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**MONEY IN THE MELTING POT**

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WORLD PROBLEMS OF TO-DAY

# Money in the Melting Pot

By

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## PREFACE

“THE future of the gold standard is the future of peaceful relations between nations of goodwill.” So says Dr. Feliks Mlynarski, Professor of Banking at the Academy of Commerce in Vienna, and formerly Vice-Governor of the Bank of Poland, in a Memorandum on the Functioning of the Gold Standard, submitted to the Gold Delegation of the Financial Committee of the League of Nations. Since he wrote, the gold standard has been wrecked; but whether it be restored or whether some new standard be evolved out of its ruins, it remains true that no international monetary system can work, unless it has political confidence and goodwill at its back. This obvious fact is plentifully illustrated by the events, at once so disastrous and so absurd, related in the following pages.

HARTLEY WITHERS.

DANBURY,

*February 15th, 1932.*



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## CHAPTER I

### INTRODUCTORY

What Money Is—Stuff Used in Buying—Acceptability Essential—Early Forms—Useful or Ornamental—Or Purely Conventional—The Fei of Uap—Gold and Silver Victorious—Then Gold, or Paper with Gold Behind It—Is Intrinsic Value Necessary?—Legal Tender—Limitations on Fiat Money—Confidence Essential—Steadiness in Value—The Quantity Theory—Its Limitations—Bankers' Power to Regulate Prices—Steadiness in Exchange Value—Secured by the Gold Standard—Its Successful Working Under England's Leadership.

BEFORE we can understand the causes, course, and consequences of the present international money muddle, we have to know what money does for us and what are the qualities that we want in it, and how it did its work for us before the muddle began. For those who have never studied the subject of money, I have thought it necessary, in this introductory chapter, to give a very brief sketch of its evolution, up to the successful working of the gold standard in the period before the War. Those who are tired of reading this

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old story, as told in innumerable text-books, will be well advised to skip the first few pages.

Money is something with which we buy what we want. Notes and coin in our pockets are only used when we take them out and spend them. A balance at the bank is only used by us when we draw cheques on it and spend them ; though in the meantime it may be used by the bank to lend to someone who spends it. Money that we put away by investment is spent by those who receive it, and, out of the profits that they earn, they pay us (if the investment has been successful) interest or dividends that we can spend or re-invest.

Money is thus merely buying power. All that we want from it is that wherever we are it will do this work for us, of enabling us to buy things that we need or desire, up to the limits of its value. And since some of us put money away by investment, meaning to spend it many years hence or to leave it to our heirs to spend when we are dead, we want the buying power of our money to be stable, or at least not to diminish ; so that when the day comes for spending it, it may be just as efficient in giving us a claim to things that we want as when we put it away.

Since buying power is the essential quality of money, it follows that any article can be used as money which is readily accepted in payment by those who have goods or services to sell. Unless there is some such commonly acceptable article, we have to live under conditions of barter, exchanging goods that we make or possess for those that we want ; and then we have to put up with the nuisance and waste of time and trouble involved by hunting for someone who has got what we want and wants what we have got.

To avoid all this bother, custom and convenience must have developed the system under which some article that most people were likely to want was taken by those who had goods to dispose of, and so grew into use as money. In primitive communities useful things such as hides, pigs, cattle, bullets, etc., have served this purpose, because those who took them were sure that they would be readily taken by others who had goods to sell ; but man being a very vain animal, ornaments, such as shells and feathers, were very soon found to possess the quality of general acceptability ; and it was doubtless owing to their beauty in the form of ornaments that gold and silver finally drove all other kinds of money out of the field and

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acquired a domination as money that has only been modified by the use of paper.

Nor has this ornamental quality that made beads and gewgaws good money in primitive times lost its power now that the world is supposed to be civilised. Not long after the War, at a time when the moneys of most countries were in a state of confusion, with wildly fluctuating values, especially when one tried to turn them into one another, I met a much-travelled man, otherwise very quietly dressed, with a conspicuous diamond pin in his tie. Being twitted on the point, he explained that he only wore it because he found that wherever he went, whatever people might think about the buying power of dollars, pounds, or francs, he could always raise enough to pay his way on a diamond.

But there have also been examples of money which cannot have gained acceptability by being either useful or ornamental. Sir Norman Angell, in his *Story of Money*, tells us of a kind of money that is still, apparently, in use, consisting of "large solid thick stone wheels ranging in diameter from a foot to twelve feet, and in the centre a hole varying in size with the diameter of the stone, so that the stones may be slung on poles and carried." This money is used in Uap, one

of the Caroline Islands, but the stones are not found there, but are quarried in Babelthuap, some four hundred miles away. If a bargain has been done involving the transfer (in ownership) of a fei, as these pieces of money are called, too large to be moved easily, the new owner is quite content to be acknowledged as such ; no mark is made on the stone to indicate the change of ownership and it remains on the premises of its former possessor.

It is even asserted that a certain family in Uap enjoys unquestioned wealth which consists of a huge fei that no living person has ever seen, since for some generations it has lain at the bottom of the sea, having been sunk in a storm on its way to the island. But its purchasing power has always been recognised as completely valid.

It seems likely that the buying power attached to such primitive conventional moneys, consisting of articles neither useful nor ornamental, may have arisen from some divine or magical properties supposed to have been possessed by them. However this may be, enough has been said to show that utility, beauty, or convention have all sufficed to make certain articles generally acceptable, and so able to serve the purpose of money.

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Anything that the public will take in payment for goods and services, because it knows that the rest of the public will take it, will do as a medium of exchange.

There is no need here to trace in detail the story of how gold and silver ousted other forms of money, and how gold in the latter half of the nineteenth century took the dominant place as the money of civilised countries, reinforced by paper in the form of notes and cheques, carrying the right to be converted into gold. These two "precious" metals, as they are now called, winning their way originally by the beauty and scarcity which made them highly prized as ornaments, completed their victory owing to their other advantages of durability and divisibility. Unlike cattle, which are perishable articles, can only be cut up when dead, and differ very widely from one another in value, lumps of gold and silver last for centuries and can be chopped up and made into coins. Such coins, if those who regulate the coinage are honest and careful and skilful, will not vary in value enough to prevent their being taken as containing so much metal, and therefore so much purchasing power, without being weighed each time that they change hands. The im-

portant thing to remember, in the discussion that is likely to rage for some time about monetary questions, is that the value and buying power of the gold coins that we handled in the days when the gold standard was in its prime, was largely a matter of convention and custom.

When people tell us that we had confidence in the British sovereign because it had value in itself, unlike a note or any other piece of paper, we can remind them that most of the value in a British sovereign was due to the fact that convention and custom had made gold the money, or the basis of the money, of all the chief trading countries. If this use of gold ceased, and the metal were "demonetised," the dentists and picture-frame makers and jewellers who make it into useful and ornamental articles could not absorb the present output of the mines—to say nothing of the £2,400 millions of gold now used for monetary purposes—unless the price were greatly reduced.

This consideration is important because we are likely to hear a good deal in the next few years about the question whether, now that the pound has fallen off gold, there is any need for a backing of gold or any other metal behind it. Those who think that this

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need is real will probably tell us that it is only safe to take money in payment when it has real value in it or behind it. When we are told this, we must remember that the value of gold is chiefly due to the convention that has caused a general demand for it for use as coinage or as a reserve against notes. Its value is thus largely conventional, though not quite to the same extent as that of the fei of Uap; those who flatter themselves that, whatever happens, a piece of gold must always have buying power because it has "intrinsic value" might find that this value was very much less if the monetary use of gold were diminished or abolished.

Acceptability, originally conferred on money by custom, is made legal and obligatory in modern communities by statute, which gives the quality of "legal tender," in England, to Bank of England notes and to token coins of silver and bronze (silver up to £2 and bronze up to 1s.). This means that any one to whom one owes a debt cannot refuse to accept payment when it is tendered in these forms of money.

It is sometimes believed that this power possessed by Governments to make any kind of money legal tender, gives them also the

power to oblige all who have goods or services to sell to accept such money from those who want to buy. This is not quite true. If a people loses confidence in money that is legal tender, those who have goods to sell may insist, before the bargain is made, on payment in foreign money which is not legal tender at all, but carries the confidence that ensures acceptability. This was shown in Germany and Austria during the days of extreme inflation after the War, when money was turned out so fast by the printing press that its value as buying power fell and fell until finally it fell to pieces. In those times those who had goods to sell often insisted, before they would part with them, that the payment should be made in American dollars or in pounds sterling. It is important to remember this example, which shows that a Government's power to issue what is called "fiat" money—money which has nothing behind it but the assertion of the ruling authority that it is worth so much—is only effective, even though backed by the modern law of legal tender, when public confidence accepts the fiat money.

Confidence, based on custom, is thus the essential influence that gives to money the acceptability that has been shown to be the

quality above all necessary to any article that is used as money. If those who have goods and services to sell will not take it from us when we go out to do our shopping, it cannot do its work.

The next quality that our money should have is that of steadiness in value over long periods, so that when we lend or invest we may, when we are repaid the loan or sell the security, get back money that is as efficient in purchasing power as the money that we put away. This is another way of saying that we want the general level of prices to be kept steady.

It is news to many people to be told that changes in the level of prices are, or may be, due to the behaviour of money. They think that prices go up or down because things that come to market are scarce or plentiful ; and this may be so when, for example, a great harvest in most or all of the wheat-growing countries makes wheat more plentiful than other goods for sale, and consequently relatively cheap. But when, as happened lately, all the foodstuffs and materials that are used by man fall together, it is clear that either there is not enough money to buy all the goods at the former price-level, or else that, owing to lack of confidence or some other

cause, money is not being used and turned over as fast as it was formerly.

So here we are faced with the Quantity Theory of money—a question that has to be wrestled with before we can have any understanding of money's recent failure and any notions about making it behave better in the future. According to this theory, the general level of prices depends on the relation between the amount of money available for buying purposes and the amount of goods coming to market. A moment's thought will show us the general truth of this doctrine. If we all suddenly found that the quantity of money in our pockets and in our bank balances had been miraculously doubled, we should feel very rich until we went out to spend it. Then we should find that, the quantity of goods for sale not having been increased, the doubled spending power of their customers would encourage and even compel the shopkeepers to put prices up all round. Likewise, if we all had our stock of money cut in half, the shopkeepers would be obliged to put prices down, because if they did not do so they could not get rid of their goods.

