896	6,835	10,092
Companies	22,762	13,128	5,431	1,317	4,564	28,223	14,303	21,368	16,469	10,734
Total	44,280	41,385	14,363	22,483	24,796	39,258	17,210	22,264	23,304	20,826
% of all issues	17·5	17·5	16·2	19·9	18·7	26·1	9·4	10·3	13·6	17·6
Foreign countries:										
Public bodies	4,122	12,551	240	—	5,299	—	509	—	5,790	—
Companies	35,813	26,206	9,006	348	2,697	3,058	2,343	3,059	1,410	4,067
Total	39,935	38,757	9,246	348	7,996	3,058	2,852	3,059	7,200	4,067
% of all issues	15·7	16·4	10·4	0·3	6·0	2·0	1·6	1·4	4·2	3·5
Total overseas	94,347	108,803	46,078	29,211	37,810	43,449	20,890	26,413	32,138	25,351
% of all issues	37·2	46·1	52·0	25·9	28·5	28 9	11·4	12·2	18·8	21·5
All issues	253,749	236,160	88,666	113,038	132,869	150,190	182,824	217,221	170,906	118,098

TABLE XLVI B. NEW CAPITAL ISSUES IN THE UNITED KINGDOM BY GROUPS

(Amounts are stated in £000's)*

	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929
Governments	19,470	97,226	89,749	89,023	91,527	31,410	46,707	63,614	57,739	30,408
Local authorities and Public Boards	53,970	23,867	22,762	5,948	22,086	26,018	50,394	43,020	31,651	7,886
Total	73,440	121,093	112,511	94,971	113,613	57,428	97,101	106,634	89,390	38,294
Companies:										
Railways	1,616	1,722	21,890	15,870	7,896	27,106	10,951	25,992	15,908	14,259
Gas and water	1,447	2,880	2,655	2,451	1,989	3,049	4,388	3,139	5,702	2,640
Electric light and power	1,982	7,018	3,240	9,924	4,680	7,243	11,523	10,960	19,127	15,691
Telegraph and telephone	3,040	540	2,340	891	540	2,136	1,221	976	—	393
Road transport	1,549	1,523	1,655	961	3,928	410	2,355	1,770	3,584	348
Shipping, canals and docks	15,635	6,652	16,893	4,550	3,237	7,337	5,572	14,767	3,238	391
Banking and insurance	19,652	5,034	1,893	1,408	5,106	4,348	2,667	15,759	13,142	13,649
Investment and finance, and property	13,080	2,676	9,598	7,237	17,229	21,595	33,068	46,214	68,707	44,836
Coal, iron, steel and engineering†	40,252	5,735	14,422	9,803	18,687	4,534	9,208	5,616	9,042	5,273
Mining	5,788	960	1,822	4,426	3,351	6,509	4,864	6,519	9,646	14,278
Oil	16,683	16,599	17,031	4,428	2,380	1,323	391	2,231	2,649	4,244
Tea, coffee, rubber	6,642	1,306	473	3,474	1,767	14,952	14,200	4,909	3,090	2,460
Breweries and distilleries	3,043	4,461	1,695	5,186	2,141	1,432	494	8,414	4,643	4,651
Miscellaneous commercial and industrial	180,362	37,595	27,552	38,178	37,001	60,496	55,265	60,813	114,650	92,344
Total	384,211	215,795	235,669	203,760	223,546	219,897	253,266	314,714	362,519	253,749

* Figures and totals rounded.

† Including motors and aviation.

TABLE XLVI B. NEW CAPITAL ISSUES IN THE UNITED KINGDOM BY GROUPS* (*cont.*)

(Amounts are stated in £000's)

	1930	1931	1932	1933	1934	1935	1936	1937	1938
Governments	67,327	30,812	24,642	32,796	10,731	3,416	896	8,812	7,900
Local authorities	30,919	7,432	10,358	22,552	26,770	23,634	41,242	35,039	28,215
Public Boards	16,355	2,875	23,310	9,405	7,842	943	6,877	3,514	1,540
Total	114,601	41,119	58,310	64,753	45,343	27,993	49,015	47,365	37,655
Companies:									
Railways	34,378	3,925	9,778	3,383	874	32,059	31,380	9,245	305
Gas and water	9,330	2,321	6,188	3,002	3,330	6,624	8,060	2,822	5,769
Electric light and power	6,802	5,899	11,862	6,985	6,970	11,715	6,903	12,586	15,032
Telegraph and telephone	144	—	—	360	142	305	213	165	—
Road transport	1,132	2,068	236	117	748	687	474	681	473
Shipping, canals and docks	33	2,170	155	1,220	315	—	1,455	1,076	526
Banking and insurance	10,115	136	2,017	1,472	1,056	2,969	3,890	4,767	525
Investment and finance	12,300	8,171	3,509	5,381	15,941	16,532	21,880	13,270	5,627
Property	2,984	2,232	4,214	9,076	11,005	12,072	6,519	6,346	5,389
Coal, iron, steel and engineering†	75	2,525	1,865	2,461	11,116	16,928	22,355	18,920	11,020
Mining	5,485	3,952	934	2,879	17,677	9,000	11,395	10,967	5,925
Oil	8,050	—	714	10	—	48	1,786	869	4,917
Tea, coffee, rubber	1,345	558	190	734	2,395	804	1,945	2,003	138
Breweries and distilleries	2,680	1,068	499	4,462	2,994	2,263	5,071	4,074	5,678
Miscellaneous commercial and industrial	26,706	12,523	12,567	26,574	30,234	42,825	44,880	35,750	19,119
Total	236,160	88,666	113,038	132,869	150,190	182,824	217,221	170,906	118,098

* Figures and totals rounded.

† Including motors and aviation.

TABLE XLVII. THE EXPANSION OF BRITISH CAPITAL ABROAD

Date	Estimates £ millions	Source	Scope and qualifications
1854	195–230	Jenks*	Does not include 'direct investment' or investment in the British Empire
1880	1,150	Nash†	Omits commercial investment (chiefly mines) other than railways
1885	1,302	Hobson‡	Obtained by capitalization of Inland Revenue figures of investment income
1895	1,600		
1905	2,025		
1907	2,694	Paish§	Stock Exchange securities only
1909	2,339	Hobson	See above
1913	3,763	Feis‖	Publicly issued capital only
1929	3,391	*Economist*¶	Stock Exchange securities and other securities of British companies only. Omits estimate of £50 million for nominee holdings
1929	3,438	Kindersley**	Stock Exchange securities and other securities of British companies only. The holdings of unquoted securities he estimated at £300 millions for 1929–30, £290 millions for 1931, £285 and £280 millions for 1932 and 1933, £300 and £350 millions for 1934 and 1935 and £400 millions in 1936–8. This is almost certainly a gross underestimate
1930	3,424		
1931	3,410		
1932	3,356		
1933	3,385		
1934	3,414		
1935	3,438		
1936	3,364		
1937	3,353		
1938	3,292		

* Jenks, *The Migration of British Capital to* 1875 (1927).

† *A Short Enquiry into the Profitable Nature of Our Investments* (1881), quoted and amended by Jenks, op. cit.

‡ Hobson, *The Export of Capital*, based on Hirst's 1912 edition of Porter's *Progress of the Nation*.

§ Sir George Paish, *Journal of the Royal Statistical Society*, 1909.

‖ Feis, *Europe, the World's Banker* (1930), based on estimate by Sir George Paish in *The Statist*, 14 February 1914.

¶ 18 October 1930.

** Kindersley, in *The Economic Journal*, December 1938, and earlier issues. The full scope and qualifications of Kindersley's estimates are clearly laid down in his articles.

This proportion fell sharply in the post-war period, mainly due to the restrictions on foreign lending which can more conveniently be discussed in the next subsection. The detailed statistics of the Midland Bank show that overseas borrowing only once, in 1923, reached as high a proportion of total issues as two-thirds.[1] On the average it did not amount to more than some 40–45 per cent of total issues between 1924 and 1929. British countries took between a sixth and a third of this; foreign countries between 13 and 27 per cent. There was, however, a distinct change both in the destination and in the purpose of these issues.

[1] Cf. also Tables XLVIA–XLVIB taken from *The Economist*, Nov. 20, 1937 and brought up to 1938.

TABLE XLVIII. GEOGRAPHICAL DISTRIBUTION OF BRITISH CAPITAL ABROAD

(Paish's estimate for 1913 (modified by Feis), and estimates of *Economist* (C. = commercial capital) and Kindersley (G. = Government and Corporation loans) for 1928.)

(Amounts stated are in £ millions)

	1913	1928			1936
		C.	G.	Total	Kindersley
Canada and Newfoundland	515	410	102	512	443
Australia and New Zealand	416	51	521	572	651
India and Ceylon	379	135	219*	354†	438
South Africa	370	83	203‡	480§	248**
Other British countries	100	194			201
Total, British Empire	1,780	873	1,045‡	1,918§	1,981
United States	755	77	149	839	81
Argentina	320	292			372
Other Latin America	437	321			374
Russia	110	269	113	382	236
Rest of Europe	108				
Other foreign countries	253	159	93‖	252¶	196
Total, foreign	1,983	1,118	355‖	1,473¶	1,259
Total, world	3,763	1,991	1,400	3,391	3240††

* Excluding Ceylon.
† Excluding Ceylon Government and Corporation loans.
‡ Including Egypt.
§ Including Egyptian Government and Corporation loans.
‖ Not Egypt.
¶ Not Egyptian Government and Corporation loans.
** Including Rhodesia. †† Some commercial capital excluded.

In pre-war days most loans were destined to finance new countries and their capital development, largely railroads. In the inter-war era the reconstruction loans to Germany and other central European countries played an important part. The distribution of loans to the Empire also changed. In the inter-war period Australia and New Zealand took the first place and Canada fell behind. The importance of Government loans increased from 25·9 per cent of the total (out of which 13·5 per cent were Empire) to 57·9 per cent (43·8 per cent Empire).[1]

[1] Cf. p. 253 n. 1, and Sir O. Niemeyer (*M.E.* Qu. 6818–19). His figures are different somewhat from the Midland Bank statistics: 75 per cent home and 25 per cent foreign issues for the post-war period (but 56 per cent home and 44 per cent overseas for the year 1929) as contrasted with 21 per cent home and 79 per cent overseas issues for the period 1907–11 and 21, 24, 21 and 79, 76 and 79 per cent for home and overseas issues in 1912, 1913, and 1914 respectively.

TABLE XLIX. INCOME FROM BRITISH INVESTMENT ABROAD

(Amounts are stated in £ millions)

Years (Annual averages)	Sources		
	Hobson*	Inland Revenue†	Kindersley‡
1870–74	48·0	—	—
1875–79	47·6	—	—
1880–84	53·1	—	—
1885–89	76·6	—	—
1890–94	90·3	—	—
1895–99	94·7	—	—
1900–04	104·7	—	—
1905–09	138·2	—	—
1910	166·0	—	—
1911	171·0	156·3	—
1912	176·0	166·6	—
1913	—	180·0	—
1914	—	176·2	—
1915–19	—	—	—
1920–24	—	179·7	—
1925–29	—	230·6	—
1929	—	238·7	230·9
1930	—	206·2	209·0
1931	—	173·5	168·7
1932	—	165·1	156·4
1933	—	164·6	149·7
1934	—	168·8	159·2
1935	—	—	167·9
1936	—	—	184·0
1937	—	—	197·7
1938	—	—	184·9

* Based on Inland Revenue returns.
† For scope see note below, Fiscal Years.
‡ *Economic Journal*, 1939.

NOTE. The Inland Revenue Commissioners now divide 'income arising abroad to British residents' into three groups: I. Dominion and foreign interest and dividends paid through paying agents in this country or received by the encashment of coupons through bankers, coupon dealers, etc., in this country. II. Income arising from business controlled in this country, but mainly carried on abroad and with assets situated abroad, interest and dividends payable abroad (not included in Group I) and income from other foreign possessions. III. Income arising from trading operations carried on abroad by British concerns trading mainly at home, but partly abroad. Group I is identifiable. Group II is in part identifiable, and certain data exist on which an estimate of the aggregate amount can be made. Group III cannot be identified.

The issues on behalf of public bodies in the Commonwealth were offered, in general, directly to the public. Foreign countries and companies, however, almost without exception, used the services of a small number of private banking houses to raise capital in London. These also placed both on the market and directly with large investors the short-term obligations of numerous overseas

borrowers.[1] Large blocks of shares were also sold by them directly to the public. The commissions earned on these issues and their servicing, for which they were made responsible as agents, must have been considerable. The prestige which they acquired in sponsoring successful issues secured them a strong following which facilitated further flotations. This is perhaps the explanation for the ease with which issues could be placed at a time when more careful economic investigation would have shown the risks involved.

C. Investment Business

The investment business of the banking houses also increased substantially.[2] Before 1914 a firm was established (Robert Fleming and Co.) which specialized, as its primary business, in the management of investment trusts.[3] Another firm (Robert Benson and Co.) had also important connections in this field.[4] After the war these activities had considerably increased—although 'independent'

[1] Cf. Part II, Chapter 10. The Supply of Bills, Subsection A, i. Other 'one name paper'.

[2] The special connection with banking houses obviously secures the investment trusts not merely the advantage of participating on favourable terms in large-scale transactions, but also valuable day-to-day information on the general economic position (as well as on specific investments). The larger and the more intimate the business connection between investment trusts and other investment agencies such as insurance companies and private bankers the greater the capacity of the banker to obtain such information. At the same time the revenue from this relatively stable business represents a valuable contribution to the general overhead costs of the banker.

[3] This group now amounts to fifteen trusts with a capital of almost £25 millions:

Fleming group

Clydesdale	2·0	London and Holyrood	2·5
Second Clydesdale	0·9	London and Provincial	1·4
Caledonian	2·2	London and Clydesdale	1·2
Second Caledonian	1·0	Capital and National	1·0
Third Caledonian	1·0	Railway and General	1·0
Scottish Western	2·1	British Steamship	4·2
Second Scottish Western	2·0	Second British Steamship	0·9
Third Scottish Western	1·4		
			24·8

[4]

Robert Benson Group

English and New York	1·4	Investment Trust Corp.	7·1
Merchants	3·3	Metropolitan	2·5
Traction and General	2·0	U.S. and General	2·7
Charter Trust and Agency	1·3		
			20·3

groups still predominated. In particular, Schröders, Samuel and Helbert Wagg had representatives on, or have sponsored the formation of, investment trusts.[1] A table[2] is given below showing some of the connections between investment trusts and banking firms. Altogether about 20 per cent of existing pure investment trusts (in capital strength and in numbers) had some sort of connection with banking firms other than one representative on a trust. There may have been, however, in addition, less obvious connections.[3] It must be remarked, however, that this table may possibly be misleading in some instances, as the bankers may well have been chosen to serve on the board in their *personal* capacity and not as representatives of their firms. Their prestige would in many instances account for their membership.[4]

In the United States of America this connection between issuing houses and investment trusts has caused much discussion. Legislation has been passed to control what was felt to have been a source of abuse. No such development took place in Britain. There is no doubt that the intimacy to which representation on the board of investment trusts gives rise will facilitate the underwriting by these trusts of those loans which a particular banking firm is engaged in issuing. It will lead to investment business for the securities department of the firm which is represented on the board, and to a decrease of the brokerage paid to the broker firm through which the order is eventually executed, the issuing house receiving one-half (one-third) of the brokerage. This need by no means imply, however, that the investment trust's (i.e. 'other people's') money is used to render the banking firms liquid after an unsuccessful issue.

Banker	*Investment Trust*
Goschens and Cunliffe	Anglo-Celtic Trust (chairman); Second Anglo-Celtic Trust (chairman)
Grace Brothers and Co.	Cumbre Trust Ltd.
Guinness, Mahon and Co.	Continental and Industrial; British and Foreign-Electro Trust Ltd. (twice); London United Trust Ltd.
Hambros Bank	Hambros Trust

[1] We must exclude the role of one banking firm in the unit trust movement.

[2] Prepared for the Securities and Exchange Commission by *The Economist* and others.

[3] Contrariwise Lazard Brothers had intimate connections with the Whitehall Securities Corporation, the Cowdray family having a substantial interest in both. They seemed to co-operate on certain issues.

[4] This is even more true in the case of their membership of insurance companies, cf. Arnold (*The Bankers of London*) rather belabours and overstresses a good point.