During the War, when prices rose, we thought at first that the rise was due to extortions by shopkeepers and manufacturers

—many of whom certainly did their best to make all that they could out of a public that was nervous about the supply of food and other goods. But it soon became clear that most of the rise was caused by an increase in the supply of money, created, directly or indirectly, by Governments that chose that way of paying for part of the cost of war. As a rough working principle, the Quantity Theory was shown to have a great deal of practical truth behind it. It follows from it that if we want to keep prices steady the amount of money must be expanded as fast as the increasing productive power of the world, thanks to the improvements made by science and invention, pours out a growing quantity of goods.

From which the further conclusion is reached that since under our modern monetary system banks can increase or contract the supply of money, by lending or calling in loans, within limits that are only regulated by law and custom, there need be no changes in the general price level, if only the bankers would do their work properly, and the law gave them enough freedom, and the public would make due use of the money supplied to it, and of its power to borrow from the banks.

But the general price level is measured by a device known as index numbers, which puts together the prices of the chief commodities, adds them up, giving due weight to their varying importance, divides by the quantity of them, and so arrives at a figure which is a rough indication of the average level of the prices of the commodities included. And so the Quantity Theory can only be relied on to work with the nice regularity and clearness that statisticians demand from it, when the money available is mainly directed into the purchases of those commodities, or of articles made from them. If the public is perverse enough to divert some of its money into gambling in securities on the Stock Exchange, or into buying houses and land, which do not usually figure in the index numbers, the working of the Quantity Theory may be obscured, and nothing that bankers can do will keep prices of commodities steady.

Or again, at a time such as the present, when depression and apprehension have taken all the heart out of business and made most of us feel even poorer than we are, money lies idle and does not go into market to buy goods. Velocity of circulation, as the economists say, is checked. Borrowers do not

apply for loans, because they see no chance of earning profits. The public does not buy because its members know that they have an extra lump of income-tax to pay at an increased rate and assessed on an income earned in better times, or because they are afraid that they may lose their jobs ; shop-keepers and merchants do not buy because, as a commercial traveller lately said, " you could not sell a glass of water in hell to-day " ; nobody wants, by investing, to hand over the spending job to somebody else, because the trade and political outlook is so obscure that no one knows what may be going to happen to the prices of securities.

For these reasons, and others that might be given, it is a mistake to suppose that banks can, by expanding and contracting the supply of money, do what they like with the course of prices. The sentiment of business and of the general public is an influence that they cannot control, though they can affect it to some extent, since the offer of cheap money tends, except at times of acute depression, to cheer the minds of those who work with borrowed funds. When it is a matter of lowering prices by restricting credit the bankers' power is greater ; for though competition obliges them to meet as far as

possible the requirements of their customers, they can, by raising the rates that they charge for advances, give industry a warning, that it seldom neglects, that it is time to take in sail.

Nevertheless, when all these limitations are recognised, the fact remains that the Quantity Theory, in so far as it can be relied on to work, makes it desirable that the action of banks should not be allowed to cause unnecessary disturbances in the price level, but that bankers should endeavour, by watching the symptoms of trade activity, to see that falls in prices are not produced by scarcity of money, and also that excess of money should not drive prices up. One of the questions that we shall have to consider is whether such regulation of the money supply, to suit the expansion of production, is possible under the gold standard ; and if not, whether it is better to put up with the caprices of the gold standard rather than subject the progress of trade and prosperity to the vagaries that might be performed by well-meaning but fallible bankers in trying, by a study of possibly misleading index numbers, to make the currency fit the goods.

To decide this question it may help us if, before looking into the causes that have reduced civilisation to helpless inability to

consume what it produces, we see how the gold standard worked for the world in the century before the War. But before doing that we have a loose thread to pick up.

It was stated in the third paragraph at the beginning of this chapter that we want our money to be acceptable wherever we are. This ambition implies that when we are abroad we want to be able to take a Bank of England note or a cheque on a London bank to a local bank, with the knowledge that we can turn it into the money of France or Argentina or wherever we may be at a rate that we can calculate with reasonable confidence. In other words, stability in exchange value is another quality that we want in our money, besides acceptability at home and steadiness in value over long periods. This quality, important and convenient as it is to travellers, is very much more so to those who buy and sell abroad. When rates of exchange—which mean the rates at which the moneys of different countries are exchanged into one another—fluctuate wildly, as they did in the after-War years, and as they have since England was driven off the gold standard, international trade is evidently a much more difficult and risky business than when, for example, any Englishman who sells coal to

France can know how much, within a small range of variation, the francs that he gets for it will fetch when he turns them into pounds. This steadiness in exchange was secured by the gold standard, and is a very important advantage in its favour.

Under it, as it worked before the War, the moneys of all the chief trading countries were based on gold. They consisted of gold coin, circulating side by side with banknotes which were, with a degree of certainty that varied in different countries, convertible into gold on demand, and subsidiary coins, like England's shillings and pence. The notes had to be backed by gold, usually to an extent that was fixed by law, and they, with the coins minted by the Governments, were the legal tender currency. But in England and America by far the greater part of the commercial and financial transactions were settled by means of cheques drawn on banks: these were not legal tender, and were only accepted because those who took them had confidence in the solvency of the banks on which they were drawn and of the person or firm that had signed the cheque. These cheques gave their holders the right to have them paid in legal tender money, and it was either gold or convertible into gold.

By this arrangement the moneys of all the chief countries were linked together by gold and could not vary widely in exchange value. Steadiness in exchange was secured by the gold link, because if, for example, an American had sold cotton to a British merchant and found that pounds were quoted at a low price by the dealers in exchange, he could turn the pounds into gold in England, bring the gold across the Atlantic, and turn it into dollars at the statutory rate. Fluctuations in exchange rates were thus limited by the cost of sending gold from one country to another, insuring it in transit, and being "out of" one's money while it was on the way. The system did not work with perfect precision. It was not always possible to convert French or German money into gold, and the American monetary system was still in those days liable to violent dislocation owing to faults of which it was fortunately cured, just when the War was beginning, by the establishment of the Federal Reserve banks, which gave America a central banking organisation. But by and large, as far as steadiness in exchange went, the gold standard did its work as well as can be expected of any human institution.

As to acceptability, there was never any

question. Custom and convention had done their work for gold, and gold was more or less behind the moneys of all the chief nations. London was the acknowledged financial centre of the world. The British sovereign was known and welcome everywhere ; and the trade of most countries was financed largely by means of bills of exchange drawn on British banks and firms.

In the matter of steadiness of prices the gold standard in its palmy days was less successful. Money being based on gold, its supply varied to some extent with the amount of gold available. The connection was not cast iron, because the power of banks to create credit by means of advances to customers which were transferred chiefly by cheques, and so seldom involved any demand for gold, enabled them to build a fabric of paper credit, the size of which could be varied without any exact relation with its gold foundation. But the fact that all paper credits might lead to demands for gold was a restraining influence : when gold was scarce credit and the supply of cheque money were likely to shrivel, and with them prices of goods and enterprise and activity—for when prices fall merchants hesitate to buy, fearing that they will fall further, and manu-

facturers hesitate to expand their output, fearing that before they have turned out their boots or knives, or whatever it may be, a further fall in leather or steel will have made the merchants inclined to wait for cheaper finished articles.

So it was that after a period of rising prices in the third quarter of the nineteenth century, due to gold discoveries in California and Australia, there was a long-sustained fall, with occasional upward reactions, lasting until 1896. During this time the gold standard was defeating itself, as far as steadiness of prices went, by becoming too popular. Germany celebrated her victory after the Franco-German war by deserting silver and adopting gold as the basis of her currency. Other nations followed, and there was not enough gold to go round, according to the contention of the Bimetallists, who argued, as they are arguing now, that the way to restore active trade was to put silver back into double-harness with gold.

Then, with the discovery of the goldfield of the Transvaal, the position was righted, and between 1896 and 1914 there was a period of rising prices and trade activity.

Nevertheless, in spite of these variations in the tempo of progress and prosperity, the

gold standard had proved itself as a system under which immense material progress was achieved. Wide as were the fluctuations in prices, it is admitted by Mr. Keynes, one of its keenest and most effective critics, that the remarkable feature of the period between 1815 and 1914 was the relative stability of the price level. Approximately the same level of price ruled in or about the years 1826, 1841, 1855, 1862, 1867, 1871, and 1915. Prices were also level in the years 1844, 1881, and 1914, and also, as he now adds in his *Essays in Persuasion*, in 1931. "The metal gold might not possess all the theoretical advantages of an artificially regulated standard, but it could not be tampered with and had proved reliable in practice."

It was worked chiefly by the Bank of England and the London market, the dominant power of which in those days has already been noted. Behind them were the industrial power and financial strength of England, pouring out goods all over the world and lending freely to younger countries, at an earlier stage of development, enabling them to buy goods for equipment and development. In this task of international lending England was ably seconded by France, and out of smaller available resources

by Germany, Holland, Switzerland, Belgium, and the Scandinavian countries. There was thus a wide and free international loan market distributing £300,000,000 to £400,000,000 every year among the borrowing countries; and these sums were transferred from lenders to borrowers in the form of goods and services, greasing the wheels of trade. England's market was wide open for the goods of all the world, if the goods were such as England's inhabitants wanted; and so with a free market in which borrowers could borrow and sellers could sell, world trade went forward, with occasional side-slips, at a rate which promised well for material progress.

## CHAPTER II

### WHY THE MUDDLE HAPPENED

The Crash of War—The After-War Boom and Reaction—The Bankers Blamed—Back to Pré-War—The Question of Price-Level—Restoration of the Gold Standard—Devaluation Suggested—British Industry's Failure to Adjust—England's Financial Position thus Weakened—Her Smaller Savings—and Smaller Proportion Invested Abroad—America as Active Lender and Seller, but Reluctant Buyer—France's Political Anxieties and Unwillingness to Buy or Lend—America's Boom—Sucks in Gold—Central Banks Powerless—Did England " Play the Gold Standard Game " ?

INTO the monetary system, thus working with reasonable success and with every prospect of improvement as the functions and use of credit were more fully understood and more scientifically applied, came the bombshell of the Great War, which broke it to smithereens; and then the after-War fever of speculation, when most business men thought that rising commodity prices, and rising profits easily earned by the mere rise in prices, had become part of the scheme of the

universe. After that came disillusion and a fall in commodity prices which cut them in half, in 1920-1, and this terrific tumble was by many critics ascribed to the action of bankers in contracting credit.

In fact, as any one will see who looks up the figures of the volume of banking credit, as measured by the aggregate bank deposits—which are created by the credit operations of the banks—the contraction of credit did not happen until after the fall in commodity prices. What the bankers did was to make it clear, by raising the rate for money, that credit expansion could not be indefinitely extended ; and at the same time the buying public, by means of a “ buyers’ strike,” forced upon many of its members by inability to make both ends meet, had shown merchants and shopkeepers that the pace of the boom was too good to last. And so the contraction of credit, marked by a decline in aggregate bank deposits, followed the fall in commodity prices, simply because, with prices shrivelling in the after-boom reaction, less credit was needed to carry stocks of goods and to finance the greatly reduced trade turnover.

This first point of the after-War criticism of banking action, and its slender foundation, are worth noting.

After the collapse of the after-War boom came a period in which there was a general desire to get back to something like the old orderly working of the world's monetary system. Commodity prices, as measured by the wholesale index numbers, were still about 60 per cent. above the pre-War level, and there was some division of opinion as to whether it was better that they should, if possible, be kept there, or whether "back to pre-War" was the ideal to be aimed at.

As usual, there was much to be said on both sides. Falling prices are good for creditors and for all whose income is fixed or steady ; but they are bad for debtors, because they have to produce more goods to pay debts with, and also for employers and shareholders and others who divide the final profits of industry, if earned, and suffer its losses when losses are the order of the day, because falling prices mean that profits are less easily earned. Hard cases were put forward of the poor *rentier* who had bought trustee securities before the War and was now getting the same money income, of which the buying power was about halved (because retail prices had not come down nearly as much as wholesale), and on which, in England, he had to pay income-tax that had been

multiplied by about five. But such hard cases, though involving very real distress, were comparatively few ; and on the other hand, the effect of falling prices in knocking the heart out of enterprise and in increasing the burden of debtors was a strong argument for "stabilisation," if it could be secured, at about the ruling level of prices.

It was at least clear that violent fluctuations in the price level were a cause of disastrous dislocation, which ever way they went. A slight rise, keeping business and enterprise cheerful, had much to be said for it ; and so also had a slight fall, giving some benefit from the improvement in productive methods, due to science and invention, to the *rentier* and the wage-earner. But we did not want any more bulges and tumbles such as had been experienced in the War and after-War period.

Otherwise, "back to pre-War" in money matters, with balanced budgets and a properly working gold standard linking the moneys of all the chief trading nations together, was looked forward to as a pleasant and restful ambition, after the rocketing performances of rates of exchange during the time when nearly all the world was on a paper basis.

It is true that as early as 1923 Mr. Keynes

began, by the publication of his brilliant *Tract on Monetary Reform*, his campaign against the gold standard as an obsolete absurdity, which ought to be replaced by a scientifically managed system by which we should try to keep prices steady by contractions and expansions of credit, regarding exchange fluctuations as a matter of less importance. Most of his readers, however, were more impressed by the many passages in his book in which, with all the fair-mindedness of a scholar and a scientist, he testified to the satisfactory working of the gold standard in the pre-War period, than to those in which he explained his scheme, which looked too clever to most of us.

So "back to pre-War" the course was set. England screwed up the pound to its old parity with the dollar and returned to the gold standard in 1925. This action was criticised by many at the time as premature, and by a few as a fundamental blunder. At the old established rate (with 113 grains of gold to the pound and  $23\frac{1}{4}$  grains to the dollar) the "mint par," measured by the gold content of British money and America's, was 4 dols.  $86\frac{2}{3}$ . The alternative to putting the pound up to par was to link it to gold at some lower value, making it equal to

4 dols. 20, or some such figure. By going back to the old par, England made herself a good country to sell to and a bad one to buy from, unless she brought down her prices. An American who sold her £1,000 worth of goods was able to turn them into 4,866 odd dollars, instead of 4,200 dollars (if 4 dols. 20 had been chosen), and so was encouraged to sell to her and enabled to cut prices in competition with her industries; while the latter, in order to earn £1,000 in America—and the same principle applied to sales in other countries—had to get 4,866 dollars for their goods instead of 4,200, and were thus handicapped in competing abroad. Putting the pound back to parity thus faced British industry with the necessity for either reducing its costs of production and so its selling prices, or seeing itself bested both in its home market and in those of its foreign customers.

It was a very serious step; and there was much to be said for the view of those who contended that England was in too much of a hurry about restoring the pound to a rate at which it could, as was said at the time, “look the dollar in the face.” But in favour of making the effort quickly was the consideration that the sooner the pound was restored

the better it would be for world trade, and so also for British industry.

As to those who suggested that it was a mistake to return to the old parity at all and that it would be better to "de-value" the pound by stabilising at about 4 dols. 20, or some such figure, their contention was in effect a proposal that England should rob all those foreign creditors who had left money on deposit with her by repudiating a considerable fraction of her debt to them. To commit such an act of larceny, except under extreme pressure and after making every possible effort to avoid it, would have been a serious blow not only to England's financial prestige but also to that reputation for honesty which is quite the most valuable asset that the name of England carries with it.

It is true that France, by writing down her franc to a fifth of its value and stabilising it at 124 to the pound, committed an act of which her foreign creditors have bitterly complained. But when she did so France's financial position was extremely weak and she was justified in claiming necessity as an excuse for her action. As it was, she had raised the franc from an exchange value of about 1*d.* to 2*d.* and any attempt to bring it up to the old par would have been sheer

madness. Moreover, her responsibilities as a place of deposit for foreign money were not nearly as great or important as England's. And so England went back to the pre-War gold par by the passing of the Gold Standard Act of 1925, which obliged the Bank of England to sell gold bullion to any one who paid for it in legal tender money, at £3 17s. 10½*d.* per ounce standard, the rate which had been established more than two centuries before by Locke, had been restored after the suspension of gold payments at the time of the Napoleonic war, and had since been looked on as the "ark of the covenant" of English monetary policy. The only difference was that whereas before the War Englishmen could take notes to the bank and have them turned into the sovereigns which they then carried in their pockets, this luxury of a gold coin circulation was now obviously too expensive; and so the Bank was only required to sell gold in bars containing approximately 400 ounces (with a value of nearly £1,600). This meant that gold was only taken from it for purposes of export, which secured the gold link between British money and that of other gold-using countries.

By making this effort a big problem was set

before British industry of reducing costs, if it was to be able to compete abroad effectively. Other countries, such as Holland, Switzerland, and the Scandinavians, faced a similar problem with success (see Mr. Loveday's *Britain and World Trade*, pp. 158, 159). British industry failed. The wage-earners were naturally unwilling to lower the wage standard for which they had so successfully struggled, arguing that British industry notoriously needed reconstruction, better management, better selling organisation—for all which contentions they could quote chapter and verse from industrial leaders—and that reconstruction should be tried before wages were attacked. Employers retorted that reconstruction was impossible while they had to pay higher wages and higher taxes than their foreign rivals, and also had to face rising tariffs all over the world, while their rivals were able to dump goods in the open British market. And so the job was only half done. Competition forced wages down in some of the export trades, but those in the "sheltered" industries were kept pegged, which meant that the cost of transport, public services, etc., all of which entered into the price of British goods, refused to budge. In these

conditions unemployment became a chronic disease in England, and during the period of fairly active world trade from 1923 to 1929 British progress lagged and the British trade balance dwindled.

This weakened industrial vigour had important effects on monetary problems. It diminished England's power to lend abroad, and made the task of maintaining the exchange value of the pound more difficult. By selling abroad a country creates claims on other countries, which it can sell to those who present claims to it for goods and services that it has bought. If claims against it cannot be satisfied in this way, because the balance of payments is against it, then the exchange value of its money will fall and its stock of gold (when the gold standard is working) will be threatened. This threat can be, for the moment, averted by a rise in Bank rate, which means that the threatened country offers a higher rate for the use of foreign money, so creating claims on other countries by borrowing. But this relief is only temporary and makes its financial position weaker, unless the rise in the rate for money has also the effect of forcing its inhabitants to sell cheaper, and so restore the balance of payments by the only really

effective method, which is ability to sell its goods and services abroad.

With England's power to export thus weakened, she was also saving less than before the War and keeping a much larger proportion of her savings at home, using them to build houses and to create new industries, which absorbed some of the energy that the staple export trades were unable to use. This meant that her contribution was lessened to the international capital fund, the importance of which to the flow of international trade and development was shown in the last chapter. We shall see later that the diminution and final drying up of this fund was an important cause of the collapse of world trade which led to the money crisis.

In the first years after the slump of 1921 America did great work as an international lender. Thanks to the handsome profits that she had made out of the War, she had leapt, in one huge jump, from the position of a heavily indebted country into that of world creditor—a leap which, if the War had not happened, might have taken her a generation or two to accomplish. Thanks also to the tremendous vigour which she put into industrial effort—in strong contrast with the flabbiness of the impoverished and war-

weary countries on this side of the Atlantic—she was producing wealth on a vast scale and was ready to sell her surplus on credit, lending freely and taking an active part in the reconstruction loans that helped Europe to set her finances in order.

But there was a marked difference in the use that America made of her power as world creditor, as compared with England's action in the same capacity in the pre-War period. America was an eager seller and for some years a ready lender, but a reluctant buyer. While England threw her market open to all the world, enabling her debtors to pour in goods in payment of interest charges and debt redemption, America not only put a high tariff wall between her market and her debtors, but also by pouring out millions of dollars on building and subsidising mercantile ships, often sailing at a loss, she made it difficult for her ship-owning debtors to meet their debts as international carriers. Her activity was so eager that she wanted to lend and sell to everybody and do everybody's business, and at the same time to allow, as far as possible, no one to sell to her. Such a policy, carried out by the wealthiest country in the world and the creditor of all the rest, could only lead to financial trouble.