Banker	*Investment Trust*
S. Japhet and Co.	Compass Investment Trust (3 times); Chartered Trust and Agency-London Foreign Colonial; U.S. and General
Kleinwort, Sons and Co.	Drake Trust (4 times)
Lazard Brothers and Co.	Mercantile Investment and General Trust; Second Mercantile; Whitehall Trust (4 times)
Baring Brothers	Bankers Industrial Development Co.; British and German Trust; Hellenic and General; 1929 Investment Trust; Independent Investment Trust; London and Lomond Investment Trust; Traction and General; Trans-Oceanic (twice); Westpool Investment Trust (twice); British Combined Investment Trust
Higginson and Co.	Investors' Trust Corp. (twice); Anglo-Celtic Trust; Second Anglo-Celtic Trust; General and Commercial; London and Provincial; St Andrew Trust
Samuel and Co.	1928 (twice); 1929 (twice); French and Foreign Investors Corp.; London and Holyrood Trust; English and Dutch Investment Trust
J. Henry Schröder and Co.	Bankers Industrial Development Co.; Continental Industrial; Grange Trust (through Schröder Banking Co., N.Y.)
Seligman Bros.	London and South American
Erlanger Ltd.	Sterling Trust; City and International (3 times); Latin American Investment Trust; Hellenic and General Trust
Brown, Shipley and Co.	London and Scottish American; Second London and Scottish American

Banker	*Issuing Houses and Trusts*
Robert Benson and Co.	Merchant Trust; Industrial Select. Trust; Traction and General Trust; Brunner Investment Trust (twice); Chartered Trust and Agency; Investment Trust Corporation; London, Foreign and Colonial Securities; Telephone and General Trust; Great Northern
O. T. Falk and Co.	Independent Investment Trust; Industrial Select. Trust; Constructive Finance and Investment Co.; Mid-European Trust; Romney Trust
P. H. Hill and Partners	Quadrant Trust; Wallbrook Trust
Nicholson and Co.	Yorks and Lancs Corporation
W. A. Phillips and Partners	Yorks and Lancs Corporation (twice)
Dawnay, Day and Co.	English and International Investment Trust; Mid-European Corp.
R. Fleming and Co.	(Cf. p. 256, note 2.)

Connections between Bankers and Investment Trusts in Great Britain

Investment Trusts	*Current Bank connections*	*Representation on board*
Ailsa Investment Trust	Morgan, Grenfell and Co.	—
British and German Trust	Helbert Wagg and Co.	Helbert Wagg and Co. (twice)
City and International Trust	Erlanger Ltd.	Erlanger Ltd.
Compass Investment Trust	S. Japhet and Co.	S. Japhet and Co. (3 times)
Continental and Industrial	J. Henry Schröder and Co.	J. Henry Schröder and Co. Guiness, Mahon and Co.
English and International	J. Henry Schröder and Co.	J. Henry Schröder and Co. Dawnay, Day and Co. Ed. de Stein

Investment trusts	*Current Bank connections*	*Representation on board*
General Consolidated	Erlanger Ltd.	Guinness, Mahon and Co.
Grange Trust	Morgan, Grenfell and Co.	—
Mid-European Trust	Hambros Bank	Ed. de Stein
		Dawnay, Day and Co.
1928 Investment Trust	M. Samuel and Co.	M. Samuel and Co.
1929 Investment Trust	M. Samuel and Co.	M. Samuel and Co.
		Helbert Wagg and Co.
Trans-Oceanic Trust	Helbert Wagg and Co.	Helbert Wagg and Co.
Winterbottom Trust		
Anglo-Celtic Trust	Morgan, Grenfell and Co.	Goschen and Cunliffe
		Higginson and Co.
Second Anglo-Celtic Trust		Goschen and Cunliffe
		Higginson and Co.
Hambros Trust		Hambros Bank
Charter Trust and Agency		S. Japhet and Co.
		Robert Benson and Co.
U.S. and General		S. Japhet and Co.
Mercantile Investment and General		Lazard Brothers and Co.
Second Mercantile Investment and General		Lazard Brothers and Co.
Hellenic and General		Helbert Wagg and Co.
		Erlanger Ltd.
Independent		Helbert Wagg and Co.
		O. T. Falk
London and Lomond		Helbert Wagg and Co.
British Combined Investors		Helbert Wagg and Co.
Investment Trust Corp.		Higginson and Co. (twice)
		Robert Benson and Co.
General and Commercial		Higginson and Co.
London and Provincial		Higginson and Co.
St Andrew's Trust		Higginson and Co.
London and Holyrood		M. Samuel and Co.
Sterling Trust		Erlanger Ltd.
City and International		Erlanger Ltd. (3 times)
London Scottish American		Brown, Shipley and Co.
Second London Scottish American		Brown, Shipley and Co.
Merchant Trust; Great Northern Investment Trust		Robert Benson and Co.

No official information is available on the growth of the day-to-day investment business of banking firms on behalf of private clients. There does not seem to be any doubt that it was considerable in this period and that it is still increasing.[1]

D. The Rise of Finance Companies

A number of 'trusts' and finance companies[2] were established in the inter-war period—quite apart from the numerous mushroom growths of the 1928–9 new issue boom—which regarded the pre-

[1] The problems of the Stock Exchange which were made more acute by this process of continued loss of business (and brokerage) cannot be discussed here.

[2] These companies must not be confounded with financial houses managing, financing and issuing for special industries (such as rubber, tin, gold, etc.).

paration and sponsoring of issues of securities as their principal business.[1] Contrary to the practice of the international banking houses these institutions did not, in general, enter the field of foreign finance. They were to play a large part in the 1932–6 internal British recovery, but their activity was substantial already in this earlier period.

The far-reaching changes in the internal economic and especially industrial structure in consequence of the last war and of the monetary and financial policies pursued afterwards, began to make their influence felt. There was a growing feeling that British industry, especially its smaller units, was not adequately supplied with facilities for raising long- as contrasted with short-term capital.[2] There were some beginnings of what was later to develop into a concerted effort to solve this problem and to assist British industry by creating new institutions to supply credit and capital for home rather than international needs. But all this was a development which can much better be described in the next subsection on the world crisis and the British recovery. The post-war period up to 1931 in Britain was almost wholly devoted to the vain effort to recreate the pre-war monetary and financial position. It was not realized that the economic basis of that position had disappeared, and that the policies followed, so far from tending to favour a real readjustment to the new requirements, were tending to render such readjustment impossible, and to accumulate and aggravate disequilibria not merely in Britain but in the whole world economic system. There can be no doubt that the violence of the world crisis of 1929–33 was due to a considerable extent to the mismanagement of the financial and monetary field. It is tragic that the political developments to which the slump gave rise prevented any concerted international action to mitigate the shock of financial liquidation.

[1] Charterhouse, Cheviot, Power Securities, Quadrant, London and Yorkshire are only a few of the more important. Cf. below, pp. 289–90.

[2] Cf. *M.R.* p. 375 et seq., also Grant, *A Study of the Capital Market in Post-War Britain* (1935).

CHAPTER 16. *THE WORLD CRISIS AND AFTER*

THE publication of the Macmillan Report and the report of the experts appointed by the London Conference to inquire into the German monetary and financial position almost coincided. The first showed the dangerous banking position into which England had been drifting.[1] The second was more explicit in stating the extent to which English credits had to be considered as frozen in Germany alone.

The more or less orderly retreat on the financial front of 1930 was changed into a rout in the spring of 1931. The deflation had progressed so far as to wipe out in several important instances the equity capital protecting the international credit structure. A return to the *status quo* by international co-operation was made impossible. The Austrian Creditanstalt suspended payments and the exchange control was instituted. The central European and Balkan countries followed suit. A few weeks later the German banking system collapsed under the strain of the internal and international capital withdrawals. Its reorganization, after a *de facto* moratorium had been instituted, could only be undertaken by introducing foreign exchange control. A number of the South American countries were forced to apply the same measure.

The immobilization of its international short-term debtors had a double influence on the London market. The liquidation of international credit forced debtors to use their London balances. As London was a net debtor on short term, this led to a loss of funds to the ultimate creditor, the U.S.A. Doubts arose as to the solvency of important firms which had been active in extending credits to debtors in the countries which had—by the indirect method of controlling foreign payments—instituted moratoria. These doubts were crystallized by the report of the so-called May Committee on the financial position of the British Government into scepticism about the ability of Britain to maintain the gold standard. Foreign funds lodged in London were withdrawn. This led first to a Government crisis and then to the suspension of the gold standard. For a second time in seventeen years the London money market was

[1] But, singularly enough, even Lord Keynes, who was formerly strongly opposed to the return to the gold standard on the basis of the old gold parity, did not envisage its abandonment which, in fact, took place a few months afterwards.

faced with a world-wide transfer crisis. The contingent liabilities of the firms engaged in international finance once more became actual liabilities. The main brunt of the collapse hit the acceptance houses.

A. Short-term Business

If those houses which publish balance sheets can in any way be regarded as typical, the acceptance houses were confronted in 1931 with a most unenviable task. According to the Macmillan Report[1] foreign funds deposited with these houses amounted to not less than £81 millions in March 1931. At this level foreign funds were somewhat *larger* than in the period of monetary stringency experienced in 1929 as a result of the efforts of the American monetary authorities to check the Stock Exchange boom. In December 1929, the foreign deposits of the acceptance houses were only £79 millions. They increased by June 1930, when money rates returned to more normal levels in America to 86·5 millions. The liquidation of acceptance credits, however, once more resulted in a drop. In the beginning of 1931 (28 February) they stood at £75·8 millions. There was yet another expansion next month, even though acceptance credits remained stationary. Thus the deposit liabilities of acceptance houses were rather high at the outbreak of the panic.

The volume of acceptance credits to foreigners granted by these houses, according to the Macmillan Report, reached its peak[2] on 30 June 1929, at £150·1 millions. As the crisis deepened the volume of these credits fell steadily though slowly. On the last date for which we possess statistics, 31 March 1931, their total was £120·6 millions. It is interesting to note that the total volume of acceptance credits granted by clearing and Scottish banks to foreign customers declined in the same period from £51·6 to £32·3 millions. The clearing banks seemed to be more successful[3] and/or more anxious to curtail their engagements,[4] which is at least

[1] Appendix I, Table 11.

[2] But it must be taken into account that the Macmillan Report gives only half-yearly figures for acceptances of acceptance houses on behalf of foreign customers. As we pointed out in Part II there was a pronounced seasonal variation in the acceptance credits of the clearing banks which are given monthly and the peak falls without exception in the early months of the year.

[3] The distribution of their acceptance credits between inland and international debtors was more favourable than that of the 'private' houses. Cf. Part I.

[4] Significant, however, are the figures of Barings showing a large drop in their acceptance credits which emphasize the inability of other banking firms to contract their credits. Cf. Part II.

interesting in view of the fact that the ratio of such engagements to capital was, of course, far higher in the case of private than of clearing banks.

In contrast it is significant that the volume of dollar acceptance credits arising from foreign storage and shipment transactions granted by U.S.A. banks increased during this period from some $150 millions to almost $600 millions,[1] only to fall afterwards more rapidly than the volume of British credits. It has to be emphasized, moreover, that this volume of dollar acceptance credits does not represent the *total* of acceptance credits granted to foreigners; much of the acceptances drawn to create dollar exchange—commonly called accommodation bills—must have been on foreign account, as also were the greater part of the acceptances drawn to finance exports. The American bankers were even less aware of the problem than their British colleagues.

The crisis completely changed the rate of liquidation. Within what must have been a few months the acceptance houses lost between one-third to two-thirds of their deposits.[2] It seems that they experienced no difficulty in meeting this drain. They had always kept rather higher cash reserves than the joint-stock banks. They liquidated their own bill holdings, which also were proportionately very much larger, and sold investments. A large part of their acceptance credits, however, were frozen. Had they been called upon to face the liability for their acceptances, in the face of the default of their overseas debtors, the consequences would have been incalculable, since they had already made use of their liquid assets to repay their depositors.[3] It is probable, however, that some at least of these deposits were used to liquidate credits.

The problem was identical with that of 1914. It was solved, however, not by a State guarantee as on that occasion, but by the co-operation and the discipline of the City itself under the leadership of the Governor of the Bank of England. The Bank of England declared its willingness to continue to rediscount frozen bills or

[1] Cf. Beckhardt, *The New York Money Market* (1935), vol. III, p. 337.

[2] The deposits of Barings were more stable, due presumably to the special funds they held which were not subject to withdrawal by their owners.

[3] *Report of the Committee of Experts appointed by the London Conference* (Wiggin Committee) *and first Standstill Agreement.* About Rm. 900 millions were repaid between July 1931 and February 1932 (Harris, op. cit. p. 27). The Wiggin Committee (p. 33) estimated that Rm. 300 millions of Germany's short-term assets were used in 5 months to repay credits.

bills issued under the Standstill agreements even without Government guarantee.[1] No official statement has ever been made as to whether any arrangements were made to safeguard the position of the holders and endorsers of these acceptances, similar to the guarantees given by the Government to the Bank of England at the outbreak of the war. It is thought that a fund was established at the initiative of the Bank of England in which all interested parties, including the joint-stock banks, participated, on an agreed basis.

With the passing of time the acceptances embodying these credits were slowly taken up by the acceptance houses themselves. The character of the loans changed. They increasingly lost their commercial basis in spite of all efforts of the creditors, and were more or less automatically renewed. At the outbreak of the 1939–45 war only a few millions were placed in the market, although the total volume of these frozen credits has not diminished as rapidly as the credits granted by bankers of certain other countries.[2] There was a widespread conviction in London that by waiting long enough the loss on these credits would be reduced. Whether this principle which has often justified itself in the past was applicable to this problem is a question which only time can answer. Up to the present the magnitude of the paper losses on the outstanding credit has steadily increased. We must remember, however, in this connection, that with the passing of time most of the firms involved were able to accumulate substantial reserves out of their current business, not the least from the relatively high rates of interest paid by Germany at first on the frozen loans and as a result of the appreciation of their investments. They were also able to find opportunities for special deals (shipbuilding, etc.) which permitted them to liquidate some of these credits without loss. The maintenance of the frozen credits—which could be carried at par—helped to gain time and so to avoid a liquidation which would have caused unnecessary casualties and might have easily made further untimely liquidation inevitable.

The management of the great crisis, once it broke, is, like the handling of that of 1890, an excellent example of the value of orderly co-operation and a triumph of what is best in the traditions of the City. The solution of technical financial problems on a

[1] Cf. Harris on a more detailed history of the Standstill. Similar arrangements were concluded with other debtor nations.

[2] Cf. Part II on the volume of these credits.

'personal' and 'loyal' basis, more or less in keeping with previous experience, however difficult they appear, seems to come easier to those who hitherto managed the country's financial destinies, than early action based on general considerations which could anticipate or mitigate the problem.

The unwanted and opposed depreciation of sterling very much eased the financial position of London. It resulted in substantial gains on foreign assets. And the recovery in this country and the constant monetary trouble abroad once more increased the volume of deposits of the acceptance houses. In the case of some of the houses which publish balance sheets, these deposits had again before the 1939–45 war reached the pre-crisis level. Most of these funds seem to have been used by these firms to increase their liquid reserves, though investments also increased substantially.

Acceptance credits, on the contrary, showed a very uneven revival. From certain indications which have been discussed above (Part II) we know that the total volume of bankers' acceptances had not recovered to its pre-crisis level. On the other hand, two of the more important firms which publish statements have extended their commitments beyond that limit. It follows that the acceptance credits of other firms not publishing balance sheets must have shrunk considerably. It seems also clear that the international acceptance business in general lost its former importance as a source of income in the case of most of these firms. Their recovery, such as it was, must have been due to the development of other outlets for their capital, to expert knowledge and to connections.

If there has been no violent casualty among acceptance houses during the shock period of the crisis, several joint-stock companies have had to liquidate their business, and have disappeared. The heaviest toll was taken from among those houses which had been established during the halcyon days of optimism. The slow decay of the new joint-stock competitors of the old houses still continues. The Anglo-French Banking Company, the Merchant Banking Co., the Anglo-South American Bank, the Anglo-International Bank,[1]

[1] It seems, however, that the two last became the agents of the Bank of England in the foreign exchange market after 1931 and before the organization of a special exchange department. They must have derived a substantial income from that task. The British Overseas Bank absorbed F. Huth's Co. in 1936. The renewed crisis, however, again undermined its position. The Prudential Assurance Co., the Union Bank of Scotland, and Williams Deacon's Bank surrendered their participation in the British Overseas Bank (cf. *The Economist*, 17 December 1938, p. 607) for the benefit of the holders of the common stock, having made a deposit to secure the ordinary depositors.

the British Overseas Bank[1] and certain of its affiliates have ceased to exist, or were wholly reorganized. Nor is it to be expected that the competition of others, if they survive, will be quite as unsophisticated as it had been prior to 1929. At the same time the steady pressure of the competition of the clearing bank continued up to the war, and the efforts of two of the acceptance houses, Erlangers and Samuels, to re-establish the inland bill has not succeeded.[2]

With the creation of a general and transfer guarantee by the Export Credits Guarantee Department there seems to be no reason why acceptance houses should not increase their commitments, at least as far as British exports are concerned, protected as they now can be against the vagaries of the international business cycle and politics. But that guarantee reduces the original usefulness of the international acceptance credit in so far as it enables the producer and the trader to give the security required by their banks for overdrafts. Nor is it clear whether such subsidization of this particular branch of international banking business as this guarantee implies[3] will always commend itself to the Government of the day. The future of the business is therefore too dependent on political considerations, even if no further structural changes take place in the world economic system in general and in the methods of conducting foreign trade in particular. It is at least highly doubtful whether, in the circumstances which will obtain after the war,[4] with international trade tending to be increasingly subject to State 'interference' or planning, there is much hope for an early revival of this activity.

The growing capital strength of overseas countries which enables them to carry the finance of their own foreign trade is a further factor in the same direction which would operate even if the trend towards collectivism were to be reversed. It is more than probable that the international acceptance business will never recover its past remunerativeness, and therefore will come to be regarded more as an ancillary business or as one of the necessary services at the disposal of the clients[5] of a bank rather than as the basis of the

[1] See p. 265, note 1.

[2] Cf. Part II. The causes of the decline of the London bill.

[3] As it will be used only in case of exports destined to countries or customers who are more risky, whereas it would not be used in case of the 'safe' and hence remunerative business. The State thus refrains from business which could enable it to accumulate reserves for its more 'dangerous' commitments to exporters.

[4] Written at the beginning of 1940.

[5] Kindersley, *M.E.* Qu. 1162.

business of specialized firms. The likelihood is great, however, that both the risk inherent in such business as will survive and the new forms of international trading (clearing, barter agreements, etc.) which seem necessary concomitants to a planned stabilization of economic activity will throw the main burden of conducting international credit business on official agencies such as, for example, the Export and Import Bank in the U.S.A. In that case banks may have to accept the status of agents for these institutions.

Those other activities (foreign exchange and bullion dealing, deposits, investment advice and business, etc.[1]) which were formerly regarded as of secondary importance have, on the other hand, very much expanded and helped to conserve the existence of the old international firms. It is doubtful, however, whether this temporary relief will ever again be available to the private bankers. Under exchange control it certainly cannot be considered an important source of revenue.

The other International Banks in the Crisis and After. We have seen the vicissitudes of the newly founded international banking institutions in this period. The old-established international banks with head offices in London have succeeded in weathering the crisis with greater success. The Anglo-South American Bank, once the most powerful British banking institution in its sphere of influence, had to be reorganized and was eventually absorbed by the Bank of London and South America. The latter itself is controlled by Lloyds. But the other older and bigger banks survived.[2]

The importance of the branches of the foreign banks has considerably increased during the period under review. They held at times vast amounts of funds for overseas owners who were anxious to keep their liquid resources in London. Especially the French and American banks were at times extremely active, particularly as exchange dealers, notably also in the forward markets. Sometimes they competed for deposits in order to use the funds for swaps. In other periods their deposits were actively bid for by certain of the clearing banks. They also actively dealt on the gold market. Except for the American banks, however, their role in the money market was not important.

[1] We shall not once more repeat what was said in Chapter 13 on these activities.

[2] There even was a new formation, the Trade and Deposit Bank (1938), an offshoot of the Société Générale pour favoriser le Commerce et l'Industrie.

B. Long-term Business

The issue business of the merchant banking firms played a double part. It was that branch of their activities which was most affected by the world crisis; and it was also that which afterwards provided them with the most solid basis for adapting themselves to the new world economic and financial position and policies, by reorientating their activities in new directions.

(i) *Foreign Issues.* The subsection (3) of the Gold Standard (Amendment) Act of 1931, suspending the obligation of the Bank of England to supply gold bullion at a fixed price, enabled the Treasury 'to make, and from time to time vary, orders authorizing the taking of such measures in relation to the exchanges and otherwise as they may consider expedient for meeting difficulties arising in connection with the suspension of the gold standard'. The validity of this subsection was limited to a period of six months from the passing of the Act.

On the basis of this authority the Chancellor of the Exchequer (Mr Snowden) on 22 September 1931 prohibited the acquisition of foreign exchange by British subjects and residents in the United Kingdom. This order remained in force until 3 March 1932, when Mr Chamberlain revoked it because the restoration of confidence in sterling and monetary difficulties abroad resulted in an increasing inflow of funds to London and threatened to raise the value of sterling to an unduly high level.[1]

It will be seen from the wording of the Act that there was no *legal* obstacle in the way of foreigners issuing loans in the London market and transferring the proceeds abroad. In fact, almost throughout the post-war period[2] there had been an effective (though not statutory and defined) control of foreign and certain home issues.[3] In the period before the resumption of gold payments

[1] The lifting of restrictions was not sufficient to stem the inflow. At first the effects on the rates of exchange were offset by purchases of dollars and francs to repay the loans contracted in the summer of 1931 in the 'defence' of the gold standard. But this outlet was soon exhausted. As the Bank of England was prohibited from valuing gold higher than the old statutory price it became necessary to establish the Exchange Equalisation Account to conduct operations on the foreign exchange market and acquire gold at higher prices.

[2] The official embargo and control on capital issues imposed as a war-time measure in 1915 was discontinued in 1919. It was followed by an unofficial control of issues discontinued in the beginning of 1924. The control was resumed preparatory to the return to the gold standard in 1924.

[3] It appears that the Bank of England was consulted especially in connection with securities which enjoyed Trustee privileges. The laws of 1859,

this control amounted to a complete *de facto* embargo on foreign issues. A few months after the return to the gold standard it was relaxed but never entirely abandoned. The control was based on so-called 'moral suasion' backed by the power of the Bank of England.[1] In so far as most merchant banks responsible for capital issues were also active as acceptance houses they could hardly refuse to comply with the wishes of the Bank of England.[2] The authorities could furthermore prevent the trading on the Stock Exchange of any issue of which they disapproved. Thus their ultimate control over issues and large transactions involving Stock Exchange introduction was also effective. Less effective was their control of sales, in small and large blocks, directly to investors of securities floated elsewhere.[3]

After the abandonment of the gold standard the restriction on foreign issues was not tightened up explicitly, probably because in the circumstances then obtaining foreign issues were in any case out of the question. When confidence was restored—and more especially when the measures calculated to facilitate the conversion of the 5 per cent War Loan were undertaken—a more explicit statement of public policy seemed necessary in order to concentrate fully on the home capital market the beneficial effects of these measures. It is interesting to observe that the announcement was not, in this instance, made by the Bank of England, but by the Chancellor of the Exchequer himself:[4]

'I am sure that anyone who may be contemplating the issue of new capital in the market in the early future will forbear from coming forward for a few weeks while this great operation is proceeding and that the authorities in the City of London will co-operate in this necessary project.'

This announcement amounted to a complete embargo on all capital issues. It was relaxed after two months.[5] On 30 August

1889, 1893, 1900 and 1925 define eight categories: Government securities; mortgages; certain Indian loans; obligations and preferences of British railroads which paid at least 3 per cent on their ordinary shares in the last 10 years; Imperial and Dominion Government Loans; Local Government obligations issued in accordance with the law; Housing obligations and obligations of the Metropolitan Water Board and similar public bodies.

[1] Cf. the evidence of Harvey (*M.E.* Qu. 390–6) and Kindersley (ibid. Qu. 1362). Also *M.R.* para. 363, p. 155.

[2] Cf. *The Problem of International Investment*, Royal Institute of International Affairs, 1937, p. 77.

[3] *M.R.* ibid.

[4] Speech announcing the Conversion of the War Loan, Hansard, 1931–2, vol. CCLXVII, col. 2125.

[5] Cf. *The Economist*, 10 September 1932, p. 479.

1932 conversion operations not requiring underwriting or cash subscriptions were permitted to domestic and Empire borrowers. On 1 October 1932 all restrictions were lifted for the benefit of domestic borrowers, except in the case of trustee securities. Operations involving underwriting or invitation to the public to subscribe new capital for the optional replacement of existing securities by new issues[1] remained prohibited. In the case of trustee securities, the consent of the Bank of England had to be obtained both with respect to conditions and to the date of the new issue. The 'request' was made, moreover, that the consent of the authorities (i.e. it appears to be that of the Treasury, but through and by the advice of the Bank of England) should be obtained prior to issues in favour of borrowers 'domiciled *outside* the Empire, or issues the proceeds of which would be remitted directly or indirectly to countries outside the Empire'. There is no doubt that even Empire Governments consulted the Treasury prior to undertaking conversion operations.

There were at first no restrictions on private placing of foreign securities. In May 1933 a group of banking firms purchased a block of shares in a British firm which happened to be in American hands. The Treasury thereupon issued a statement (17 May 1933) followed by a letter to the Chairman of the Stock Exchange Committee in which the placing of large blocks of shares either by an issue to the public or otherwise (i.e. even without an intermediate purchase by an issue house) was declared to be contrary to public interest.[2]

On 19 July 1934 two further concessions were made.[3] Foreign issues by a country within the sterling block for the purpose of increasing its sterling assets and so minimizing fluctuations in the exchange; and also issues on behalf of any borrower in those cases

[1] *The Problem of International Investment*, R.I.I.A., p. 78. This seems to have been devised to assure priority to new investment. It was lifted on 14 January 1933 (cf. *The Times* of that date).

[2] As a result of this intervention the particular deal which had given rise to it was abandoned. When the seller of the shares threatened to take legal proceedings (which in the view of counsel would undoubtedly have been successful —the embargo having no legal basis) another financial group was formed which happened to possess foreign exchange holdings with which to finance the transaction. Another almost equally awkward incident arose in connection with the purchase of some American ships in 1935. It was never explained why the Authorities held that use of existing foreign exchange reserves, in contrast to the acquisition of the foreign exchange required, would reduce the dangers, if any, of such transactions.

[3] *The Times*, 20 July 1934.

where the proceeds were used mainly for purposes directly benefiting British industry, were exempted from the embargo.

The Chancellor finally announced in April 1936[1] that henceforth the duty of advising him on problems—both as far as the 'general scope of restrictions and as far as their particular application was concerned'—would be entrusted to a Committee known as the Foreign Transactions (Advisory) Committee.[2] Lord Kennet was appointed as the first Chairman of this Committee. Representatives of the Bank of England, of the Stock Exchange Committee, of the clearing banks, of the issue houses, and of industry were asked to serve on it. According to its terms of reference the main task of the Committee was to co-operate with the authorities in protecting the sterling exchange. All placing of stock in London, whether by public offering (issue by prospectus, offer for sale, or introduction[3]) or otherwise (private placing[4]), was made dependent on their consent. Preferential treatment was to be given to the Empire—in so far as it also belonged to the sterling block[5]—and to the members of the sterling area. Issues which involved only small remittances to foreign countries, i.e. the proceeds of which were spent mainly in Britain, were also to be treated favourably. Decisions were to be based on the volume of capital available for export, the invisible capital export (i.e. the volume of small purchases) and the exchange position in general.[6]

On 1 February 1938—presumably as a result of the temporary heavy influx of flight capital, which the balance of payments did not show—it was officially announced that the Committee would henceforth favourably consider applications by British borrowers who wished to acquire assets or develop enterprises abroad, as well as applications for permission to repatriate British securities owned by foreigners. This measure, based as it was on the surprising expectation of the return of more 'normal' conditions, had to be cancelled almost immediately afterwards (20 December 1938) because of the heavy loss of gold by the Exchange Equalization Account due to the unabated succession of political crises. The restrictions were

[1] *The Times*, 8 April 1936.
[2] This became subsequently the 'Capital Issues Committee'.
[3] Cf. below.
[4] Cf. below.
[5] Cf. *The Problem of International Investment*, R.I.I.A., p. 79. Canada, for example, seems to be treated as a foreign currency area.
[6] But the Committee may take into account any other, not necessarily financial, problem outstanding between Britain and the country of the prospective borrower. This was the nearest point to acknowledging the existence of a 'sterling area'.

tightened up again and the banks were requested to withhold facilities, even for short-term operations, which might weaken sterling.[1]

The indirect control of capital exports proved rather ineffective in curbing the individual purchase of foreign securities.[2] There was, especially in the period prior to the establishment of the Committee, some uneasiness in the City about specific decisions of the authorities,[3] and about the general effect on the City of the restrictions.[4] The establishment of the Committee and the increasing clarity[5] of the definition of its scope (though not of its principles) somewhat mitigated this criticism, though it was generally realized that wholly different methods would have to be used to make an embargo on capital exports really effective.

In consequence of these controls and of the widespread defaults abroad due to the Great Depression, the foreign issue business did not recover. Austria issued a loan in 1933 in order to convert the Guaranteed League Loan and to fund the credit granted by the Bank of England in 1931. In 1934 Ireland and Argentina were permitted to issue conversion loans. New capital was raised for the Danish Government to pay for British steel shipments for a bridge. A further loan was made to Norway to permit her to increase her exchange reserves.[6] According to the Midland Bank in the seven years following the abandonment of the gold standard total foreign issue amounted to £28 millions, i.e. were smaller than in any *one* year prior to 1928. Foreign Government issues totalled just £11 millions. In four out of these seven years no issues for foreign public borrowers were reported. Sir Robert Kindersley estimated[7] that

[1] Such as speculative forward exchange transactions, advances on, and forward transactions in, gold. Cf. *The Economist*, December 1938.

[2] A special request was made later by the Chancellor to stockbrokers to refrain from recommending such purchases. In March 1937 the Chancellor expressed his hope that investment trusts would refrain from increasing their foreign assets. According to the American Treasury the capital inflow to U.S.A. from Great Britain amounted to almost $1000 millions in the four years 1935–8. The greater part of the increase was due to security purchases.

[3] Cf. *The Economist*, 17 July 1936 and *The Problem of International Investment*, R.I.I.A., p. 81.

[4] Cf. statement by the Treasury of March 1937 on the classes of transactions which had to be submitted to the Committee.

[5] This uneasiness had been shared by official circles, e.g. Sir Otto Niemeyer (*M.E.* Qu. 6821–31) thought that the control was ineffective and resulted in the loss of issue and underwriting business.

[6] Cf. *The Problem of International Investment*, R.I.I.A., p. 78–9.

[7] *Economic Journal*, December 1937, p. 661. This process of slow liquidation of overseas assets was—unlike in the 1914–18 War—startlingly transformed into a complete change of Britain's position as an international lender. Cf.

in three out of six years between 1931 and 1936 capital repayments by foreign borrowers were higher than visible British subscriptions to foreign loans. Calculations by *The Economist* gave an even more unfavourable picture. Income on foreign investments fell sharply, due to the decline in dividends. These fell on the average from 8·9 per cent in 1929 to 4·2 per cent in 1932. By 1934 they had only recovered to 4·9 per cent. The average rate of interest rose from 4·6 per cent in 1929 to 5·3 per cent in 1930 and declined (mainly through defaults) to 4·5 per cent in 1933. The overall return (on nominal capital) fell from 6·2 per cent in 1929 to 4·4 per cent in 1933. In spite of the grave losses, this cannot be considered unfavourable to Britain.

But, even without a second war, the steady ageing of investments, the absence of participation in young and expanding industries (apart from mining and some direct investments) was a legitimate cause for apprehension. The predominance of investment in railroads characterized this process of ageing.

It is apparent that the issue houses could not count on this source of income in the years after the crisis. A return to the pre-1929 (and *a fortiori* to the pre-1914) basis has been precluded by the complete change in the capital balance and the balance of payments position of Britain. Certain commentators, in their desire to see their principles vindicated, consistently ignore this change in the same way as the authorities ignored the (lesser) change after the last war. The consequences of that wilful blindness were unfortunate.[1]

below and 'The post-war international economic problem of Britain. A background of the Monetary Plans,' *The Banker*, 1944. On the influence of this change on internal employment policies, cf. 'The International Aspects of Full Employment', in *The Economics of Full Employment*, Institute of Statistics, Oxford, 1944.

[1] The United Nations Monetary and Financial Conference (held at Bretton Woods, 1–22 July 1944, Final Act, Cmd. 6546) proposes to establish an International Bank for Reconstruction and Development. This undoubtedly represents an advance on previous attempts (e.g. the so-called Franqui-project) in the inter-war period to develop a conscious international investment policy. Nevertheless, the proposals largely disregard the lessons of the failure of international investment in the inter-war period. They hope to ensure the 'soundness' of the loans to be granted by arbitrary (and futile) provisions, forgetting that repayment depends almost more on the policy of the creditor than the precautions taken by the debtor. By contemplating the finance of 'single projects' they ignore the divergence between social and private returns (cf. the article quoted, p. 248, n. 3). The possible contribution of the Bank is thereby limited to a far smaller amount than is contemplated in the plan. The European countries, e.g. France and Britain, can hardly benefit, but might be considerably embarrassed by the joint guarantee of the loans which is envisaged.