Of the other powers, which before the War had been active partners and rivals with England in the international lending business, France was crippled and afraid, and Germany, faced with an enormous Reparations charge, was going through a period of paper-money creation on a monstrous scale, which finally wiped out the value of the mark. The memory of this monetary collapse, and of the distress and demoralisation that it caused, has imbued not only Germany but the rest of the world with an exaggerated terror of inflation. This word merely means an expansion of currency and credit leading to a rise in commodity prices. When the world is suffering from a disastrous fall in prices a rise in prices is the obvious remedy ; but the terror of inflation, owing to its after-War abuse, is so powerful that the alternative policy of cutting down incomes, spending, and imports has been generally preferred and has brought civilisation within hailing distance of general bankruptcy.

It was not until 1926 that M. Poincaré took hold of French finance, balanced the budget, and by his masterly appeal to his countrymen restored their confidence in themselves, in France, and in its franc.

Before that date French Governments had been borrowing to pay their way and French citizens had been "flying from the franc," selling abroad any securities or commodities that they could sell, and leaving the proceeds abroad. In consequence of this flight the franc had fallen to an exchange value of 240 to the pound (its pre-War parity was roughly  $25\frac{1}{4}$  to the pound), and the French press and public had accused British and other foreign speculators of deliberately selling francs in order to depress their value and make gambling profits out of France's distress. In fact, most of the selling was done by the French themselves, as was shown by the enormous balances which Frenchmen were found to be holding abroad when confidence in the franc was restored. But foreign speculators undoubtedly took part in the operation, and were very skilfully "caught bears" and skinned by the French authorities, who were thus able still further to increase the balances abroad, the use of which by France has been a cause of so much bitter criticism—largely unjustified as we shall see—by English and other commentators.

These balances were increased, in the years after the stabilisation of the franc, by

French prosperity and thrift. The rate at which the franc was fixed, in strong contrast with England's action in screwing up the pound, was favourable to French industry, because it made France a good country to buy from and a bad one to sell to. To the English or other foreign traveller or buyer, French hotels and French goods were relatively cheap when he turned his pounds, etc., into francs. And so France had for some years a steadily favourable balance of payments, which was used by her citizens either by being left abroad on deposit with banks or in purchases of bills of exchange or other short-term securities, or was brought home in the form of gold.

In a book called *Behind the Scenes of International Finance*, Dr. Paul Einzig, a very clever and well-informed writer on international monetary affairs, tells us that the choice of the rate at which the franc was fixed—124 to the pound—was “in itself a master-stroke without parallel in financial history.” It was unpopular in the eyes of millions of Frenchmen, who saw, thereafter, no hope of recovering the loss that they had suffered of four-fifths of the value of their *rentes*, bank deposits, and securities with fixed interest—a fact that should be remembered

by British holders of French securities who have suffered a similar loss. But in Dr. Einzig's view "M. Poincaré, the greatest financial statesman of our generation, was prepared to face the consequences of his unpopular decision. He realised the immense advantages of stabilising the franc at a level which would enable French producers to undersell their foreign rivals, and through which France could accumulate the huge gold and foreign exchange reserve which was to play a predominant part in International Politics during the subsequent years."

This view is one of the arguments on which Dr. Einzig bases his contention, which is the theme of his book, that the violent crisis of 1931 "is to be attributed almost exclusively to the financial warfare conducted by France for political ends." But this sinister motive is hardly necessary to explain the fixing of the franc at a point favourable to French industry. Except in a country like England, which had special reasons for putting her exchange back to par, any statesman, when considering the stabilisation point for his country's currency, would naturally choose one that suited its industrial interests. As for its being designed by M. Poincaré in

order to enable France to accumulate gold and so gain political predominance in Europe, this contention is made doubtful by the attempts, recorded by Dr. Einzig, to raise Paris to the position of a world financial centre, providing credit and capital through a discount market and a loan-issuing organisation. If these ambitions had been fulfilled, France, instead of accumulating gold and foreign exchange, would have been promoting world trade by lending to foreign borrowers and preventing the drying up of the international capital market.

But this could not be, because French investors were disgruntled and afraid. They had lost many milliards of francs lent to Russia before the War, they had seen their French *rentes* written down by four-fifths by the depreciated buying power of the money in which they were expressed, and, above all, they were afraid of what might happen if Germany recovered her strength. This very natural fear was at the bottom both of French policy and of the French investor's outlook. Witness Dr. Einzig, who tells us that neither British public opinion nor even well-informed political and financial circles were able to "appreciate the meaning and consequences of the nightmare of

German aggression that has been weighing upon the mind of France ever since the War." He also relates that on several occasions concessions made by France—such as the evacuation of the Rhineland before the term of occupation actually expired—were followed by a swing towards aggressive nationalism in Germany. "This," he adds, "explains why a predominant section of public opinion in France has come to the conclusion that force is a better safeguard than a policy of *rapprochement*."

With this fear of a dangerous neighbour always before their eyes, French investors were not inclined to give much practical assistance towards the reconstruction of Europe, in so far as it tended to restore the wealth and strength of Germany, or to lend money abroad by subscribing to long-term loans. Naturally a race of savers and hoarders, they were more than ever inclined to keep a tight grip on their money, and so they piled up their ever-growing balances on deposit abroad, or brought them home in gold when their expanding trade and hoarding habits made it necessary to increase the note circulation of the Bank of France.

Gold movements for this purpose, often interpreted abroad as the result of sinister

intentions to weaken the financial power of London and other centres, were frequently necessitated by the medieval arrangements of the Paris money market, in which funds are locked up to an extent that looks absurd to those accustomed to more modern methods, by loan subscriptions and tax collections, and the Bank of France's power to relieve the market, by purchases of securities and other "open market policy" methods practised in New York and London, is extremely limited.

No one can doubt that France, as is evidently the duty of any country that believes itself to be threatened by a strong and dangerous enemy, had a keen eye to the preservation of her own security, but the suggestion that every time that gold went to France there was a sinister political motive behind the operation, ignores many important factors in monetary movements. Fear, hoarding, and an antiquated monetary system were often the causes of the movement.

France's action in thus refraining from supplying the international capital market with funds, by investment in long-term loans, and in gathering into the vaults of the Bank of France gold that was sorely needed elsewhere as a basis for credit expansion that

would have maintained commodity prices, was evidently unfortunate for the progress of world trade. The right cure for it was not to abuse France for not "playing the gold standard game," which expects those countries which have balances to lend them, or buy goods with them, or, if they import gold, to expand their currency and so turn the exchanges against themselves. The obviously sensible cure would have been to give France the guarantee of her frontier promised to her at the time of the negotiations which produced the Versailles Treaty, by President Wilson and Mr. Lloyd George. But, as we all remember, the Senate Committee refused to confirm Mr. Wilson's promise, and so it fell through. If there had been enough statesmanship in the world to relieve France of the "nightmare of German aggression," as Dr. Einzig calls it, her financial activities might have helped the process of recovery instead of being a nuisance to her neighbours and a contributing cause of depression ending in crisis.

But even if it had been impossible to induce France to play anything but a lone hand, the rest of the world, if its inhabitants had behaved in a normal and reasonable fashion, might easily have made a shift to

manage without her help. The gap made in the world's gold stock by French suction might have been successfully ignored, if other countries had reduced the—purely conventional—ratio of gold to note-issues permitted to their central banks. If there is not enough gold to supply the legal backing for the required amount of paper money, all that is necessary is to slim the Golden Calf by lowering the legal proportion between gold and paper.

This simple reform has been suggested by expert committees and by many others who have considered the question of a possible scarcity of gold ; and it may, perhaps, some day be adopted if the world goes back to the gold standard out of the present monetary welter. But it was too soon to try it as a remedy against French gold demands, because in the meantime they had been reinforced and made much more serious by a drain of gold to America, adding to its already enormous accumulation heaped up during the War.

In the case of America, critics have been vigorous on the subject of the monetary policy which caused or permitted this gold drain. Charges of sinister political motives are not here brought forward ; but it is

alleged that if the Federal Reserve Board had "played the gold standard game" and allowed the expansion of credit to take place that the gold stock made possible, the consequent rise in commodity prices and cheapening of credit would have turned the exchanges against the United States and reversed the flow of gold.

There is some ground for these criticisms, as is proved by the immoderately high proportion of gold to liabilities—often more than twice the figure required by statute—shown in the years before 1931 by the Federal Reserve banks' aggregate balance-sheet. But Americans, in refuting the charges brought against their monetary authorities, can argue with perfect truth that there had been an immense expansion of credit in their country, and that the use made by the public of the increased credit is another example of the limits of the power of central banks in influencing prices.

According to the theory of the gold standard game, the banks of a country that sucks in gold, owing to a favourable foreign balance of payments, should then make money cheap and expand credit by making advances to customers, so that buying power is increased. If these things are done the

public's increased demand for commodities is supposed to cause a general rise in prices, making the country a good one to sell to and a bad one to buy from, while at the same time the cheapness of money attracts borrowers and repels lenders. These influences, when the game works successfully, turn the exchanges against the country, stop the inward flow of gold, and, if persistently exercised, reverse it.

Such an effort was made by the American banking authorities in 1927-8, with the result that by the end of June 1928 the gold stock had declined by £116 millions from the high point which it had touched in May 1927. And this outflow was accompanied by no restriction of credit, because during the period of the gold exports the Federal Reserve banks had increased the volume of bills discounted for the ordinary banks by £120 millions.

But central banks, with the best intentions of trying to cause a rise in commodity prices by expanding credit, cannot control the use that the general public may make of the extra buying power so produced. If the public puts the money into gambles in "real estate"—houses and land—or Stock Exchange securities, then, since goods used in

international trade are not affected, no influence is exercised on the course of the exchanges by a rise in commodity values.

And this is what happened in America. Commodity prices showed a slight tendency to fall, but the American public, being convinced that it had established an era of prosperity which was never going to end and that any one could make a fortune by buying shares in American railroads and industrial and "public utility" companies, started a boom in these securities which had already risen fast with the growing prosperity of the country.