(ii) *Home Capital Issues.* It was in the internal capital market that the international banking firms succeeded in establishing for themselves a new outlet for their connections, organizations and capital resources.

Several factors contributed to this change in the functioning of the capital market. They were not new. Most of them have been recognized and discussed already in the post-war 'reconstruction' period.[1] The crisis, and the circumstances in which recovery was achieved, strengthened their force considerably. If issues for British industry, especially certain public utility companies, were not unknown prior to 1931, they did not play a major role among the activities of the most powerful City firms. It will be useful, however, to summarize the position on the problems of the internal capital market in Britain as they had developed since before 1914.

We have seen how the successful competition of the clearing banks for deposits had forced the private banker either to amalgamate with other smaller banking firms or to permit the absorption of his business by the clearing banks. We have seen that as a result of these amalgamations a gap opened in the capital market. The joint-stock banks, contrary to Continental practice, would not and perhaps could not fill the role of the 'country banker' in assisting directly or indirectly in the provision of fixed capital. There was—as we have seen—a complete unanimity among the witnesses before the Macmillan Committee in this respect. It appeared that the deposit banks were averse to taking over, reorganizing and running even those industrial firms of which they more or less became unwilling owners as a result of the inability of these firms to repay their advances.[2]

Prior to 1914 this lacuna in the structure of the organized capital market did not make itself felt. Lavington, when describing the methods by which British industry raised its fixed capital, found that 'business men obtain their supplies of capital in a great measure from other parties associated with them by business or personal relations'[3] and that 'this (i.e. capital obtained by public issues) stream is conspicuous and its volume considerable, but it seems to be of quite secondary importance in relation to the flow

[1] Cf. e.g. the *Reports of the Departmental Committees on Financial Facilities* (see p. 243 and p. 302, n. 3.

[2] Hyde (*M.E.* Qu. 1083): 'We are not fond of having representation on the board.' (Qu. 1084): 'We should put in a supervisor, who would keep us informed of what was going on but not as a director.' (Qu. 1085): 'A watchdog?' 'A watchdog.'

[3] Op. cit. p. 111.

of resources by way of private contract and the reinvestment of profits'.[1] He could explain with confidence the lack of institutions engaged in providing industry with fixed capital by the absence of any need for their services. The difference between the German and the English capital market, already conspicuous in this respect, was due in his view to the difference between the economic background and social conditions in the two countries; and from this comparison he drew conclusions favourable to Great Britain.[2] This lack of urgent and sufficiently wide-felt need for firms specialized on providing a channel for long-term capital investment explains the disappearance of the English private banker when he could not maintain his position in the banking business proper in competition with the branch banking institutions.

The war and post-war period saw a complete change in this position. Several factors must be mentioned to explain this change. They operated both on the demand and on the supply side of the capital market. On the demand side there was, first of all, the increase in the optimum size of industrial firms due to technical progress. Secondly, there can be no doubt that the growing tendency, due only partly to the increase in taxation and much more to the change in the social status and ambitions of the former owning families, towards converting family businesses into public companies contributed to this development. There was also a shift in the geographical distribution of industry towards the south which hindered local financing and at the same time brought industry nearer to the London market. There was the depressed state of business due to the monetary policies followed in the post-war period, especially after it was decided to return to the pre-war gold parity. Finally, the incidence of direct taxation must have impeded the finance of industry by private capitalists[3] and must have made it difficult for the smaller or new firms to accumulate sufficient capital for purposes of expansion.

There can be no doubt that savings (both absolutely and

[1] Cf. also the interesting examples for diverse industries, ibid. pp. 277–80.

[2] A similar view was expressed with respect to the historical background by the Macmillan Committee. They came to very different conclusions as regards the post-war position. Cf. below and *M.R.* pp. 375–404.

[3] According to Clark (op. cit. p. 172) the net savings of the richer classes other than those accumulated by institutions or companies owned by them were negligible. The position of the 'rich' was maintained by the appreciation of their assets (including the violent rise in land values). Cf. my article 'Taxation, Risk-bearing and Investment', *Oxford University Institute of Statistics Bulletin*, vol. 7, Nos. 11 and 12, 1945.

relatively to national income) have substantially fallen since 1913 and that, at the same time, the economic progress of this country relatively to other countries has also shown a decline. Part of this is explained by the startling change in the country's foreign balance at a time when its traditional export markets were endangered both by the rapid progress of overseas countries and by the relative failure at home.[1] In the most depressed (and relatively least progressive) economic branches, the failure to rationalize production was due at least to some extent to the fear of increasing unemployment. It is in the protected prosperous and expanding industries that the increase in productivity and employment had to be looked for. It was the failure in these new industries to expand sufficiently to absorb the unemployed, thus forcing (or enabling) the older industries to set their house in order without aggravating the problem of the 'special' areas, which was the serious feature of the situation.

In spite of this sharp relative and absolute decrease in savings the instability and the under-employment of the system increased. There is, therefore, an *a priori* indication that the relative incentive to invest fell. Until 1931 it might be argued that this was mainly due to the high rates of interest. After that time (or at least after 1934, when the rationing of home issues was discontinued), however, that factor cannot have played a significant role.

The most striking developments were the worsening of the balance of payments which changed the positive balance of £320 (£160–190) millions[2] (in terms of 1924 prices) in 1911 to a negative balance of almost £80 millions (also in terms of 1924 prices) in 1938, i.e. a change of between £240–400 millions. This accounts for almost the whole in the decrease in net investment (and savings). While actual home investment fell considerably *relative* to national income (from 11·1 to 7·5 per cent), absolutely it remained almost constant (with due consideration of price changes).

Potential full employment savings (disregarding any impact effect on the balance of payments) might have been some £100

[1] The increasing disadvantage of British industry has been confirmed by recent investigations. Cf. L. Rostas' article in the *Economic Journal*, 1943, p. 39. The ratio of both gross and net investment to national income was higher in the U.S.A. in prosperous years than in the equally prosperous years in Britain. Cf. S. Kuznets, *National Income and Capital Formation*, and R. Stone, *Economic Journal*, 1942, pp. 164–5. It is interesting to note that, even in 1929, corporate savings played a small role in the U.S.A. as compared with the U.K.

[2] Cf. note 10 of following Table.

TABLE L. NATIONAL INCOME, INVESTMENTS AND SAVINGS IN GREAT BRITAIN, 1911, 1924 AND 1938

(Amounts are stated in £ millions)

	1911	1924	1938	
1. National income	1,988[1]	3,803	4,350[1]	4,619[2]
Ditto in terms of 1924 prices	3,750	3,803	4,830	5,130
2. Investment gross	505[10]		715	
Ditto in terms of 1924 prices	954		800	
3. Investment net	320[10]	475	275[3]	(342)[4] (320)[5]
Ditto in terms of 1924 prices	605	475	305	(380) (355)
4. 2 as percentage of 1	25·4		16·4	
5. 3 as percentage of 1	16·8	12·5	6·3	5·95[7]*a* 7·4[8]
6. Increase in home assets	220	319	345	(365)
Ditto in 1924 prices	396	319	383	(365)
7. Increase in foreign assets	100[10]	156	−70	
Ditto in 1924 prices	(190)*a* (160)[10]	156	−78	
8. Undistributed profits	115	205	170	(240)[6]
Ditto in 1924 prices	219	205	190	(270)[9]
9. 'Other net saving' (residue)*b*	205	270	172	
Ditto in 1924 prices	386	270	190	

Sources: A. L. Bowley, *The Division of the Product of Industry*, 1921; and Sir J. Stamp, *The National Income* 1924; and *Studies in National Income* (N.I.E.S.R.); White Papers, Cmd. 6520 and Cmd. 6623 and N. Kaldor, *The Quantitative Aspects of Full Employment Policy*. The price index used was (1924=100) 1911=52·9 and 1938=90. This might not have been appropriate for an index of the real value of investment, especially abroad. Under (*a*) therefore the valuation was based on 1911=65, the import price index. The terms of trade have changed almost consistently in favour of Britain. (*b*) for 1911 and 1924 arrived at by subtraction; for 1938 from the White Paper.

[1] Bowley; [2] White Paper; [3] Net increase in assets; [4] Private net saving according to White Paper; [5] Net investment according to White Paper (Cmd. 6520, p. 9); If changes in the value of stocks are disregarded, this rises to £365 millions; [6] According to Kaldor (op. cit. p. 359); [7] [3] over [2]; [8] [4] over [2]; [9] Net private saving including tax reserve [10] According to Bowley foreign investment amounted to £194 millions. In that case net total investment would be £414 millions and gross investment £599 millions. In terms of 1924 prices this is equivalent to £320 (362) and £780 and £1,030 millions respectively.

millions more than those actually achieved in 1938.[1] Even if such—potential—expansion is taken into account, the total thus achieved would have represented a relative fall as contrasted with 1911 in terms of the national income (from 11·1 to 9·6 per cent), though it would have represented an expansion in absolute volume of about 12 per cent.

If we then analyse the distribution of actual savings between undivided profits and 'other' private saving, the result is equally striking.

[1] Kaldor, op. cit. pp. 358–9.

TABLE LI. UNDISTRIBUTED PROFITS, 1924–35[1]

(Amounts are stated in £ millions)

	Profits and interest	Profits, interest and rent after writing down stocks	% covered by *The Economist* sample	% of profits undistributed	Estimated total undistributed profits
1924	834	834	18·0	22·3	186
1925	1,014	793	20·8	21·1	167
1926	823	749	23·9	17·9	134
1927	853	765	22·7	20·6	158
1928	801	778	25·4	20·3	158
1929	821	740	26·8	18·6	138
1930	902	651	28·8	15·8	103
1931	620	518	26·9	5·5	28
1932	590	539	25·5	8·8	47
1933	642	642	24·8	17·2	110
1934	781	749	27·0	20·9	156
1935	949	949	—	24·0	228

Mr Colin Clark's estimates are given in Table LI. If these estimates are contrasted with the statistics on the capital issues for internal purposes in the same period, it is seen that throughout this period (though we have no accurate information on the distribution of real investment such as is now available for 1938) undivided profits played at any rate a more important role in financing enterprise quantitatively than did public issues.[2]

There had been no appreciable decrease in terms of actual purchasing power in undistributed profits between 1911 and 1938. Indeed, if we follow Mr Kaldor in adjusting profits for price changes,[3] they have appreciably increased (i.e. from £219 to £270 millions). It must not be forgotten, moreover, that the general movement of prices does not reflect accurately the changes in the purchasing power of sterling over capital goods. The technical progress tending to depress the price of instruments of production of a given efficiency was marked throughout this period. On the other hand, the cost of the most efficient machines available in any given industry must have increased markedly with the introduction of mass-production methods.

[1] Op. cit. p. 187. On the basis of his own estimate of total profits and the current statistics of *The Economist* on the distribution of total profits between paid out and undivided profits.

[2] In new industries there were some conspicuous examples of rapid expansion almost entirely undertaken by internal finance, such as Courtaulds, Morris Motors, Marks and Spencer, etc.

[3] Op. cit. p. 360.

Whatever quantitative importance we may attach to each of these quantitative factors, it is certain that the undistributed profits were amply sufficient to finance such investment as was undertaken in industry in 1938. According to Cmd. 6520,[1] investment in fixed capital was as follows:

TABLE LII. PRIVATE INVESTMENT AT HOME IN 1938
(Amounts are stated in £ millions)

	Gross investment	Allowances for maintenance, depreciation, etc.	Net investment
Fixed capital, works, etc.:			
(*a*) Public utilities	145	80	65
(*b*) Other branches of activity, including house building:			
(i) Buildings	360	105	255
(ii) Plant and machinery	120	100	20
(iii) Other fixed capital, etc.	65	55	10
	690	340	350

To this might be added £15 millions net and £50 millions maintenance and depreciation expenditure on highways and bridges the inclusion or exclusion of which does not affect the argument, however. By far the largest part of home investment consisted of buildings. Of this, house-building and connected public works must have absorbed at least £200 millions. More than 330,000 houses were built that year. Most of this investment must have been financed by the banks, building societies and insurance companies if not out of direct private savings. This leaves only £150 millions of net investment unaccounted for.

But undivided profits, as we saw, amounted to at least £170 millions, while in the same year some £75 millions of industrial and public utility issues were made on the Stock Exchange. Apart from this, private companies with £120 millions of capital were incorporated. Part of these issues, of course, were used to pay a large part of the financial expenses involved in the transfer of property which, according to the White Paper, amounted to £66 millions in all. Some of the accumulating reserves were no doubt used for financial purposes. Even after full allowance has been made for all these factors, there were ample means in the hands of the larger companies to undertake a multiple of the investment they actually undertook and certainly all investment they wished to undertake,

[1] Cmd. 6520, Table D, p. 9.

especially if we bear in mind that out of the, say, £150 millions of fixed investment (apart from buildings) at least £65 millions are accounted for by the public utilities which were, in the main, not carried by undistributed profits.

We must conclude, therefore, that there is no reason to believe that the second effect of the pre-war taxation policy, the effect of *reducing the investment capacity of the taxpayer* had a deleterious effect on investment as actually undertaken by established limited liability companies. It is probable that it was the decline of the *willingness to invest* which was responsible for the decline in the relative quality volume of British capital equipment.

It must be taken into account that (*a*) undivided profits cannot finance new types of enterprise except by forming affiliated firms or by establishing new departments in an existing firm, and that (*b*) the continuation of satisfactory conditions, i.e. of undiminished profits of existing firms, depends to a great extent on whether savings undertaken outside existing firms are currently invested.[1] This financial method does not therefore by itself solve the problem of the capital market as a stabilizer of economic activity.[2] In so far as undivided profits might be regarded by the management of a company as loan capital on which no interest need be paid, the withholding of an important fraction of the annual savings from the capital market can in unfavourable circumstances accentuate the maldistribution of investment. The effectiveness of the rate of interest as the 'distributive mechanism' of capital, weak as it is, because of the conditions of imperfect competition on the capital market, is thereby further weakened.[3]

[1] The fact that profits are not distributed to shareholders might contribute to such changes in the character of the savings of the nation as will render investment in new enterprise more difficult. The wealthy owners of shares in existing companies might consider that the increase in the capital value of their shares due to the 'ploughing back' of profits represents a sufficient capital accumulation and may therefore refrain from further saving out of their available income. As the savings of the poorer classes are not available for risky investment, this change might contribute to the difficulty of private finance of new companies or processes.

[2] It will also tend to concentrate the trend towards the control of industry by existing firms, i.e. monopoly or oligopoly. The technical advantages of large firms derived from mass-production methods are further reinforced by advantages opening in the financial field. Cf. M. Kalecki, *Essays in the Theory of Economic Fluctuations*, on the 'principle of increasing risk' and J. Steindl, 'On risk', *Oxford Economic Papers*, No. 5; 'Capitalist enterprise and risk,' ibid., No. 7; and *Small and big businesses*, Oxford University Institute of Statistics Paper.

[3] The interests of the management and of the proprietors of an industrial undertaking might, moreover, easily clash in this respect. It would obviously be in the interest of the management to increase the size of the firm even at

A further contributory cause of the decay of private (and local) finance was the weakening of the independent merchant both on account of the very heavy losses suffered in the post-1918 period crisis and because of technical and world economic changes.[1]

The extent of the decline of local private finance is shown in the most striking way in the increase of the relative importance of issues for home purposes relative to total savings. Whereas the capital export amounted to at most 50 per cent of total net savings in pre-1914 days, external issues were not less than some 80 per cent of *all*

TABLE LIII.* COMPANIES REGISTERED, WITH SHARE CAPITAL

Year	No.	Nominal capital £
1914	(6,101)	(113,251,583)
1915	(4,004)	(53,354,606)
1916	(3,324)	(50,442,871)
1917	(3,901)	(67,813,926)
1918	(3,388)	(127,879,495)
1919	(10,596)	(412,967,204)
1920	(10,866)	(593 189,032)
1921	6,713	107,214,586
1922	8,386	131,729,895
1923	8,357	113,944,466
1924	8,385	123,209,601
1925	8,416	132,202,608
1926	8,157	214,365,418
1927	8,736	183,734,653
1928	9,408	236,523,194
1929	8,982	240,422,640
1930	8,740	112,259,379
1931	8,680	65,058,290
1932	10,541	13,044,616
1933	11,852	98,954,522
1934	12,953	148,029,517
1935	13,613	143,365,007
1936	14,260	164,422,038
1937	13,220	120,302,501
1938	13,132	75,196,466

* England and Scotland. Figures in brackets including Ireland. Limited and unlimited. The limited significance of these statistics—because of the importance of financial firms, reorganizations, etc. leading to multiple overlapping—has been stressed by Lavington (op. cit. pp. 200–9). It is further exemplified by the fact that of the capital of £11,709,224,712 incorporated since 1861 only 14,355 public companies with £4,096,805,588 and 143,221 private companies with £1,893,738,013, together representing £5,980,543,601, remained in being at the end of 1938. The discrepancy cannot be explained by bankruptcy or liquidation alone (cf. Board of Trade, *Thirty-first* and *Forty-eighth Annual General Report* (1922 and 1939 respectively)).

a loss of the *average* return on capital. This factor played an important and mischievous role in the American boom of 1928–9. Cf. Berle and Means, *The Economics of Corporations*, New York, 1931.