It was this speculative streak in the American public mind that had doubtless caused, and justified, the action of the banking authorities in "sterilising" a large part of their gold stock and refraining from expanding credit until they were induced by considerations of international gold policy to make the effort, already recorded, in 1927-8. As we all know, the speculative streak took charge of the position, causing a rise in security values that looked as if it were never going to end, as the public and those who advised it began to make calculations as to what the price of shares would be if profits went on expanding for another

five or ten or ever increasing number of years.

The Federal Reserve banks again did their best to check the gamble by raising the price of money, but with prices of securities soaring as fast as they did, speculators were not deterred by the rates that they had to pay for loans, when they could use them for buying stocks that, by bounding upwards, quickly made good the cost of the loans and left a handsome profit to boot. Rates in Wall Street in those hectic days ranged up to 8 and 10 per cent. without causing speculators to turn a hair, and on one occasion even 20 per cent. was touched.

This amazing boom had two adverse effects on the international monetary position. It dried up the flow of American capital abroad, because no one in America wanted foreign issues when fortunes were so easily to be made in home securities, and so the international capital market was left barer than ever, to the detriment of the habitually borrowing debtor countries. And it had an even more serious effect in that it sucked in money from all the impoverished world by the attraction of the stiff rates current in Wall Street and of the gambling profits there to be earned. With world trade stag-

gering on crippled and ill-shod feet, money that was needed to finance it was being sent to America, the richest country and the creditor of all, to finance a gamble and to make something out of it.

And so the gold that had gone out of America, thanks to the Federal Reserve banks' effort, came pouring back again and more behind it, and France and America have been branded as having caused depression, culminating in crisis, by accumulating masses of gold and sterilising them and so diminishing the amount of money in other countries and causing a disastrous fall in the prices of commodities. That they did so is undoubtedly the fact, though other causes besides their gold accumulations were at work to increase the troubles of the uneasy world. Sir Henry Strakosch in a memorandum published as a special supplement of the *Economist* of July 5, 1930, showed that in 1929 not only was the whole of the new gold that was available for monetary purposes absorbed by the United States and France, but the two countries had also managed to deplete the reserves of other gold standard countries to the net extent of £14 millions. They had thus together sterilised gold to the value of £110,000,000, and to this extent

deprived the rest of the world of the possibility of increasing the amount of credit and currency as required for the exchange of its increased production. "That," says Sir Henry, "sufficiently explains the catastrophic fall of the general level of commodity prices in 1929 and the beginning of this year" (1930)—a fall that has gone on spreading disaster ever since.

But were the banking authorities of these two countries responsible? We have seen that gold went to France chiefly because her inhabitants, Protectionists by instinct and always too thrifty to buy abroad freely, were too nervous to lend abroad. The Americans, to most of whom a high tariff is something almost sacred, bought abroad much more freely than the French, in spite of their monstrous import duties, and lavished millions of dollars abroad on foreign travel and charitable gifts to poor relations in the old countries; but their buying was far from being on the scale warranted by their wealth and required by their position as world creditors. As for lending, we have seen that they began with a rush. But they soon dried up that flow owing to the attractions of their own securities and their disillusionment concerning the course of politics in Europe,

where after-War bitterness showed no sign of abating.

These things being so, what could the central banks of either country have done? They could not, even if they had wanted to, have brought down tariffs either in France or in America, and it was equally impossible for the Bank of France to compel French investors, in a state of acute political and financial fear, to lend abroad, and for the American Federal Reserve banks to induce the American public to forsake a wildly successful (while it lasted) gamble in their home securities in order to lend to impoverished and discredited Europe, daily showing that it was still wallowing in militaristic barbarism.

And what of England? Did our banking authorities also neglect the rules of the gold standard game? Those who believe that we made a mistake in going back to the pre-War gold parity in 1925 have some ground for this contention. - But even it was not done, and could not have been done, by the banking authorities alone, but by Act of Parliament with the great mass of business opinion behind it; and the special reasons which justified it have already been mentioned. But foreign critics go further and

say that the Bank of England by means of a high bank rate and credit restriction should have forced England to curtail imports and bring down the cost of production, so that England's gold stock might have been less vulnerable, being protected by the efficiency of British industry and by the larger balance of payments that its efforts would have produced if this severe monetary policy had put it into a stronger position.

For the protection of London's gold stock measures of this kind might have had some effect. But would they have been good for world trade? They would have meant that England was joining in the pull-baker, pull-devil struggle for gold that was being carried on unwittingly by France and America and in the deflationary policy that was having an adverse effect on commodity prices. The Bank of England was doing its best to promote the recovery of Europe and the rest of the world, as being the object most important to British industry and to all others interested in material progress. In 1929, the year in which the American boom first toppled and fell, the Bank of England was commended by Professor Cassel, the distinguished Swedish economist, for having done the world a great service by showing

that it considered gold reserves to exist in order to be used. But it also, as well as the central banks of France and America, had to work for a public that, by actions over which it had no control, made the task of the monetary authority difficult. Some people accuse the British trade unions of having by their unyielding attitude towards wage reductions prevented that adjustment of production costs which was necessary if England was to follow up the return to the pre-War parity and play the gold standard game. The unions, as we saw above, would retort that the employers were to blame for being so slow about reorganising their industries; and also that wage reductions in England would only have led to still lower wages abroad. England, in short, was hoping that other countries would return to political and economic sanity, and was making well-meant but quite fruitless efforts to make them see that the policy of keeping out everybody else's goods was strangling world trade. But sanity was out of fashion in frightened France and madly optimistic America, while Germany was struggling with a Reparations burden that was growing heavier as trade declined and prices fell.

## CHAPTER III

### MORE TWISTS IN THE COIL

The Dried-up Capital Market—The Reparations Problem—Its Influence—Points of View of Germany, France, England—French Mistrust of Germany and England—War Debts—America's Just Claim to Payment—Her Moderation in Assessing Capacity—Her Unfair Action in making, through Tariffs, etc., Difficulties for her Debtors in Paying—Effect of "Uneconomic" Debts—Tariffs and Restrictions, Increased Productive Power and Prices—Effects on Debtors—Nationalism and After-War Bitterness—The Macmillan Report on "Non-Monetary Factors"—and on the Limited Powers of Central Banks.

IN the last two chapters it has been shown how widely the international monetary system differed in its after-War working from the lines on which it had furthered the prosperity of the nations in pre-War days. In the earlier time, England the chief creditor gave a free market to the goods of all countries and at the same time stimulated their development by means of a strong and steady stream of capital and of emigrants.

“ Under such an obviously desirable policy,” says Professor Rogers of Yale University, “ not only did British industry and trade develop greatly and almost continuously for more than half a century, but British capital exported to various parts of the world led to healthy and rapid economic development of the debtor countries. In fact, a very great part of the development of the United States came about in this way.” \*

After the War America, the chief creditor, shut her market with a high tariff wall, in accordance with her traditional policy and her belief that she thereby maintained the high standard of life of her population. Owing to her enormous wealth and the preference of many of her people for costly articles just because they were costly, she was, in spite of her tariff, a considerable importer of manufactured goods ; but her contribution, as consumer, to world trade was not nearly in proportion with her effort as producer, and this fact was one of the many influences that gave a lop-sided list to the ship of commerce and so upset the financial balance. As banker and investor, she was capricious and wayward, as was natural to a nation that was trying its in-

\* *America Weighs her Gold*, p. 80.

experienced wings on world-wide flights and was liable to attacks of giddiness. She lavished credits with a free and open hand and then pulled them in again with a ruthless claw. For some years she had keen-eyed emissaries looking in all parts of the world for opportunities for placing long-term loans, which she poured, sometimes indiscreetly, into the pockets of hungry borrowers, often urging them to borrow much more than they wanted, because loans of moderate size were not worth while to New York's sky-scraping finance. Then she turned off this tap with a jerk, and in the year after the Wall Street slump is calculated by her own economists to have thrown over £100 millions' worth of securities on to the stock markets of Europe and England, already staggering under the losses that the American collapse had inflicted on them—if we contrast America's youthful and very pardonable vagaries as financial leader with the stolid steadiness of stuffy old England in the same job, we need not look much further for causes of dislocation and maladjustment.

And France, as we have seen, was naturally frightened and anxious, and this mood inevitably quickened the inborn hoarding habits of her people and made them prefer

to keep their money at home or, if abroad, at "short call," so that it could be quickly brought home if needed.

England, with her huge war debt and high taxation, her industry struggling with over-expanded war-time plants, rigidity in wages, deficient organisation, and the dumping of foreign goods in her still unprotected market, was trying at once to do her old work as lender abroad, to improve her social services and the standard of her workers, to pay what she owed abroad, and by generous concessions to her debtors, to further the recovery of world trade. It was a fine effort and well worth trying, and if other nations had worked in anything like the same broad-minded spirit, it might have been successful. As things were, it failed, and the effort to maintain the gold standard cramped England's power to keep the international capital market, deserted by America and shied from by France, in the free flow that had done so much to keep world trade active.

This drying up of the capital market was especially inconvenient to Germany, which had been relying on foreign borrowing in order to meet the Reparation charge imposed on her first by the Dawes plan and then by

the Young plan. Having made sums which are estimated at some hundreds of millions by selling marks to speculators all over the world and then printing them so fast that they lost all value, Germany was rescued from financial chaos by her creditors, who reorganised her finances under the Dawes plan, which imposed annual payments on her rising to £125 millions a year. These sums, however, were only to be paid as long as the Transfer Agent, who was responsible for their remittance to the Ally creditors, could turn the marks collected in Germany into foreign currencies without endangering the exchange value of the mark. This condition meant, in effect, that if Germany could not provide the necessary credits abroad either by selling goods and services or by borrowing, Reparation payments would be suspended. Anxious as the Allies were to secure Reparation payments, they were still more anxious not to let Germany's monetary arrangements be forced back by them into a condition of chaos.

But owing to the existence of this transfer clause, the Allies were not able to count with certainty on the receipt of Reparations; and so, in 1929, a fresh arrangement was made by which Germany gave up the

protection of the transfer clause, had the annual payments reduced to a figure which was to average about £100 millions for thirty-seven years, and recognised as an unconditional obligation about £30 millions of this amount ; as to the balance, she was given the right, if she found that she could not pay it, to appeal to the Bank for International Settlements (which was founded primarily to receive and distribute the Reparation payments) to summon a committee to be nominated by the central banks of the interested powers to examine the problem of her capacity to pay. This provision of the Young plan came into operation in November 1931.

In the opinion of many wise and disinterested judges, this Reparation charge has been the main cause of the financial and commercial dislocation which ended in acute and world-wide crisis ; but if the figure required from Germany is viewed in relation with the total sum of world trade, it looks so moderate that, oppressive as such a charge may well have seemed to the paying country, its influence, had trade been proceeding on normal lines, need scarcely have been felt as a cause of disturbance.

According to the estimates of the economic

organisation of the League of Nations, the trade in goods across the frontiers of all the world increased from £13,010 millions in 1927 to £13,341 millions in 1928—this increase, in one year, being more than three times the whole amount of the annuity demanded from Germany under the Young plan. If trade had not been paralysed by other causes, it looks as if its huge amount, as distributed all over the world, might easily have absorbed the Reparations contribution of Germany, artificial and uneconomic as it was, without being seriously dislocated.

Discussions about what might have been if things had been different are a somewhat futile amusement, and the Young plan, as things were, certainly could not be worked. But it is important to remember that the terms of the Young plan, which were drawn up by skilful and well-qualified experts, were not as impossible and ruthless as some people are inclined to assume, now that an exceptional train of circumstances has made them unworkable. And it is especially necessary to take a broad view of this matter, because some of the many critics of France's financial policy in recent years accuse her of deliberately aiming, by laying an impossible charge on Germany, at keeping her in a

financially and therefore also politically weak position.

From this point of view—of France's attitude and the different sentiment on the subject in England—the Reparations question has undoubtedly been an important cause of differences that have helped to inflict disaster on the world ; and it is essential that fair-minded people should try to see the point of view of all the chief parties concerned in the problem.

Germany naturally wants to pay as little as possible. Her younger generation feels that the rulers who conducted the war for her have passed from power, and that they themselves have little or no responsibility for the actions of a set of statesmen and generals who belong to another era. They also resent and repudiate the assertion, most unnecessarily incorporated in the Versailles Treaty, of Germany's sole responsibility for the War. They look on Reparations as a monstrous charge, based on a lie, somewhat naturally ignoring the precedent set by their own country in 1871, when Germany imposed on France an indemnity of £200 millions, then believed to be a terrific burden, and described by the *Economist* in 1876 as a " ferocious " charge.

This precedent, on the other hand, has been very much in the minds of the French, who regard the payment of a heavy indemnity to the victors as a natural consequence, established by custom, of war. Having suffered more, from the fact that their country had its richest provinces devastated, than any other belligerent, France thinks that Germany should be made to pay as much as possible ; and Frenchmen have some reason behind them when they argue that the fear of force is the only argument that will make Germany pay at all ; many of them believe that if it had not been for the Ruhr occupation, the Allies would never have got anything in the shape of Reparations. That the exaction of a heavy indemnity weakens Germany and prevents her restoring her strength as a possible aggressor is, from the French point of view, a strong argument in its favour, and this consideration has had a great deal of weight in the attitude of French statesmen towards the Reparations problem.

England's point of view was wholly different. It has always been our habit to shake hands and be friends when a fight is over, a policy which has plenty to be said for it, as long as the beaten enemy is not making nationalistic gestures on the other

side of a land frontier that has twice in living memory been aggressively crossed. Moreover, we had reasons of our own for being anxious to set Germany on her feet and to let her off lightly in the matter of Reparations. Germany has long been one of our best customers, and our interest as world trader made us want to see the prosperity of Central Europe, largely dependent on that of Germany, restored as soon as possible. Further, she is an active competitor with us in many lines of trade, and ever since Reparations were first mooted, our industrialists have feared that Germany's obligation to pay great sums year by year by the sale of goods and services abroad would make the competition of her well-organised and hard-working population all the more difficult to meet. British sportsmanlike sympathy with a beaten foe thus went hand in hand with British material interests ; while, again according to keen-eyed Dr. Einzig, neither public opinion nor even well-informed political and financial circles in this country were aware of the extent to which French opinion was dominated by the German nightmare. And so France mistrusted not only Germany but also England, a fact which had important consequences in contributing

to the money muddle, making French investors still more inclined to button up their pockets and so quicken the flow of gold to France.

Closely connected with the problem of Reparations was that of war debts. All the Allies had borrowed from America during the War, and most of them had borrowed from England. These debtors, including England, wanted Reparation payments to help them to meet their debt charge due to America. Some people in England and many in the other Ally countries have suggested that since we were all in the war for the same cause, it would have been a timely act of generosity and justice if America had cancelled these debts lent to her brothers in arms. When we remember how much more remote America's interest in the contest was, this claim was, surely, much too large an order. From the American point of view, the United States intervened in order to put an end to a disgraceful exhibition of barbarism in Europe, the continuance of which was causing them some inconvenience, but was not nearly such a vital matter to them as it was to the warring powers on this side of the Atlantic. The Americans also had a good deal of reason to believe that if

they let the Allies off their debts, the only result would be that the money saved by some of the debtors would be used in preparations for another war. It seems to me that America was wholly justified in asking her Ally debtors to pay some part of their debts, and that the compositions that she made with them, especially in the case of France, were highly generous—even England was allowed to scale down a 5 per cent. debt to one bearing interest at 3 rising to  $3\frac{1}{2}$  per cent. It was not in asking payment on a moderate scale that America wronged her former associates in arms, but in the trade policy of high and ever higher Protection and of grabbing their business by means of shipping subsidies. By these methods she made it difficult for them to pay, and so sucked gold from them and helped to promote the money muddle and reduce the working of the gold standard to a discreditable farce.

England also made generous compositions with her ex-Allies, and expressed in the Balfour Note the policy under which she only collected from them and from Germany in the form of Reparations enough to meet her debt charge due to America, leaving herself short of some  $\pounds 133\frac{3}{4}$  millions (or  $\pounds 197\frac{1}{2}$  millions if interest is added) of arrears

which she had already paid out of her own pocket.

These artificial and uneconomic burdens of Reparations and war debts differed in essence from the charges connected with ordinary loans raised for productive purposes. In the case of the latter the country that has to meet the charge has received from the lender capital which it has—or ought to have, and, in fact, generally has—laid out to advantage, so stimulating its own productive power and enabling it to meet the charge. Reparations and war debts have no such benefit behind them, and so their burden is more onerous ; and in order that they should be met without causing too great a strain, and with the ease with which France met Germany's indemnity demand after the Franco-German war, it was essential that world trade should go ahead with expanding vigour and that prices of commodities should be at least maintained. Given favourable conditions, it is conceivable that these payments might have been made.

But conditions were far from favourable. Mention has already been made of America's tariff policy, so grossly unfair to her debtors ; and this bad example was followed all over the world by countries which had much

better reasons to show for protecting their industries—new countries which wanted to free themselves from dependence for supplies on neighbours whom they mistrusted ; and “ neutral ” countries which had suffered in the War from being cut off from their usual sources of supply and saw no reason why they should allow the industries that they had created to meet the emergency to be destroyed by the competition of the ex-belligerent producers when the latter were ready to resume business on the old lines.

So high tariffs and all kinds of official obstacles to the exchange of goods between the nations were the order of the day. International Conferences and periodical meetings of the International Chamber of Commerce passed resolutions deploring this tendency and pointing out that it was strangling world trade ; and then the eminent gentlemen who had expressed these admirable sentiments went home and put up, or abetted the raising of, another row of bricks on the tariff walls. Nationalistic spirit, strengthened and embittered by the War, expressed itself by an effort to keep out the goods of other countries, oblivious of the fact that international trade is a two-sided affair and that nations which will not

buy from others cannot expect to sell to them.

At the same time the world's productive power had been greatly increased by the stimulus of war and of high prices, which had quickened the wits of inventors and scientists and brought wide areas under cultivation. With increasing output, restricted international buying, and gold drifting to France and America to be sterilised, prices were bound to sag. Manufacturing producers, more easily able to control output than the farmers and growers, were able by rings and restrictions to keep up the prices of manufactured goods, and so another disequilibrium came into the picture in the form of a relatively greater fall in "primary" commodities; this made it more difficult for those who grew them to buy manufactured goods or to pay their debts, and for countries such as Australia, Argentina, and Brazil, which depend for their financial position on the sale abroad of wheat, wool, coffee, etc., to meet their external obligations.

Rings and controls and restriction schemes—official, semi-official, and unofficial—struggled in vain to maintain prices, until the collapse of the American boom in 1929 gave the final blow to financial confidence,

cut down the buying power of the richest people in the world, inflicted immense losses on speculators and investors in all countries, and began that creeping paralysis of falling prices of commodities and securities which ended by sapping the confidence of the public in many countries in their banking systems.

When it is added that China had been in a state of chronic civil war and that Russia, once a substantial producer and consumer, had been to a great extent out of the business picture, there is no need to look for further causes—though many might be enumerated—of the money muddle. In such a condition of world-wide bitterness, mistrust, and hysteria, no monetary system that ever was devised could have been worked efficiently, even if the boards of all the central banks had been manned by angels from Heaven.

For this view one can quote the authority of the Macmillan Committee, composed of eminent business men, economists, bankers, and Labour leaders, which published its report in July 1931. It states its belief that “the economic difficulties of the post-War decade are primarily due not to any wanton misbehaviour on the part of the monetary factors themselves, but to unusually large and

rapid changes on the part of what are rightly described as non-monetary phenomena, these non-monetary factors again themselves producing monetary changes. In particular, War and post-War non-monetary causes led to the great and unwanted flow of gold to the United States from which such vital consequences have ensued." Among other non-monetary factors which warped the course of trade and finance the Committee enumerates rapidity of technical changes in manufacture and agriculture; want of balance between the demand and supply of services as against manufactured products, of new types of manufacture as against old, and of manufacture as a whole as against agriculture; the rigidity of wage rates; the growth of tariffs; the embarrassments of budgets; and violent changes in speculative activity in New York and elsewhere.

As to the limitations on the powers of central banks, this authoritative document reminds us that "the Federal Reserve system of the United States has endeavoured to keep that country on an even keel since the War, and yet, even if we ignore the violent movements of the immediate post-War period, it has been unable to prevent one of the greatest oscillations of boom and

collapse in history. Again, the Bank of England has aimed for some years to bring about an equilibrium between this country's conditions and world conditions, but, while prices have fallen, costs have remained rigid and the desired equilibrium has not been attained. The Bank of France, restricted by legal enactments, was unable to prevent its vaults being filled with many millions of gold that it did not want."