[1] Cf. e.g. P.E.P. *International Trade Report.*

issues. This discrepancy has very much diminished in the post-1914–18 war and even more in the post-crisis years.

The formation of new limited liability companies, apart from the speculative inflationary period of 1918–20, did not recover to its pre-war level (if the change in the price-level is taken into account).

There were, however, factors on the supply side of the capital market which worked in the same direction. The investment in securities was popularized to the broader masses of the public by the propaganda in connection with war finance.[1] This was shown by the success of recapitalizing and floating on to the public large sections of industry (especially heavy industry and cotton) during the armistice boom and the ease with which issues could be placed in 1928–9. It was also shown by the impressive expansion of 'Unit trust' catering for the small investor.[2] If the large direct investor slowly lost importance, the number of small savers who became more enterprising, if not speculative, increased. The untoward results of this change showed that the need for reliable guidance was also growing.[3]

Thus already in the post-war period a combination of circumstances arose which would have enabled private banking firms, untrammelled by the considerations and the structural difficulties which inhibited the clearing banks from entering this field, to establish a new outlet for their activities. There were several factors which retarded—though, as we have seen, did not altogether prevent—the reorientation of the activities of these firms which would certainly have been favourable both from their own and from the national point of view.[4] The most important of these reasons was the persistent depression of that part of industry (especially the heavy and ancillary industries) which, from a structural point of view, could most easily have approached old-established banking firms. This increased their disinclination to enter into a new, untried field of activity, the reputation of which had not been enhanced by those promoters who had been previously active in it. Nor seemed there to be any immediate necessity for assuming new commitments in what was unquestionably con-

[1] Cf. Grant, op. cit. p. 179.

[2] Cf. *The Economist*, Unit Trust Survey, 1938–9, and 'Fixed Trust', *Report of the Departmental Committee appointed by the Board of Trade*. The funds invested through these trusts amounted to almost £100 millions in the beginning of 1939.

[3] This change was not strong enough, however, to offset the decline of the volume of 'risk-bearing' funds.

[4] *M.R.* §§ 384–5, pp. 165–6.

sidered in the 'best circles' a rather second-rate business. The international financial field—both short and long term—seemed capable of great expansion, and if the first was not as profitable, the second not as broad as it used to be before the war, it gave sufficiently good scope for the activities even of the strongest firm. There was a further, and more technical, financial reason for their reluctance to enter this specific field of business. Most of these firms were active in granting acceptance credits, and they were disinclined to enter into transactions which might involve the immobilization of their funds. They had assumed acceptance and deposit liabilities and considered the liquidity[1] of the assets as important a consideration in deciding their business policy as did the clearing banks.[2] But no satisfactory market could be developed in any security the amount outstanding of which was less than £100,000.[3] Investment trusts and insurance companies whose financial structure (the maturity of their liabilities) would have permitted them to undertake investment of securities which were not marketable—provided they proved successful—followed this policy instinctively rather than by reasoning. Under these circumstances the great international firms felt constrained to restrict their activities to issues which could be marketed easily—and large enough issues such as foreign Government obligations were then thought to be 'liquid' investments.[4]

The record of capital issues undertaken in the more speculative years of the post-war period is more than lamentable.[5] The Macmillan Committee estimated that in May 1931 the depreciation relatively to the nominal value of the shares and obligations of 284 companies which had been issued in 1928 was not less than 47 per cent, i.e. £51 millions as contrasted with £117 millions.

[1] Cf. Granet (*M.E.* Qu. 9098 and 9101), Norman (ibid. Qu. 1921), Kindersley (ibid. Qu. 1307–9, 1490–5), Hyde (ibid. Qu. 1091). This view was accepted by the Committee (*M.R.* § 402, p. 173).

[2] Goodenough (*M.E.* Qu. 586), McKenna (ibid. Qu. 1507).

[3] Kindersley (*M.E.* Qu. 1526–7).

[4] This explains why certain industrial shares and obligations of suitable industries (such as electricity) were handled by the international firms. There can be little doubt that the depression of the great basic industries in which the industrial units could have been large enough was a contributory factor to and was aggravated by the deadlock in the capital market. (Cf. above and Kindersley, *M.E.* Qu. 1523 and following.)

[5] Professor Clay (op. cit.) shows, however, that 194 issues amounting to £65,107,682 (the bulk of the total of 283 issues of £78,000,000) floated in 1924 *rose* in value to £76,645,564 in 1927, and even in May 1931 were worth £59,989,890, despite of a fall of 25 per cent in wholesale prices and of 34 per cent in industrial shares.

TABLE LIV A. RESULTS OF SUBGROUPS

Nature of issue	No.	Subscribed in 1928	Market value May 1931	Depreciation %	Market value April 1933	Depreciation %
1. Old companies	41	£36,273,261	£27,825,522	23	£28,134,000	23
2. New companies guaranteed by old companies	4	3,915,500	3,805,500	3	4,091,063	Nil
3. Public issues by old private companies	11	3,629,810	2,601,420	28	2,250,144	38
4. New companies acquiring businesses (past profits stated)	74	28,886,266	23,844,300	18	19,349,917	33
4a. Do. (excluding Ford Co.)	*73*	*26,086,266*	*16,144,300*	*38*	*16,987,417*	*35*
4b. Do. (cash acquisitions)	*32*	*18,004,416*	*13,375,725*	*26*	*15,098,938*	*16*
4c. Do. (others)	*41*	*8,081,850*	*2,768,575*	*66*	*1,888,479*	*77*
5. New companies acquiring businesses (certified profits not stated)	29	8,036,400	366,448	95	210,362	97
6. New Investment Trust Companies	9	7,436,220	5,059,000	32	3,680,206	51
7. New or virtually new ventures	109	26,739,125	4,631,425	83	2,727,379	90
Totals	277	£114,916,582	£68,133,615	41	£60,443,071	47

TABLE LIV B. ANALYSIS OF RESULTS WITHIN SUBGROUPS

Subgroup	No. of issues	Valuation, May 1931									Valuation, April 1933								
		Appreciated	Unchanged	Depreciation %						Wound up	Appreciated	Unchanged	Depreciation %						Wound up
				0–20	20–40	40–60	60–80	80–100	No price				0–20	20–40	40–60	60–80	80–100	No price	
Old companies																			
1	41	15	3	5	8	4	4	1	—	1	20	—	4	2	2	4	7	1	1
2	4	2	1	1	—	—	—	—	—	—	4	—	—	—	—	—	—	—	—
New companies																			
4	74	7	2	9	10	12	10	11	10	3	15	—	8	2	3	12	18	5	11
4*b*	32	4	2	8	6	5	4	1	2	—	12	—	4	2	2	7	3	1	1
4*c*	41	2	—	1	4	7	6	10	8	3	3	—	3	—	1	5	15	4	10
5	29	—	—	—	—	1	2	9	5	12	—	—	—	—	—	2	4	2	21
6	9	—	—	3	4	1	1	—	—	—	—	—	—	2	5	2	—	—	—
7	109	1	1	1	5	3	4	19	29	46	—	—	2	2	1	7	16	13	68
Totals	266	25	7	19	27	21	21	40	44	62	39	—	14	8	11	27	45	21	101

In so far as many of these securities had been floated off at a premium, the losses of the public must have been even more considerable.[1] A later inquiry[2] shows even worse results. It is roughly true that most of these failures were issued by small 'trusts' formed for the purpose by syndicates or single promoters. The 1*s*. shares which were the favourite means of issue had a short but feverish career.

This coincidence of an (apparently) general 'scarcity' of capital for 'nationally useful' purposes—however unfounded as we have seen—with the abundance of fraudulent issues lead to a closer—though not statutory—supervision of issues and restrictive legislation in the 1930's. The latter had, paradoxically, the effect of strengthening the monopoly position of the Stock Exchanges, especially that of London, unfortunately without leading to a general reform of the quality of the investment advice offered. This had rendered the finance of new enterprise more difficult, though it has also contributed to the elimination of grosser abuses. The legislation enacted and certain precautions taken (cf. below) have not satisfied certain critics who demand the establishment of a National Investment Board without a consistent analysis of the causes of the phenomena to which they take exception. It is not quite clear whether a negative control of issues only is desired or a positive policy to stabilize investment. Nor is it easy to see how a mainly financial body could be made responsible for the latter, rather all-embracing task. The dismal impressions of the 1920's might thus exercise a lasting—and not altogether favourable—influence on British economic development.

The discussion before the Macmillan Committee centred around the problem of how to facilitate long-term capital investments of a type most needed for industrial progress, i.e. the finance of new enterprise. It was acknowledged that from the point of view either of liquidity or of marketability shares issued by new firms were unsuitable for the existing financial institutions controlling the major part of funds. A means had to be found to create assets of a character which these institutions would be able and willing to purchase with the accruing savings of small 'savers' entrusted to

[1] *M.R.* § 386, p. 166. The Committee found that out of the 284 companies not less than 70 had been already wound up in 1931 and 36 others were more or less worthless. The public paid nearly £20 millions for their shares and obligations.

[2] Harris, 'A re-analysis of the 1928 New Issue Boom', *Economic Journal*, September 1933, pp. 453–9.

them and to use the funds so obtained to finance 'risky' enterprise. In fact the problem amounted to creating artificially a substitute for the rich entrepreneurs and capitalists of the pre-1914–18-war period,[1] an institution which would play the role of a financial link between the small saver and his representative and such 'risky' (i.e. new) industrial enterprise[2] as needed finance. Only a few experts maintained that the London capital market and the British banking system was wholly adequate to meet all legitimate requirements.[3] Most of the bankers—both private and clearing[4]—considered that the financial system needed further extension in this direction. The type of institution which they had in mind was a specialized, powerful issue house which could provide long-term finance for industry—especially small industry—on the basis of its own equity and debenture capital; this capital could easily be placed with existing institutions and private investors; in fact they were considering an institute very much akin to the Agricultural Mortgage Corporation (see above) in this country or the Hypotheken Banks on the Continent.

The Macmillan Committee[5] itself held that the financial mechanism needed reorganization in two directions, (1) intermediate credit and (2) long-term capital. The first it divided into three classes: the finance of (*a*) hire purchase, (*b*) advances against deferred payments, and (*c*) long-term contracts. They thought that for all three classes of medium credit sufficient facilities were either existent or were in development for home trade.[6] They concluded, however, that with regard to external trade the needs (especially in the third direction) were not adequately covered.[7] The Com-

[1] Kindersley (*M.E.* Qu. 1526).

[2] Mr O. T. Falk proposed the formation of a finance institution using the *reserves* of large insurance companies and investment trusts. His recommendation was not followed up. It must not be forgotten that such a new venture would have added to the responsibilities and labours of the directors and managers of the financial institutions which they were unwilling (and perhaps even unable) to assume. The abhorrence against the State taking over these duties which private enterprise failed to fulfil was, on the other hand, potent enough to prevent a systematic and comprehensive solution in a different direction.

[3] But the minority included Norman and Granet (cf. above), Goschen (*M.E.* Qu. 1991–4).

[4] Kindersley (*M.E.* Qu. 1526–7; 31), Hyde (ibid. Qu. 1095–114), Rae (ibid. Qu. 2369–74).

[5] *M.R.* §§ 390–404, pp. 168–74.

[6] Cf. Part II and the next section on instalment purchase, especially the intervention of the Bank of England in order to permit an extension of the activities of the United Dominion Trust.

[7] This has been altered by the activities of the Export Credits Guarantee Department. Cf. next section.

mittee held that both with respect to industry in general and with respect to the finance of small industry, the establishment of at least two new and separate issuing houses was desirable. It also suggested that much closer relations between banks, issue houses and industry should be developed. The institution financing large-scale industry should be able to grant longer-term loans (up to five years) on the basis of its own notes; but in general it should operate through existing financial institutions. The finance house for small-scale industry, on the other hand, would have to obtain finance almost exclusively by issuing its own securities and not by trying to pass on the securities which it obtained from the ultimate borrower. It is interesting to note, however, that the Committee declined to recommend 'a change in the character of present banking practice'. It hoped that the banks would participate in the organization of such an institute, and thought that the Bankers' Industrial Development Company[1] might—at a suitable date and separated from the Bank of England—form the nucleus of an institution of the first type. The plea of Professor Clay[2]—afterwards repeated[3]—that the banks should use industrial expert knowledge in their handling of industrial advances, was not mentioned. The Committee, as is shown by the relative space allocated in their Report, seems to have been far more impressed by the problem of recreating generally profitable conditions for British industry, to pay sufficient attention to the structural problem which at the moment of writing their Report was undoubtedly only a secondary cause of the general malaise.

The abandonment of the gold standard, the general distrust of foreign loans, and the introduction of a more stringent control on foreign issues on the one hand, the recovery of British industry on the other, induced automatically certain modifications in the structure of the capital market in the sense desired by the Macmillan Committee and facilitated the conscious adoption of some of its recommendations.

The participation of the international issuing houses in internal issues in the period of recovery after 1931 was an obvious development. Their international business languished. The factors responsible for the recovery in Britain in general, and more especially

[1] Cf. below, p. 300.

[2] *M.E.* Qu. 8790–3.

[3] *The Financing of Industrial Enterprise* (Manchester Statistical Society, 1932). In this paper the establishment of industrial finance subsidiaries by banks was reconsidered.

the depreciation of the pound and the introduction of tariffs,[1] favoured several basic industries and stimulated new investment.

The proportion of home to total issues which—according to the statistics of the Midland Bank—did not absorb more than 60 per cent of the total capital raised prior to the crisis (in most years, as we have seen, it was substantially below that figure) increased to a maximum of 88 per cent in 1935. In no year after 1931 was it below 70 per cent. The total volume of capital issues did not reach the pre-crisis level. In contrast to 1928, when altogether £362·5 millions worth of securities were floated, the 1936 peak was only £217·2 millions. The most marked drop in the different categories of issues—apart from 'public authorities', due to the absence of foreign lending—was among 'miscellaneous' and financial issues. This fact indicates that the dire consequences of the feverish promotion of 1928 had not perhaps been quite forgotten.[2] Among the different industries, heavy industry, electric power and light show considerable expansion, the first even in contrast with 1928. The international banking houses participated increasingly in the most important of these transactions.

The public had disappointing experience with most managed investment trusts during the crisis. Hence the banking houses could not procure new capital usable for long-period finance by forming new, or increasing the capital of the old, trusts. But apart from the continued activity of certain finance houses which were in close contact with issuing and acceptance firms,[3] at least one of the great acceptance houses established a finance company (Schröder-Leadenhall Trust; capital £250,000) explicitly mentioning the recommendation of the Macmillan Report. Several other firms followed suit.[4]

The newer finance houses were nevertheless able to establish a place for themselves in this field. In fact, one of them, Philip Hill and Co., succeeded in being accepted by two of the most important banking firms not only as partner but as leader in several important issues. It subsequently became a public company and the original

[1] Protection not merely increased profitability but also reduced the uncertainty about its continuance. This factor is usually neglected. It seemed to play an outstanding role in reviving the home issue market.

[2] This is also shown by the conspicuous absence of small financial trusts and syndicates.

[3] E.g. The Whitehall Trust. (Kindersley, *M.E.* Qu. 1488–91.)

[4] Cf. below. The 'unit trust' movement could not, of course, be used for this purpose.

proprietors sold part of the capital to the public.[1] The second important firm other than the old-established houses was the Charterhouse Investment Trust Limited in the home industrial capital market. It was formed in 1925[2] and operated as a trust company and issue and finance house.