As to the co-operation among central banks—recommended by the Committee as essential to the sound working of the gold standard (off which England had not been pushed when it issued its report)—certain difficulties are set forth. "Even," says the Committee, "if it were conceded that concerted action would generally be effective if it were taken soon enough, it may be argued that it is not in fact practicable to detect and interpret the obscure premonitory symptoms of the financial weather soon enough or accurately enough, or with a high enough degree of probability, to procure concerted action amongst a number of independent authorities, each of which is likely to have its own ideas based on its local information and to maintain them with tenacity."

Quite so. The monetary system is, when

it gets a fair chance, a good and useful handmaid doing its job under great difficulties. But it is absurd to suppose that it is an autocratic tyrant that can rule the world's trade and finance as it pleases, or that it is responsible for more than a fraction of the evils that have been inflicted on the world by new conditions, mostly traceable to War-time dislocation and after-War mistrust, bitterness, and hysteria. These things will be still clearer when we consider the progress of the muddle into crisis, culminating in the fall of the pound.

## CHAPTER IV

### FROM MUDDLE TO CRISIS

Events of 1930—American Sales of Securities—Fall in Prices of Commodities—Fear and Suspicion—Banking Troubles Abroad—The Hitler Election—Begins the Run on Germany—The 1930 British Budget—Thickening Clouds in 1931—The Credit-Anstalt—Political Mistrust Grows—The Austro-German Customs Union—The Breslau Demonstration—The German Crisis—The Hoover Suspension—Effect Spoilt by Delay in Acceptance—The London Conference—The “Standstill Agreement.”

SOME of us were foolish enough to hope at the beginning of 1930 that the elasticity of the American temperament and the ingrained belief of the Americans in themselves and in their country, might produce a quick recovery in the United States from the effects of their collapse of 1929. Such hopes were a delusion. Far from resuming her activity as a feeder of the international capital market, America was estimated to have thrown in the course of the year some £100 millions' worth of bonds and other securities on to the stock exchanges of

impoverished Europe and England. The capital market, instead of pouring out a fertilising stream, had become a gaping drain, with a heavy fall in all the speculative and second-rate securities. Gilt-edged stocks, however, were kept steady, owing to the cheaper money that was made possible by the relaxation of the strain imposed on the world's money markets during 1929 by the American boom.

Commodity prices also tumbled at a terrific pace. In its *Commercial History and Review of 1930*, published with its issue of February 14, 1931, the *Economist* tells us that "whereas the fall in the average level as measured by our index number amounted in 1929 to approximately 7 per cent., the decline last year was over 22 per cent. All the groups of commodities into which our index number is sub-divided participated in the recession. The textile group, which led the way in 1929 with a fall of 19 per cent., again headed the downward movement with a fall of nearly 38 per cent., followed by cereals and meat with a drop of 24 per cent." It further summed the year up as one of "widening and deepening depression which no country entirely escaped, and from which no industry was wholly immune. Quarter

by quarter the economic malaise became more and more severe ; nor at the close of the year was it possible to see any signs of assurance that the downward trend of the economic cycle was near its end. The past year, then, will live in history as a black period both for Britain and for most of the rest of the world."

We know now that the economic blizzard of 1930 has been eclipsed by the still more violent tornado of 1931 ; also that some of the causes which produced the tornado were already at work in 1930. Says the *Economist* in the same review, "one major influence at work—which is at once an effect and a cause of the depression—is psychological. In the world in general and in Europe in particular the psychology of fear has been prevalent. . . . Fear and suspicion straddle the path that might lead to European co-operation. Fear of Europe's stability prevents the investors of America and France from financing debtor countries. Fear of further price falls and of higher taxation discourages enterprise and damps initiative."

Here we have more than enough causes for serious trouble—a fall in prices of food and materials, making it difficult for their producers to pay their way, and making

lenders, such as there were, still more shy of lending to them, and affecting the financial position of countries such as Australia, which depended for financial strength and for meeting her external obligations on the prices fetched by wool and wheat ; and a state of mind in which political fear, which we have seen to be a cause of France's unwillingness to lend and consequent accumulation of gold, became more acute and more general. Banking troubles were another cause of anxiety in France and America, and the banks of both these countries began the process, which did so much to create the tornado of 1931, of trying to still the mistrust of their home customers by pulling in funds that they had placed abroad. French gold demands on London for this purpose prevented the Bank of England from making any addition to its gold stock during the course of 1930, which was in many ways an extraordinary year for gold movements. France increased her gold holding by £90 millions—nearly £5 millions more than the whole amount produced by the goldfields of the world during the year, and America added £41 millions to her already Gargantuan store.

French anxiety as to Germany's political intentions were seriously increased in the

autumn of 1930 by the General Election in Germany, which gave a great accession of strength to the Nationalist party, under the leadership of Herr Hitler, and so has since been commonly spoken of as the "Hitler election." Some of the Nationalist leaders had given utterance to sentiments which implied a determination, if they came into power, not only to upset the Versailles Treaty and so, of course, the Reparations charge, but also to deal drastically with the claims of capitalists in general. The surprising increase in their voting power, as shown by the Hitler election, very naturally alarmed not only Germany's foreign creditors, but also many German property owners; and so a flight from the mark began, both on the part of Germans, who used every device for transferring property abroad, and also of foreign bankers and money-lenders, among whom French and American institutions were conspicuous, who started that "run on Germany," which, transformed in July 1931 into a run on London, forced England off the gold standard.

That is to say, that the root cause of the tornado was political—lack of confidence in the political stability of Europe—and nothing but a real improvement in the political atmo-

sphere of the Continent can rescue us from the economic evils which have upset the working of the world's monetary machine. Germany and France both accuse one another, and can show plenty of reason for so doing, of causing the mutual mistrust, which, combined with America's vagaries, has inflicted so much distress on the world. It remains to be seen whether these two great nations are now so frightened by the financial consequences of their bickerings that they will be forced by fear into amity.

Before leaving the subject of 1930 and the seeds that it sowed of the harvest of foul weeds that was reaped in 1931, we must note the British budget of the former year. Mr. Snowden, as he then was, found himself faced with the necessity for finding £47 millions of fresh revenue, and did so by laying the whole burden on the large incomes and large estates. He put the income-tax up but at the same time increased the exemptions for the smaller incomes in such a way that they were not affected; sur-tax—the additional income-tax imposed on incomes over £2,000—was screwed up till it amounted on any excess over £50,000 to 7s. 6d., while estate duties on the big fortunes, from £120,000 upwards, were raised, till they

amounted on estates over £2,000,000 to 50 per cent. By these measures Mr. Snowden claimed that he had laid the burden on the shoulders best able to bear it ; but he was accused by Opposition critics of deliberately penalising capital. These charges are believed to have alarmed British property owners and increased their desire to place money abroad and, if possible, out of the reach of the tax-gatherer ; and at the same time to have made foreigners who had money deposited in England less confident about her as a safe place of deposit. For these reasons a flight from the pound is said to have begun from the time of the 1930 Budget.

In 1931 all the adverse influences noted as at work in the previous year were still busy, and most of them grew busier still. France, with her nerves shaken by her local banking troubles and the Hitler election, continued to take gold from London, and during the first half of the year she and America added £24 millions and £95 millions respectively to their gold stocks, the American accession being acquired in spite of extremely cheap money in New York, whose Federal Reserve bank broke all records in May by reducing its official rate to  $1\frac{1}{2}$  per cent. Such a rate

ought, according to those who clothe the central banks with unlimited power to sway the movement of money, to have sent American money abroad in heaps. In fact, Americans were taking it home in heaps because they were afraid of what might be going to happen on the Continent.

In the meantime, the run on Germany had to be met by shipments of gold, which, with receipts from Argentina, Australia, and the Cape, raised the Bank of England's stock to more than £160 millions at the end of June. Pressure on Germany, originating with the Hitler election, had been revived and intensified in the middle of May, when it became known, to the astonishment of even the best informed, that the Austrian Credit-Anstalt, the largest and most important bank in what is left of Austria, was in serious difficulties. Not long before it had to come to the rescue of the Bodencredit-Anstalt, and in so doing had assumed liabilities much greater than it had expected. Austria also had indulged in a pale reflection of Germany's Hitler election. In her case it took the form of an attempt at a *coup d'état* by the Heimwehr. Austria's position had been extremely difficult ever since the Treaty of Versailles had left her a trunkless head, with all her former

markets cut off by high tariffs imposed by the Succession States. As elsewhere on the Continent, her banks were deeply committed in her industries as joint-owners rather than creditors, and so industrial depression led to general mistrust of the banking position in Central Europe, and indeed all over the Continent. Unable to raise long-term loans, owing to the state of the capital market, European countries had been obliged to finance themselves by means of short-term credits raised through their banks, and were about to reap a harvest of disaster from this policy.

Then, in this miserable spring of 1931, when, if cheap money had really been an infallible cure for economic ills, cheerfulness and revival should have been the order of the day, banking instability was reinforced as a cause of anxiety by fresh developments of political bitterness. In March the diplomatic world had been startled by the sudden announcement of a proposal for a customs union between Germany and Austria. Tactfully handled, such a scheme need not have roused much bitterness. Announced as it was, it produced explosions of resentment in Czechoslovakia and France, where it was regarded as a violation of the Versailles

Treaty ; and it was described by the *London Times*, in a leading article in its issue of April 27, as an attempt by the two German-speaking countries to "steal a march on the rest by arranging secretly to effect their economic unification." The question whether it was an infraction of treaty obligations was first referred, at the suggestion of Mr. Henderson, then British Foreign Minister, to the Council of the League of Nations, and by it to the Court of International Justice, which expressed the opinion on September 5, by eight votes to seven, that it would "not be compatible with the 1922 protocol." But five days before this opinion was delivered the project had been dropped. In the meantime it had had important effects on French action.