The increase in the interest of the banking firms and financial houses in industrial flotations had important repercussions on the method of finance. Prior to the war and in the first part of the post-war period the most usual method of raising capital for industrial concerns—in so far as they were sufficiently established to do so—was to use a brokerage house to place the issue.[3] The brokerage house had no capital of its own to guarantee the success of the issue. It therefore had to insure that the issue would be taken up. A special method was evolved, therefore, to solve the problem.[4] Finance houses, banks,[5] banking firms, insurance and trust companies, big concerns and rich individuals were approached by the issuing broker (or house) and asked to 'underwrite' the issue, i.e. to guarantee to take the unsold proportion of the issue up to a certain limit. If a firm, for example, underwrote £5,000 of an issue of say £100,000 and the public took only £80,000, the underwriters were 'left' with 20 per cent of the issue, i.e. in the case of £5,000 with £1,000.[6] The underwriter received a fee for this service, the level of which depended on the risk involved. It was usually not very high.[7] The firm who arranged the issue received

[1] Incorporated 31 March 1932, as a private company. Converted into a public company 12 October 1936. It owns the share capital of the Quadrant Trust (cf. above). Authorized capital £5 millions. Issued and paid up £2,312,500, out of which £1,250,000 5 per cent cumulative preference shares. The ordinary shares received £25 per cent dividend in 1938. Earned profit was not less than 50·7 per cent. Its working capital included £450,000 secured bank loans (30 June 1939).

[2] Capital £1·5 millions, half of which is represented by 4½ per cent cumulative preference stock. Borrowing power of directors £5 millions. Earned between 3·7 and 19·1 per cent on common stock. It controls the Monument Property Trust and the Charterhouse Industrial Development Co. Ltd. See below.

[3] Cf. Norman, *M.E.* Qu. 9121. Norman deprecated the idea that any permanent alteration of the institutional structure of the City was necessary. He attributed the inability of firms to raise money to their lack of profitability.

[4] Most issues and offers for sale (see below) were underwritten, even when an issuing house has purchased the whole of the issue first.

[5] Cf. above Part I. Also Goodenough, *M.E.* Qu. 579.

[6] Often these firms would underwrite part of this amount 'firm', i.e. purchase the stock in advance at a price equivalent to the issue price minus the underwriting commission.

[7] In 1929 in most cases it was 4 per cent on ordinary shares with 1 per cent overriding commission. By 1937 the typical underwriting rate had fallen to

a further fee called the overriding commission. The influence and reputation of an issue house secured it a long list of willing underwriters who usually accepted a 'share' in the underwriting without very much investigation on its own.[1] The technical banking functions involved in an issue (posting of letters of acceptance, the receipt of the money) were usually handled through a bank ('bankers to the issue'), in most cases one of the clearing banks. For this service they charged a fee.[2]

The increasing activity on the long-term capital market of the international banking houses and of finance houses led to a marked change in the issue methods, although brokers continued to play a considerable role in raising capital, especially in the case of public corporations and well-known companies. Instead of direct issues by the company the issuing houses bought the issue, and offered it to the public ('offer for sale'). Since 1927 both the issue house and the company were made responsible for the statements made in the prospectus which must be published even in this case. Hence the main drawbacks of this method, i.e. the escape from liability for the statements in the prospectus, has been eliminated. Another method of placing new shares which was increasingly used was by way of a 'Stock Exchange introduction'. The issuing house acquired the issue, but did not offer it at a fixed price to the public but placed it privately at whatever price it could obtain. It then applied for a permission to deal in these shares on the Stock Exchange. The Stock Exchange, before granting this permission, insisted on the publication of a prospectus in at least two leading London papers. The price at which the introduction was made could, however, easily be manipulated, and the Stock Exchange

3 per cent. The overriding charge remained at 1 per cent. Preference shares were underwritten at 2 per cent with ½ per cent for overriding. In the case of established companies or public bodies the charges were lower.

[1] Relying on the general 'following' of the issue house to 'stag' the issue, i.e. apply for it in the hope of reselling it at a quick profit.

[2] Cf. Part I, pp. 110–12. This procedure in certain cases gave rise to ambiguities as the name of the bank was prominently displayed and may have induced investors to believe that the bank was responsible (cf. Hyde, *M.E.* Qu. 1100–7) for the issue in the same way as issuing houses are supposed to be. Their experiences in this respect impelled the banks to investigate prospectuses and satisfy themselves about the honesty of the statements. Certain banks seem to go even further in this direction before agreeing to act as bankers to the issue. Cf. Hyde (ibid. Qu. 1095–6), who said the bank had to exercise reasonable care, but could not (ibid. Qu. 1099) take responsibility with respect to anything except formal soundness. It could not act as an issue house, as it would not care to have its name linked even with sound issues if speculative. See also Goodenough (ibid. Qu. 581–3) and Rae (ibid. Qu. 2378–87).

Committee decided in 1936 to permit this method of raising capital only if 'from the public standpoint the necessity or advantage of a private placing is indicated by the circumstances'.[1] The relative cheapness of this method, however, has prevented a decline in its use. The power of the Committee to refuse permission has been used to insist on adequate and correct information being supplied.

TABLE LV. 'INTRODUCTIONS'

	Nominal capital introduced £	Cash involved at opening prices £	Prospectus offers* £
1931	8,757,183	8,883,578	102,044,291
1932	15,046,360	16,335,341	188,909,963
1933	34,811,194	39,123,520	244,780,500
1934	28,247,872	42,310,082	169,108,700
1935	31,739,482	49,633,742	236,147,637

* To the public, or to shareholders; excluding conversions, but including issues by governments, municipal corporations, etc.

The Stock Exchange Committee extended its supervisory function to other public issues and also to securities which were already dealt in. In some cases the permission to deal was withdrawn. The grosser abuses of financial manipulation can be at least checked. But this negative function is neither adequate to prevent general speculative bursts (though it can to some extent apply a brake, as its action amounts to an indirect qualitative credit control) nor can it safeguard the stability of private investment by positive measures. Altogether the financial markets offer a somewhat restricted if not ineffective field for intervention having that aim.

The increase of the importance of home issues among total issues suggests that the problem which arose—as we have seen—on the one hand from the changes in the volume and source of savings, and on the other hand from the changes in the character of the demand for capital, was mitigated by the end of the abnormal depression of industry, especially heavy industry. The recovery after 1931 could be said to have been due to an unusual conjuncture of favourable factors and circumstances which could hardly be expected to occur. It is therefore well worth while to investigate two complaints which did not disappear even during this prosperous period.

These complaints were: that capital issues were too costly; and that there still was no machinery to deal with small issues and to

[1] *The Times*, 12 February 1936.

provide capital for new firms or new purposes which cannot demonstrate their earnings record and which in pre-war years were financed privately and locally by wealthy individuals.

The question of the expense of issues has received scant attention. Very much has been talked about it and random remarks appeared in the papers, but very little systematic research has been hitherto devoted to this extremely important problem.[1] A group of economists published an essay in 1935[2] analysing the use of the capital raised by prospectus in the period 1927–33. Excluding home Government, and all overseas issues, they found that preliminary expenses amounted to between 0·7 and 2·0 per cent of the total issue. Unfortunately, this result is not as conclusive as one might wish because the use to which a very large part of the capital was to be put (up to 88·5 per cent in 1928) could not be determined on the basis of the prospectuses. If the amounts used for unknown purposes are excluded, expenses seem to fluctuate between 1·8 and 10·9 per cent. But it is difficult not to suspect even this figure, as it seems possible that part of the 'ambiguous' expenditure in fact represented expenses of one kind or another. The fact that the item 'preliminary expenses' seems to move in inverse proportion with the item 'ambiguous expenditure' tends to support this suspicion.

[1] *The Economist* quotes the following case (24 October 1936):

Issue	£94,500		
Underwriting	3,780		
Brokers	2,500		
Brokerage	1,000		
Banks, etc.	2,000		
Advertising	2,500–2,750		
Prospectus	1,000		
Stamps, etc.	750	Total expenses	% of total issue
		13,530–13,780	14 %

Grant (op. cit. p. 168) quotes another analysis of *The Economist* which gives a different picture. The total issues analysed amounted to £77·8 millions. Expenses were not less than £4·1 millions, i.e. 5·3 per cent. He rightly remarks, however, that the average has little meaning. 'Candidus', writing in the *Investor's Chronicle* and quoted by Grant, mentions two issues where expenses amounted to 13½ and 14 per cent respectively, though both were for amounts over £100,000. He also mentions an issue where expenses and the profit of the issuing house were not less than 25 per cent. Out of this, 7 per cent was the known profit of the issuing trust. There were cases when expenses amounted to even more (over 30 per cent). The abuses are to some extent limited in so far as the underwriting commission is limited to 10 per cent, and all expenses must be disclosed in the prospectus. This, however, can to some extent be evaded by private placing and by other more complicated methods.

[2] *Studies in Capital and Investment*, edited by G. D. H. Cole, 1935, Recent Capital Issues, pp. 105–33, with a footnote by Ernest Davies.

TABLE LVI. METHODS OF SPENDING NEW CAPITAL—HOME GOVERNMENT ISSUES AND ALL OVERSEAS ISSUES EXCLUDED, 1927–33

(Amounts are stated in £000's)

	Existing assets acquired	New capital	Conversion and Repayment of loans	Preliminary expenses	Ambiguous	Total
1927	£19,673	3,966	6,026	2,232	71,272	103,169
Per cent	19·1	3·8	5·8	2·2	69·1	100·0
Per cent	61·7*	12·4	18·8	7·0	—	—
1928	£27,145	11,818	5,502	4,195	73,767	122,427
Per cent	22·2	9·6	4·5	3·4	60·3	100·0
Per cent	55·8*	24·3	11·3	8·6	—	—
1929	£9,051	6,197	2,639	2,194	52,105	72,186
Per cent	12·5	8·6	3·6	3·0	72·2	99·9
Per cent	45·1*	30·9	13·1	10·9	—	—
1930	£1,794	1,021	10,202	911	107,838	121,766
Per cent	1·5	0·8	8·4	0·7	88·5	99·9
Per cent	12·9*	7·3	73·2	6·5	—	—
1931	£588	92	7,468	147	21,017	29,312
Per cent	2·0	0·3	25·5	0·5	71·7	100·0
Per cent	7·1*	1·1	90·0	1·8	—	—
1932	£4,837	29,992	17,203	956	7,079	60,067
Per cent	8·5	49·9	28·6	1·7	11·2	99·9
Per cent	9·1*	56·6	32·4	1·9	—	—
1933	£18,757	22,469	52,085	2,181	11,334	106,826
Per cent	17·5	21·0	48·7	2·0	10·6	99·8
Per cent	19·6*	23·6	54·6	2·2	—	—

* 'Ambiguous' excluded.

The most complete analysis hitherto undertaken is contained in a communication to the Industrial Research Section of the Royal Statistical Society (unpublished) by Mr J. B. Selwyn. According to him expenses[1] vary so widely—from under 1 to over 30 per cent—that averages are somewhat misleading. The cost of issue for all public issues analysed was 8½ per cent. When issues were broken up into two groups, one below and one above £150,000, a striking

[1] He defines expenses as the difference between the amount the company receives and the amount the public pays for the shares. This method may, under certain circumstances, yield problematical results (cf. below on the interpretation of 'expenses').

difference was revealed. The cost of the bigger issues was found to be only 7 per cent, whereas in the case of the smaller issues expenses absorbed not less than 15 per cent. He thought that the expense of even smaller issues (below £50,000) was 'even higher, possibly of the order of 20 per cent'. There were too few issues, however, to permit the calculation of an average. It is interesting to observe that 'offers of sale' were costlier than 'issues'. Even more interesting is that the cost of Stock Exchange introductions—if due allowance is made for brokerage and stamp duty—is even higher. Part of this difference may be explained by the fact that the latter methods were used mostly for smaller flotations.

TABLE LVII. PERCENTAGE COST OF ISSUES, UNITED KINGDOM INDUSTRY, 1937

	Old companies	New companies taking over established businesses	New companies	All companies		
				Less than £150,000	More than £150,000	All amounts
Issues	5·5	7·9	11·2	11·6	6·0	6·7
Offers	4·1	11·6	—	17·1	8·3	10·5
Issues and offers	5·2	10·3	11·2	15·0	6·9	8·4
Stock Exchange 'Introductions'	3·9 2·0	12·2 2·0				

The considerable difference between the relative cost of small issues is not very difficult to explain. There are, first of all, what one might call 'overhead' costs, such as advertisement, prospectus, legal expenses, and so on. These costs do not vary much with the size of issue and there is an irreducible minimum which, e.g. with respect to advertisement, amounts to, say, £1,200 to £1,400, i.e. a sizeable part of an issue of, say, £50,000. There are, furthermore, items which, though usually fixed as a percentage of the issue, increase more than proportionately when the size of the issue is so small that the usual rate would not cover the minimum expense (e.g. banker's fee for receiving subscriptions and making allotments). Then there is the remuneration for underwriting and issuing. In the case of small issues, when the company is not well known, the risk that the underwriter will be left with a considerable proportion of the issue is higher than with issues of well-known companies. There is, moreover, a further risk that if the stock must be taken over it will prove a 'lock up'. No financial institution

likes being left with an unmarketable security, however good it may be intrinsically—hence the higher charge for underwriting.[1]

These statistics *prima facie* appear to support the view that the expense of issuing is rather high. Before any definite conclusions can be drawn, it is necessary to analyse carefully the exact significance of the statistics presented. The total cost of the issue obviously includes the fee or profit the issue house is obtaining in launching it. In fact Mr Selwyn found that more than a third of the total cost of issue is represented by the remuneration of the finance house. Now, according to Mr Selwyn (and his evidence is supported by the statistical material published by the Cambridge group), not less than 45 per cent of the proceeds of all issues (before expenses) was not used for the purpose of capital expansion but for purchasing existing earning assets including goodwill (25 per cent) and for buying the shares from vendors other than the company concerned (it is not known whether the vendors paid the identical sums or transferred assets of the same value to the company when they acquired the shares). It is not known with respect to the issues analysed whether the vendors were interested in the issuing house and took their profit indirectly nor whether the issue house had a monopoly position with respect to any particular issue.[2] In order to be able to come to a definite conclusion about the true cost of raising new capital in London the issues would have to be broken up far more minutely than has been done hitherto. It is likely that such exhaustive analysis would prove the contentions of those who complain about the high cost of issues. It may well be that the apparently high total cost of long-term borrowing or of obtaining equity capital does not really burden industry as such. It may be that, if industry—or at least the larger units—had availed itself of the cheapest existing method, it could have borrowed on reasonable terms. It may be that the level of expense—apart from the problem of liquidity[3]—is a reflection on the one hand of special, monopolistic, relations between issue houses and the particular issues, the cause of which may be *bona* or *mala fides*, and on the other, of the willingness of the public to

[1] The fierce competition for first-class issues in 1936–8, accompanied by a rapid fall of the issue cost, gives added importance to this conclusion.

[2] The prevalence, especially in 1927–8, of syndicates, issue houses created *ad hoc* to effect one particular issue, suggests this conclusion.

[3] Which will reflect itself in the high price which vendors have to pay to an issue house in order that they should be able to mobilize their capital sunk in an industrial undertaking.

pay an extremely high price for the opportunity to speculate in the shares of a particular company. Most industrial firms could not, of course, avail themselves of this willingness without the intervention of a financial house. The 'expense' of the issue in that case is simply the profit which an insider (the finance house) gets out of speculatively inclined outsiders. At any rate, a very good case can be made—though certainly less pressing than in the United States—for the necessity of a more stringent control of issues. But as long as no such control is adopted, little can be said about the actual cost of capital issues. A much more weighty charge against the present organization of capital issues would be if it could be stated (as it can be stated with some degree of probability) that companies whose shares do not provide for speculative interest and which are not well known or big enough cannot obtain long-term capital, because issue houses are not interested in their problems, as no considerable profit can be made dealing with them. A further more detailed examination of this problem than is possible in this context is urgently needed.

These considerations and statistics show clearly the very heavy burden of 'overhead costs' on small issues and the decided reluctance of reputable financial houses and of institutional investors to buy securities which may prove 'lock-ups', however sound they may seem. These are, however, the very problems which must be solved if the disappearance of local, private finance is not to have a permanently injurious effect on industrial progress and business activity in Britain.[1] The problem of increasing the 'marketability' (and then reducing the cost of issuing) of assets originating from long-term finance of small firms by interposing a separate institution between the ultimate borrower and lender, in the same way as the acceptance houses or banks are interposed in the short-term credit market, has not been solved.

If the entry of the great issue houses undoubtedly represented an important step in the right direction, it did not provide the required solution. No doubt the capital resources of these firms are vastly superior to those of their predecessors, of the brokers and promoters. But they still are wholly insufficient to permit them to participate in finance with the view to arranging issues later,

[1] Direct offers to shareholders of existing companies for obtaining new capital or the finance of expansion by retaining profits are not, as we have already seen, adequate substitutes, because these methods do not offer adequate scope for *new* industries, methods or firms.

especially in view of their obligations in other directions.[1] The total resources of the finance houses and their character were equally inadequate. The earning power of both types of firms depended mainly on a quick turnover and is not derived from the difference of the rates of interest at which they can raise capital and the yield of assets which they obtain. The fact, moreover, that the complaints about the inability of industry to obtain capital persisted, in spite of the exceptionally favourable circumstances in which industry found itself, is a serious warning for the future about the urgency of the problem for any sector of the economic structure where private enterprise is to be preserved. It seems undoubtedly true that the rate of investment in this country, even at full employment, has fallen below the level required to maintain the relative efficiency and thus the position of the country in a rapidly changing world-economy.

In fact, it might be suggested that the incomplete recovery after 1931 was to some extent due to the solution of this problem in a special field. The Building Society movement took it upon itself (in conjunction with the evolution of the so-called builders' pools) to canalize the supply of savings which their owners intended to keep in a *short-term* form towards a certain type of *long-term* demand for it, i.e. the demand for long-term mortgage loans. From a strictly banking point of view this procedure seems at least courageous, as it involves the bearing of the risk of lending long on the basis of short-term deposits. As long as the total volume of savings invested in this fashion grew and business in general expanded, this risk was small. But no general conclusions can be drawn from the experiences of this particularly favourable period. Indeed, in the last few years before the outbreak of the 1939–45 war, had State investment in the form of rearmament not maintained business activity, that experiment might well have miscarried when business activity slackened (as it threatened in the beginning of 1937). It seems clear, however, that a problem exists even when the average profitability of industry is very satisfactory: and that, contrary to the view of certain influential experts,[2] it does not seem to be exclusively the consequence of the exceptional depression which Britain ex-

[1] Cf. above on acceptances. After 1931, when acceptance liabilities of these firms declined, they seem to have somewhat relaxed the rule of not purchasing unmarketable securities, and participated in reorganizations of industrial firms, etc. Their investments of this type do not at any moment appear to have been considerable. Cf. Kindersley (*M.E.* Qu. 1488–91).

[2] Cf. above, p. 290, n. 3.

perienced after the last war.[1] It will therefore not be solved satisfactorily even if the Government succeeds in stabilizing economic activity. Indeed (unless a wholly collectivist solution is adopted) its solution would seem essential if economic stability is to be obtained without limiting maximum progress by using wasteful or at least less urgent investment outlets for the purpose of stabilization.

Attempts to facilitate capital issues

There have been several conscious efforts, some dating prior to the publication of the report of the Macmillan Committee, to supply the need for capital for new enterprise. The most notable were undertaken at the initiative of the Bank of England.[2] They proceeded in three directions.

(i) *The initiative of the Bank of England*

On the one hand, the Bank of England established one company and took the lead in the establishment of another, both of which seemed to be destined not so much to promoting enterprise as to salvaging industrial companies and industries, which, either as a result of general economic causes or in consequence of unfortunate financial policy, found themselves in an awkward position.

The first of these was the Securities Management Trust Ltd.[3] It was established as a private company, entirely owned by the Bank of England. This company took over from the Bank certain assets which the Bank did not consider suitable for the portfolio of a Central Bank and which came into its possession as a consequence of the post-war slump and the continued depression of certain (i.e. heavy) branches of industry. It acquired a small expert staff.[4] When the Bankers Industrial Development Co. (see below) was formed, it co-operated with it and supplied expert advice. The Bank regarded both as a temporary expedient useful in the particular depressed period of industry, but it did not contemplate their continuation.[5] In fact, the Securities Management Trust did not participate in any of the major reorganizations or transactions

[1] As Professor Clay (op. cit.) pointed out, three-quarters of all companies registered in England still have a capital less than £5,000, and the average capital of the 8,410 companies in 1930 was not more than £12,393.

[2] Cf. however, the next section on the activities of State and private institutions in the medium-term credit field.

[3] Cf. Harvey (*M.E.* Qu. 828–47, 54–9), Pease (ibid. Qu. 2212–3), Norman (ibid. Qu. 9146–55).

[4] Cf. *The Memorandum of Association* (p. 258).

[5] Cf. the evidence of Granet and Norman (*M.E.* Qu. 9027–184).

undertaken under the lead of the Bank of England. It was revived once again in 1938 when the Bank of England intervened to solve the financial difficulties of the tinplate firm Richard Thomas and Co., Ltd.[1] The Bank of England and a syndicate of banks and banking houses provided £5½ millions in the form of 4½ per cent Prior Lien Debenture Stock. The Securities Management Trust subscribed 1·5 million 6*s.* 8*d.* shares at par.

The second of these institutions was the Bankers Industrial Development Co. It was established in 1930 for a period of five years as a *temporary expedient* to help in the reorganization of the depressed basic and export industries. In April 1935 its existence was extended for another five years. It was not contemplated, contrary to the recommendation of the Macmillan Committee,[2] as providing a nucleus or beginning of a new type of institution. The share capital (1939) was £6 millions, consisting of forty-five A shares and fifteen B shares of £100,000 each. The latter were (indirectly) in the hands of the Bank of England. The A shares were held by the most important banks and banking firms. Only £1,000 were paid up per share and only 25 per cent of the subscribed capital was callable. The rest was reserved capital. The B shares carried triple voting power (i.e. the Bank had voting rights equal to all the other shareholders together), but were put behind the A shares in case of liquidation; they were to have been paid up fully prior to calling the 'reserved' 75 per cent of the A shares. Apart from the nominees of the Bank of England, the Board of Directors of the company was formed by the representatives of the great issue houses. It also had an 'Advisory Council' on which influential personages of the City were asked to serve. It was permitted to call on the services of the expert advisers of the Bank.[3]

In the first period of its existence, this institution, according to Sir G. Granet, did not assume a role different from that of any other finance house. It seems to have relied on the prestige of its proprietors for the successful accomplishment of tasks which were beyond the power of the other issue houses. It did not guarantee the issues it sponsored, nor does it appear to have taken a participation in the issues in that period.[4] In 1931 capital was obtained for the National Shipbuilders Security Corporation and the Lan-

[1] Cf. Part I. [2] Cf. p. 288.

[3] The company was reorganized during the 1939–45 war and its paid-up capital reduced to a nominal amount.

[4] Sir G. Granet was rather vague on this point, but insisted that the B.I.D. was not prepared to do more than a normal issue house did (*M.E.* Qu. 9056–7).

cashire Cotton Corporation. Further issues included the Lancashire Steel Co. and Stewarts and Lloyds. Subsequently it co-operated in helping a steel firm (John Summers) to obtain the necessary finance for an extension of its plant. In this connection it took over £1,000,000 ordinary shares and £2,000,000 debentures of that firm, the United Steel Co. taking 1,288,185 shares, apparently granting an option on its participation to the firms involved.

The Bank of England has also co-operated in the establishment of financial facilities for new enterprise. It participated in the United Dominions Trust[1] to enable that firm to extend its field of operation. Apart from the financing of instalment purchases (both of durable consumption and of capital goods) the United Dominions Trust established several auxiliary companies which cover the extended field of operation of the parent company: United Dominions Trust (Electric) Ltd., Continental Guarantee Co., Credit for Industry Ltd. (1934), British Medical Finance Ltd. (1936), United Dominions Corporation (South Africa) Ltd. (1937). The most interesting of these was the Credit for Industry Ltd., which was established for the express purpose of granting long-term credit (up to 20 years) for industry between the limits of £100 and £50,000 not covered by the capital market. The loans were to be repaid in equal instalments. They were secured by mortgages or bonds. The debtor had the option of repaying before maturity; the creditor had no right to call the loan except if the debtor's financial position should deteriorate and then only to protect himself. The rate of interest charged depended on the special circumstances of the case. It is said to have been somewhat lower than the yield on preference shares of firms of standing similar to that of the borrower, varying between $4\frac{1}{2}$ and 7 per cent. The company did not, however, extend credit for untried processes or new companies, nor did it enter into participation in industrial undertakings. The company was flooded with applications, but its stringent regulations, which enabled it to earn a small dividend, and to accumulate a modest reserve, have not encouraged a great extension of its

It appears, however, that the B.I.D. directly or indirectly granted short-term facilities. No report has been published on this activity. (No enlightenment was given to the questions of those who wanted to elucidate the reason why the company was formed under the circumstances. But the freezing up of new capital supplies from existing sources to the industries which were in most need of capital to reorganize and re-equip themselves was the obvious explanation.)

[1] Cf. Part II, Chapter 10, B, iii.

business. Its loans, less repayments, amounted to £384,909 on 7 July 1939. It would clearly take some expansion before this firm can be said to be a serious factor in the organization of the credit system.

(ii) *Private firms*

A similar firm, the Charterhouse Industrial Development Co. Ltd., was established in June 1934 by the Charterhouse Investment Trust in conjunction with the Prudential Assurance Co. and two of the Big Five, Lloyds and the Midland. Its capital was £500,000. The Charterhouse Investment Trust held a controlling share. In March 1939 the general finance business of the parent company was segregated into a special company, the Charterhouse Finance Co., with £650,000 capital.[1] The former company, as distinct from the affiliate of the United Dominions Trust, did not merely grant credits but was also prepared to take participations (principally in the form of preference shares). The extent of the activities of this firm are not known.

There also were, as we have seen already, some attempts to broaden the capital structure of existing issue houses.[2] They were all of very modest proportions. The 'Macmillan' gap was not bridged before the 1939–45 war, and it is very improbable that it could be bridged without Government intervention and guarantee.[3]

(iii) *State aid*

Ever since the 1914–18 war[4] various steps have been taken in the direction of State assistance to industry. This assistance usually

[1] Of which £450,000 is represented by ordinary shares. It has borrowing powers of the same amount.

[2] Cf. above, Leadenhall securities. Some new companies were established without (quasi) official help, such as the New Trading Co., the Ridgeford Industrial Developments, Lonsdale Investment Trust.

[3] Cf. the *Reports of the Committees on Financial Facilities* (Cd. 8346–1916 and Cd. 9226–1918). Both advocated the establishment of an Institution with a capital of £10,000,000. The formation of the British Trade Corporation resulted. The recommendations of these Committees as far as the reorganization of the internal capital market was concerned were, however, not carried out. The whole venture was concentrated on export credits to weak countries. It disappeared and its functions were taken over by the Export Credits Guarantee Department. Cf. next section.

Sir O. Niemeyer (*M.E.* Qu. 6755–6854) was sceptical about the usefulness of State intervention and thought that it diverted savings or relieved other institutions of bad commitments.

[4] Cf. the section on State assistance to export trade. Certain subsidies were paid to shipping already, prior to the war of 1914–18. The problem of State subsidies will be treated in the *Report on Commercial Policy*. Cf. also Part I on credit facilities to agriculture.

took the form of subsidies and cannot be treated in this connection. A somewhat new method of indirect assistance was adopted by the grant of financial facilities by the Trade Facilities Act.[1] The limit of credits guaranteed was at first fixed at 25 millions. It was subsequently increased to:

Act	Limit (£ millions)	Up to:
1921	25	9 Sept. 1922
1922	50	9 Sept. 1923
1924	65	31 Mar. 1925
1925	70	31 Mar. 1926
1926	75	31 Mar. 1927

The State guarantee covered, varying in different cases, the interest and/or the principal of loans raised by industry. The capital was obtained either by an issue of guaranteed debentures (shares could not be guaranteed) from the public or directly from Government departments, banks, or insurance companies. About half of the total raised was by the latter method. Total guarantees amounted to £72·4 millions, out of which £72·1 millions were actually used. The most important class of loans was with respect to foreign loans (£20 millions). Shipping received another £19–20 millions. Industry did not obtain more than £16 millions by this method.[2] The scheme was not considered a success. Some £9 millions of capital guaranteed had to be met up to 1937, and guarantees to the amount of £30 millions were still outstanding. Only £1·5 millions of the former amount were repaid up to that time.

A similar expedient was used in order to facilitate the extension and improvement of the London transport system by obtaining capital at a favourable rate of interest.[3] A separate company, the London Electric Transport Finance Co. Ltd, was established with a nominal capital, but with powers to borrow up to £40 millions with the guarantee of the State. These amounts were then re-lent to the railroads and the London Passenger Transport Board which, in their rather weak financial position, could not have obtained the money at the low rates of interest required to make the pro-

[1] 1921, 11–12 Geo. 5, c. 5; 1922, 13 Geo. 5, c. 4. It was supplemented by Acts of 1924, 1925, and 1926.

[2] Niemeyer, *M.E.* Qu. 6848. According to a statement in the House of Commons (16 May 1927), shipping received 29·1 per cent, railroads 25·4 per cent, electricity 20·3 per cent, steel and iron only 2·7 per cent. This statement, however, seems to disregard the geographical distribution of the eventual recipients.

[3] London Passenger Transport Agreement Act, 1935, 25–26 Geo. 5, c. 27.

posed extensions and improvements self-supporting without an upward revision of fares.[1] This programme was subsequently enlarged, and the four main-line companies were granted long-term credits by a second, similar, finance company created for the purpose, the Railroad Finance Co. Ltd. This company obtained a State guarantee on the basis of the Railways (Agreement) Act 1935[2] up to the limit of £26½ millions.

Somewhat different methods were adopted to facilitate the solution of the problems presented by the so-called distressed areas. On the basis of reports[3] on the position in those areas, the Special Areas (Development and Improvement) Act, 1935, was passed.[4] This provided for the appointment of two Commissioners (one for England and Wales and one for Scotland) with wide powers to initiate and organize measures designed to help the economic progress and social improvement of the depressed areas. The Commissioners were under the 'general control' of the Minister of Labour and the Secretary of State for Scotland and worked in close co-operation with the Unemployment Assistance Board. They were given the power to grant financial assistance for any undertaking carried on with the primary object of providing work for the unemployed with a view to making them partially or wholly self-supporting. The Act provided for the establishment of a Special Areas Fund. The Exchequer provided for it £2 millions in that financial year. Payments could be made by the Commissioners. The Act was to remain in force until 31 March 1937.

By February 1936, schemes involving grants of over £3 millions had already been approved, and dock and navigational improvements and harbour works had been started. Before the end of that year further schemes were initiated, such as the creation of trading estates, financed out of the Special Areas Fund, land cultivation schemes, afforestation plans and some schemes for social improvement. The administration of these trading estates was entrusted to trading estate companies, with boards of directors composed of representative industrialists in the area and an outsider member appointed by the Commissioners. The companies were financed by grants from the Commissioners. They did not operate for profit. They were to 'acquire suitable sites in the Special Areas and equip them with all the requisite facilities such as railway sidings, roads,

[1] Two issues were made of £32 and £9.65 millions respectively at 2½ per cent; the first was issued at 97, the second at 99½ in January 1937.
[2] 26 Geo. 5, c. 5. [3] Cmd. 4728. [4] 25 Geo. 5, c. 1.

power, and, where necessary, quays'.[1] They erected factory buildings which were let at rentals calculated to cover building costs only.[2] Expenditure on road and railway construction and maintenance and on the installation of water, drainage, gas, and electricity was borne by the trading estate companies out of grants from the Special Areas Fund.

In June 1936, the Special Areas Reconstruction Association was set up to furnish financial assistance for small businesses which were not in a position to borrow from the Banks in the ordinary way. The Association received an annual grant for administrative expenses[3] and was partially guaranteed against capital losses by the Consolidated Fund which has provided £100,000 towards reserves. The loans granted which have a normal maximum limit of £10,000 for five years have been as follows:[4]

	Number of loans	Value	Estimated additional employment
June 1936–Aug. 1937	67	£403,450	6,777
Sept. 1937–Aug. 1938	*	£166,700	*

* Not published

In 1937, the Special Areas (Amendment) Act[5] was passed to extend the period of operation and the scope of the previous Act. The Commissioners were given power to provide financial assistance for newly established industries in the Special Areas 'by means of contributions towards any sum payable in respect of the undertaking by way of rent, income tax or rates'. They were also empowered to make grants towards road and drainage expenses incurred by local authorities in Special Areas. Under the Act, the Treasury can make loans to, or provide share capital (not exceeding one-third of the share capital of the company) of, Trading Estate Companies[6] outside the Special Areas, but these loans and the loans to industries in Special Areas must not exceed a total of £2 millions. Loans had to be approved by the Minister of Labour who set up an advisory committee to help him in the discharge of this duty. The factors considered in granting such financial help

[1] Cmd. 5090.
[2] Building costs were low on account of large-scale buying.
[3] Grants in 1936–7 and 1937–8 were £10,092 and £14,631.
[4] Cmd. 5595 and Cmd. 5896.
[5] I Edw. 8 and I Geo. 6, c. 31.
[6] Not operating for profit or having constitutions which forbid 'the payment of any interest or dividend at a rate exceeding such rate as may be for the time being prescribed by the Treasury'.

were the general unemployment in the vicinity, the improbability of any decrease in unemployment and the dependence of employment on one or two generally depressed industries.

Since the passing of the Special Areas (Amendment) Act considerable assistance has been given to the depressed areas. Up to 30 September 1938, contributions towards the rates of new industries had been offered by the Commissioner for England and Wales to sixty factories, which were expected to employ 8,000 workers, and capital assistance of £954,000 had been granted by the Treasury.[1] The more important new industries that have been attracted to the Special Areas include electrical engineering, woodworking, light metal, motor-body building, paper, textile and leather industries.[2]

In September 1938, the commitments for expenditure in Great Britain on aids to industry, public works and so forth totalled £21 millions and about half of this amount had already been spent. The distribution was as follows:

Total Commitments up to 30 September 1938

England and Wales*	£000's
Industrial development	5,152
Health services and housing	7,274
Agriculture (drainage, etc.)	3,260
Social services	1,084
	16,770
Scotland†	
Industrial development	1,138
Public works (including health services)	2,641
Agriculture	194
Social services	228
	4,201

* Cmd. 5896. † Cmd. 5905.

Special Areas Fund. In the three years prior to the war the following sums of money were voted to the Special Areas Fund:[3]

1935–6	£2,000,000
1936–7	£3,000,000
1937–8	£3,500,000

[1] Cmd. 5896.

[2] The influx of refugees from persecution was a special factor helping in the establishment of new firms and industries. According to the so-called Barlow Report, however (Cmd. 6153, p. 166, §§ 343–7), five-sixths of all new enterprises were started in the strategically vulnerable London area.

[3] Civil Appropriation Accounts.

In all these cases, and to some extent even in the case of export credits,[1] the State (and the quasi-Government institutions) restricted their activities to the financial assistance of special (and mostly distressed) cases. They did not try to compete with private interests in fields which were profitable. Financial experience of this type of intervention was, therefore, necessarily unfavourable.[2]

Conclusion. The history of the period 1920–37 tends to show, that quite apart from the more general problem of controlling the business cycle, there exist two specific but related problems. The first is due to the fall in the capacity of Britain to undertake investment. The second is connected with the present organization of the capital market. Both are intimately related to the problem of industrial efficiency and thus to the economic progress of the country. The first cannot be solved without first tackling the general problem of economic stability, as an increase of savings would, otherwise, increase unemployment rather than speed progress. Nor is it possible, in a progressive economy, to solve it without the intervention of the State, as all measures tending to equalize the distribution of the national income will tend to diminish private voluntary saving. A combination of progressive social policies with an increased rate of investment is not feasible without the State providing for collective saving (e.g. in the shape of budgetary surpluses being used to promote investment). The present institutional structure of the capital market does not seem fully capable of meeting the task of providing capital for new and untried enterprises or for firms with small capital. There seems to be no bridge between the demand for marketable securities on the one hand and, on the other, the demand by scattered entrepreneurs for capital. The function which in the sphere of money and credit has been adequately discharged by the clearing banks is not being fulfilled in the long-term market. The growing importance of the self-finance of industry cannot solve this problem. The experiences of this period were sufficiently varied to enable us to venture to draw some conclusions. It seems more than probable that in view of the nature of the risks involved and the change in the character of saving—due to the less unequal distribution of income—the function of equalizing supply and demand on the

[1] Though in case of export credits a function, *additional* to that which private companies should or could perform, is exercised and a fee is charged which, in so far as the guaranteed bill fetches a better price than a not-guaranteed one, is paid for by the financial interests.

[2] Cf. Niemeyer, *M.E.* Qu. 6847–8.

long-term capital market is unlikely to be performed by private firms—issue and finance houses and investment trusts—unaided by some State intervention or agency. Had there been a sharp concentration movement among the firms which were then engaged in the issue business, had the lead of the biggest of the insurance companies in aiding new ventures been followed by the smaller institutions managing new savings, had they in co-operation with the former established a holding company, they might have conceivably filled the role of the capitalist of the last century. This has not happened. The growing distortion of the financial and physical capital structure as a result of the second World War will render any solution without State initiative impossible. A state financial pool providing capital for new enterprise, direct financial aid in the shape of guarantees and subsidies, and public works programmes, seem after the experiences of the last twenty years the minimum requirements of economic stability and social progress. In their absence the drift towards direct State enterprise is inevitable, even if it were not desired politically by the majority of the nation.

APPENDIX TO PART III

STATISTICAL MATERIAL ON ACCEPTANCE HOUSES[1]

STATISTICAL analysis of the acceptance and finance houses is beset with difficulties. Most of these firms have a juridical status (partnerships or private limited or unlimited companies) which permits them not to publish balance sheets. They have availed themselves of this liberty. The Bank of England—according to the evidence of the then Deputy-Governor, Sir E. Harvey[2]—receives periodically statements of all houses which wish to maintain the status of their acceptance as Prime Bank Paper. This information, however, is considered as confidential, and not even aggregate figures are published. There is, moreover, the further difficulty of finding a satisfactory definition and classification on the basis of which further inquiries could be conducted: such as, which firms should be considered as acceptance houses, and which as finance companies.

Nor would all problems be solved if we succeeded in obtaining yearly balance sheets. This is seen from an analysis of the sole firm which publishes monthly statements, Glyn, Mills and Co. It may be objected to this approach that Glyn, Mills is a clearing bank and that its statements, therefore, are irrelevant to a study of acceptance houses. This objection is only formally sound. Of all English private banking houses which were members of the London Clearing House[3] this firm alone succeeded in maintaining its independence from the deposit banks,[4] not merely because it succeeded in preserving important banking clients (it was known as the 'railway bank'), but because it adapted its activities to the position created by the emergence of the branch banking system, so as closely to approach those of a 'merchant bank'. Its acceptance business was a multiple of its own capital (in fact, since the depression, a higher multiple than, for example, Barings). It participated in issues and special transactions directly (which is apparent from the exceptional variations in its advances, e.g. almost 50 per cent in 1936), and it has a far closer connection with industry (especially heavy industry) and railroads than most firms. Thus, even

[1] Data on certain important finance houses and special institutions were given in the text (Part III, pp. 235–7, 256–9, 289–90). See also Part II on Hire Purchase Finance Companies. Cf. Truptil on the history and functions of the international banking firms.

[2] *M.E.* Qu. 373.

[3] In fact, except for one or two unimportant firms, of all English private banks.

[4] Only to be affiliated to (but, as it seems, by no means absorbed by) the Royal Bank of Scotland.

if Glyn, Mills remains a member of the London Clearing House, it is permissible to suppose that their policy with respect to balance sheets is not very different (and if it should be different it will rather be more representative of their average position) from that of those of the acceptance houses which publish year-end balance sheets. We have seen that the clearing banks, though they did not abandon the practice of 'window dressing' on their weekly call days, have, if not discontinued, at least diminished the artificial adjustment of their half-yearly balance sheets. This reform has not been followed by Glyn, Mills and Co. Its last year-end figures (31 December 1938) showed the following positions:

TABLE A. GLYN, MILLS AND CO.

(Amounts are stated in £ millions)

Capital and reserve		Acceptances		Deposits		Cash	
	%		%		%		%
1·590	3·9	3·204	7·9	35·809	87·5	7·635	18·7

Money at call, etc.		Investments		Discounts and loans	
	%		%		%
8·588	21	10·159	24·9	10·578	25·9

but the average of its weekly position was:

Capital and reserve		Acceptances		Deposits		Cash	
	%		%		%		%
1·590	4·5	3·288	9·3	30·162	85·3	4·628	13·1

Money at call, etc.		Investments		Discounts and loans	
	%		%		%
6·257	17·1	9·792	27·7	10·635	30·1

The differences are very marked. The balance sheets of the three great firms which publish balance sheets, however, show a great similarity to that of Glyn, Mills and Co.[1] It is perhaps not unjustified to conclude that in the year-end balance sheets the figures on the one hand for deposits, on the other for cash, money at call, and discounts, seem somewhat inflated. M. Truptil estimated the extent of this artificial expansion at year ends at not less than 15 per cent—at least prior to 1931.[2] There is no obvious reason which would suggest that this practice has been modified since, though it is of course wholly impossible to obtain even an approximate idea of the true position.

It would be important to be able to form an idea at least of the capital resources of the international banking houses. This, also, is almost impossible, although we possess a wider knowledge of this item at least, since all private firms, if they are limited liability companies, must publish at Somerset House their capital structure, even if they are

[1] There is, of course, the obvious difference that—in all probability—deposits did not play anything as important a role as in the case of Glyn, Mills.

[2] Op. cit. p. 158.

not forced to disclose their balance sheets. But we do not know their reserves and their figures are, therefore, somewhat misleading. There is a further difficulty: both in case of a crisis and for the purpose of special transactions, most of these firms can confidently count on the intervention of the families and their connections which are interested in the firm, whether they are legally forced to do so or not. As these families are usually very wealthy, the published figures mean even less.

For the best-known firms the data shown in Table B are obtained:

TABLE B. ACCEPTANCE AND ISSUE HOUSES

(Amounts are stated in £000's)

Baring Brothers and Co. Ltd.	2,050	+ 1,000	= 3,050
Erlanger Ltd.	1,600	+ 325	= 1,925
Glyn, Mills and Co.	1,060	+ 810	= 1,870*
Hambros Bank	1,400†	+ 1,400	= 2,800
Lazard Brothers	2,250	+?	= 2,250+?
Morgan, Grenfell and Co.	2,500	+?	= 2,500+?
Rothschild		?	= ?
J. Henry Schröder and Co.		?	= ?
			14,395+?

* Of which £280,000 reduction of premises reserve.
† Subscribed capital £4,400,000.

The total capital of the first two dozen acceptance houses was estimated by an expert, who had exceptional opportunities for ascertaining the position, at some £50 millions. Considering the standing and connections of these houses this means an exceptionally important, because flexible, pool of capital. Most of the biggest houses, moreover, work closely with each other (e.g. Baring and Morgan; Rothschild, Schröder and Baring; Erlanger and Hambros, are some of the important combinations) which further increases their effectiveness (see Note, p. 313).

If the balance sheets shown below in Table C of the four private banks which continue to publish them are studied closely, the most striking conclusion which emerges is the complete divergence among the policies of these houses. Barings reduced its acceptance credits from £9·3 millions in 1928 to £1·8 millions in 1933. At the end of 1938 they still had not much more acceptance liabilities than one-third of the previous record figure at £3·2 millions. In contrast to what must under the circumstances be considered a successful liquidation of acceptance credits, the firm hardly suffered a loss of deposits during the crisis.[1] Their volume fell from £22 to £17·4 millions (in 1932) and recovered to £21·4 millions. In the last balance sheet, however, they were only £16·7 millions. In both periods the liquidation was effected by reducing the bill portfolio which shrank, with only a slight interruption in 1935 and 1936, from £11·3 millions in 1928 to £2·4 millions in December 1938. Advances

[1] Cf. p. 235 above.

in the same period increased almost 50 per cent from £4·2 to £6·0 millions (having been £7·0 millions in 1935) and investments from £1·1 to £9·9 millions—mostly in Government securities.

The policy of Hambros and Erlangers was rather different, due probably to the much heavier loss of deposits during the crisis and the absence of contraction and a vigorous re-expansion of acceptance credits. Significant also is the very much larger importance of bills in the portfolio and the rapid increase of advances. The former, however, may well be due to a difference in book-keeping practice.

These differences, as well as the change in the policy and activities of the acceptance houses, prevent any attempt to establish either an 'average' balance sheet similar to that of the Big Five, or an extrapolation, on the basis of the known figure of capital, of the other elements of the balance sheet.

The published figures, however inadequate they may be, leave no doubt about the continued importance of the merchant bankers in the financial structure. If the volume of capital at their disposal was very much smaller than that of the clearing banks, the elasticity with which they were able to take decisions, and their rather large capital resources, secured them a leading place in the market, even if we do not take into account their indirect power obtained by the important directorships they hold. It may well happen that—very much like the English private banking firms which now form Barclays and Lloyds—some of the leading acceptance houses and finance companies will by suitable amalgamation and the organization of special finance trusts be able to maintain the advantages of their peculiar organization, while at the same time they will obtain the broader capital basis which they undoubtedly seem to require if they are to continue to be active in the capital market. Their pre-war position cannot be considered as either satisfactory or stable.[1] The initiative and enlightenment of the heads of these firms in recognizing the irreversibility of the changes in the economic structure and thus in their own field of operation will not be an unimportant factor in deciding their future outlook.

[1] It is perhaps too early to see in the revival of the Accepting Houses Committee, which in the time of the Macmillan Committee was almost completely quiescent (Kindersley, *M.E.* Qu. 1213), more than an attempt at closer co-operation.

NOTE

M. Truptil, in his stimulating book, has gone further in estimating the total balance sheets of these houses. He took the balance sheets of the seven houses which used to publish them: Baring, Erlanger, Grace, Hambros, Japhet, London Merchant Bank and Ruffer. He obtained the following figures:

TABLE C. FIGURES FOR SEVEN HOUSES PUBLISHING A BALANCE SHEET

(Amounts are stated in £000's)

	Capital and reserve	Deposits	Acceptances	Cash and banks	Bills	Investments	Advances	Premises	Acceptances
1927	10,394	54,372	34,413	19,192	19,346	9,719	15,596	840	34,413
1928	11,259	54,605	41,464	19,743	18,549	9,772	16,950	950	41,464
1929	11,459	49,519	36,886	18,769	16,091	9,527	15,739	950	36,886
1930	12,559	48,483	33,360	20,778	13,709	11,547	14,129	950	33,360
1931	12,122	33,072	22,016	13,547	9,861	7,786	12,902	1,011	22,016
1932	11,571	32,852	19,144	12,163	9,831	10,164	11,122	947	19,144
1933	11,573	37,387	19,958	12,516	9,678	12,449	13,383	1,004	19,958
1934	11,575	38,348	21,286	13,602	8,431	13,632	13,289	1,000	21,286
	In order to eliminate the disproportionate effect on the total of the figures of the three main houses, he then took percentage figures for each and averaged them, with this result:								
	Percentages of total resources								
1927	29·7	70·2	76·8	32·2	24·2	16·7	24·3	2·6	76·8
1928	31·1	68·9	93·8	31·9	23·8	17·9	24·2	2·2	93·8
1929	32·9	67·1	91·9	33·7	22·9	18·0	23·0	2·4	91·9
1930	36·5	63·5	86·1	34·4	19·1	19·1	25·0	2·5	86·1
1931	49·7	50·3	74·4	30·5	14·0	17·7	34·8	3·0	74·4
1932	48·5	51·5	65·0	32·1	15·3	18·1	30·8	3·7	65·0
1933	47·0	53·0	61·9	34·0	12·1	19·0	31·3	3·5	61·9
1934	46·6	53·4	61·9	35·1	12·4	19·0	30·0	3·4	61·9

Having these percentage figures he merely had to obtain one absolute figure for *all* houses to get the actual figures for all houses. This he derived from the appendices of the Macmillan Report which gives the absolute figures for

	1927	1928	1929	1930
Foreign acceptances	108	149	155	142
Foreign deposits	89·3	104·3	79·2	82·1

of *all* acceptance houses. He then assumed, on the basis of personal investigations, that English acceptances did not amount to more than 10–15 per cent of the total. On this basis he obtains for

	1927	1928	1929	1930
Total acceptances outstanding	124	170	155	143

He then compared these figures with those of Table C above for the seven houses, and found that they represented

	1927	1928	1929	1930
A ratio of	10–36	10–40·9	10–42	10–42·8

On this basis he obtains the absolute figures for all acceptance houses:

	Capital and reserve	Deposits	Accept-tances	Cash banks and call money	Bills	Invest-ments	Ad-vances	Pre-mises
1927	48,900	113,400	122,000	52,000	39,100	27,000	39,200	4,100
1928	56,400	124,800	170,000	57,800	43,200	32,400	43,800	4,000
1929	55,500	113,100	155,000	56,800	38,600	30,400	38,800	4,000
1930	60,600	105,400	143,000	57,100	31,700	31,500	41,500	4,200
1931	61,400	62,200	92,000	37,700	17,300	21,900	43,000	3,700
1932	59,700	63,400	80,000	39,500	18,800	22,300	37,900	4,500
1933	60,000	67,760	79,000	43,000	15,400	24,300	40,000	4,500
1934	60,000	68,800	80,000	45,200	16,000	24,500	38,600	4,500

As we have seen in Part II the divergence in the policy of the 'merchant' bankers was so marked after the crisis that this interesting experiment at extrapolation cannot be continued. One of the houses, moreover, disappeared. Another ceased to publish balance sheets, and two further firms had to reduce their scale of operations considerably.

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