Another event that exacerbated French suspicions concerning German sentiment and ambitions was a "Stahlhelm" demonstration at Breslau held on Sunday, May 31, when a spectacular parade of 150,000 steel helmets was graced by the official presence of the ex-Crown Prince, Marshal Mackensen, and General von Seeckt, and by the telegraphed approval of President Hindenburg. In the opinion of the Paris correspondent of the *Economist*, expressed in a letter published in its issue of June 6, 1931, this was "perhaps

the most unfortunately timed form of manifestation that could have been hit upon in view of present Franco-German relations and the general European situation. The bellicose display on the Polish frontier, following the one on the western front a year ago, has had the worst possible effect on French opinion. The corrosive effect on the man in the street of the photographs reproduced here " (in Paris, that is) " showing the ex-Crown Prince and other German war-leaders in full uniform proudly watching the march past of the Steel Helmets, is to be observed on every hand."

Such was the atmosphere in which Europe had to face her banking troubles. It may have been short-sighted on the part of the French authorities, when appealed to for help financial for the Central European countries, to boggle about the customs union and their political intentions, but no one can deny that it was extremely natural.

By the end of May, however, it was hoped that the Credit-Anstalt affair and the Austrian difficulties had been patched up by the intervention of the Bank for International Settlements, with the support of ten of the leading central banks and a strong international committee ; and the *Economist* was able to

say, in its issue of June 6, that "regarded as a proof of the reality of international co-operation in the spirit of Basle and Geneva, the episode, regrettable as it is, has its brighter side."

But it was very soon seen that banking co-operation was not enough and that things could only go from bad to worse until the statesmen provided the monetary and business machine with the essential requirements that they so long had lacked, of political security and confidence. The revelation of banking weakness in Europe had revived and quickened the run on Germany, and on June 6 the apprehensions of her creditors were increased still further by a manifesto issued by the German government. It was reported by the *Times* Berlin correspondent as being interpreted there as a notification to the whole world that Germany "considers herself to have reached the end of her tether unless it is in some way eased." The manifesto stated that the Reich had reduced its expenditure by £75 millions ; that Germany had made every effort to fulfil the obligations resulting from a lost war, having made for this purpose extensive use of foreign assistance, which was then no longer available ; that the privations which she could impose on

her citizens had reached their limit ; that the economic and financial position of the Reich, which was seriously menaced, inevitably compelled the relief of Germany from the intolerable Reparations burden ; and that the economic recovery of the world was at stake.

Such a statement was not calculated to restore confidence, necessary though it may have been in order to call attention to a situation that had become intolerable. Obviously Germany could not be expected at once to pay Reparations and meet the demands of panic-stricken money-lenders, who were pulling funds out of her, not owing to economic changes in Germany, but to " occurrences of another kind," including the troubles of the Credit-Anstalt, and perhaps also the political difficulties that at one time menaced the stability of Dr. Brüning's Government. This phrase was included in an explanation given by Dr. Luther, the President of the Reichsbank, of the reasons why it had been found necessary to raise its discount rate to 7 per cent. on June 13 owing to foreign withdrawals of credit and sales of securities. According to the *Times* correspondent, the withdrawals were chiefly on American account. France was believed

to have had little part in the run in the first half of June, having cleared most of her money out in the previous autumn, after the Hitler election. According to a statement made later on by Herr Dietrich, the Finance Minister, the losses suffered by the German economic system since the date of the election had amounted to between 3,000 and 4,000 million marks' worth of foreign exchange—£150,000,000 to £200,000,000 had been dragged out of her by terrified creditors. When universal funk is on this scale, tearing cash out of banks and throwing securities on to already demoralised markets, banking co-operates in vain. Since the funk was largely political, confidence could only be restored by political action.

This was at last perceived by President Hoover. During the week following the raising of its rate by the Reichsbank the run on Germany was quickened rather than assuaged, and the position became so serious that the Bank of England was impelled to cut through discussions raised by the Bank of France concerning political guarantees to be given before assistance could be furnished, and lend £4 $\frac{1}{4}$  millions to the Austrian National Bank. On June 20 President Hoover played his great stroke.

As described by the Washington correspondent of the *Times*, in a message telegraphed on June 21, "the climax of fifty hours of almost uninterrupted toil to produce a plan which is to meet the gathering emergency of the moment came with a suddenness that electrified Washington a little after a quarter past six o'clock last evening, when President Hoover, speaking in a voice strained by excitement and exhaustion, announced the proposal of the United States Government for the postponement during one year of all payments, both of interest and principal, on inter-governmental debts."

It was a very brave act in view of the trend of American opinion, the deficit (of £180 millions) with which the American Government was faced for the financial year just ending, and the lately expressed views of the Administration against any kind of war-debt revision. But, like other brave acts in history, it may have been prompted largely by fear. During the first six months of 1931, 685 banks failed in the United States, and though most of them were small and unimportant their aggregate deposits came to more than £90 millions, and this big loss inflicted on depositors, added to all the other causes of mistrust and depression, must

have been a cause of serious anxiety to the President and his advisers. America had crowned her banking system with the impressive edifice of the Federal Reserve banks, and had been told that such a thing as panic, due to lack of credit, could never happen again ; but she had forgotten to reform the foundation, consisting of 27,000 banks, many of them tiny, weak, and helplessly dependent on the prosperity of a local industry. The President had, just before he played his stroke, been touring in the Middle West, a region with many German commitments and connections, and it is more than probable that the anxiety that he there heard expressed concerning the possible effects on American banking of a breakdown in Germany, combined with the reports that he was receiving from Mr. Mellon, who was in Europe, of the outlook on this side of the Atlantic, induced him to make his great effort.

Its effect was immediate and electric. There was a gasp of relief in all the bourses and stock exchanges and commodity markets, from everybody except the bears, who were caught short and rushed to take cover, causing an upward rush in prices. " Isn't it good to smell a whiff of bear's grease again ? " said a veteran jobber in Throgmorton Street,

who had seen many bear-hunts in his day. It looked, for a few days, as if the Hoover suspension had saved the situation, and as if world trade, after toiling round a vicious circle for nearly two weary years, was in the straight for recovery. It was easy to jump to the conclusion that suspension meant revision of inter-governmental debts. Cheap money was there. Productive power was there. All that was wanted was confidence, and political co-operation was, at long last, going to give it to us.

But it was too good to be true. The Hoover scheme, to work its beneficent effect, had to be accepted quickly. England and Italy accepted at once, England applying acceptance not only to inter-Ally war debts, but also to inter-Imperial and after-War relief debts. She thus inflicted a loss of about £11 millions on the disordered finances of her Treasury, in spite of the generous refusal of the South African Dominion to take advantage of the war-debt relief. But France, very naturally from her point of view, wanted to know why she should suffer a loss of revenue estimated at nearly £20 millions in order to relieve her dangerous neighbour, who had lately, by the handling of the customs union proposal, the Stahlhelm

demonstration, and the production of a pocket-battleship, shown propensities that were regarded by Frenchmen as suspicious. If suspension of Reparations was to be sanctioned, with revision to follow, France wanted to be assured that the relief given to Germany would not be used to endanger France's security ; and it was only after nearly three weeks of negotiations that America and France were able to find terms of general agreement to the Hoover scheme.

This delay was fatal to the success of the scheme, though its acceptance, belated as it was, did give genuine relief to the debtor powers, and also had the very important effect of putting debt suspension and revision into the realm of practical politics, by the action of the chief creditor. But in the meantime the suspicion, current on the Continent, that Mr. Hoover had advised suspension in order to allow American banks to get their money home from Germany, revived the run again, in spite of the granting of a £20 million credit to the Reichsbank by the Bank for International Settlements, the Federal Reserve Board of the United States, the Bank of France, and the Bank of England. It is probable that panic was intensified all through this dreary period by

the modern rapidity of communication. The fact that the use of the telephone reduced the whole Continent to a condition of chattering neurasthenia has to be set against the ease with which those who, working on the side of sanity, were able to take counsel together across the Atlantic. The aeroplane now made its first appearance as a helpmeet in crisis. On July 9, 1931, Dr. Luther, President of the Reichsbank, flew to London to confer with the Governor of the Bank of England, and they left together for the Continent, Mr. Norman for Basle and a meeting of the Bank for International Settlements and Dr. Luther for Paris *en route* for Basle. It is said that while in Paris he discussed the terms of a long-term loan, but was baffled by political conditions attached to it, which no German Government could have survived after accepting.

In the meantime the £20 million credit, far from restoring confidence, had merely enabled the panic-stricken horde to take so much more out of Germany, without any sign of a pause in the run. On July 13 it was known that the Darmstädter and National Bank was unable to open its doors, and the suspension of this great and important bank caused a general run on the

German banks by their domestic customers. Prompt action was then taken by the German authorities. The Government guaranteed the deposits of the Darmstädter Bank, closed the Bourse, and ordered the rationing of foreign exchange. It also issued a decree closing all banks and credit institutions, including savings banks, in Germany on the next two days—July 14 and 15.

At Basle the Board of the Bank for International Settlements held an almost continuous session of over twelve hours and heard a statement of the position in Germany put before it by Dr. Luther, who had flown thither to deliver it; the B.I.S. Board then issued a pronouncement to the effect that it was prepared to collaborate in any measures of assistance that might be secured for Germany by the various Governments to which the German Government had applied for assistance, and that in the meantime the B.I.S. was prepared to renew its participation in the credit granted to the Reichsbank. This communication intimated, in effect, that the central bankers who composed the Board of the B.I.S. handed the problem, as being too political for them to tackle, back to the Governments. It was evident that unless the Governments could restore political

confidence, further grants of credit to Germany merely whetted the appetite of those who were dragging money out of her.

This announcement inevitably increased the general nervousness and widened the area of bank failures. On July 14, when the Bourse and all the banks in Germany were closed, as already recorded, a three days' "bank holiday" was decreed in Hungary, there were failures in Vienna, Rumania, and Latvia, and in Dantzic the banks only permitted withdrawals of 10 per cent. of deposits. Next day the Reichsbank put up its official rate to 10 per cent., without, of course, producing the smallest effect on the nerves of the panic-stricken creditors of Germany. The Paris Bourse re-opened after the national holiday with a flood of liquidation, and French withdrawals of money from London began again. But late that night it was announced that the British government had invited ministers of the chief European Powers to attend a conference in London. This announcement had some effect in quieting the prevalent hysteria, and its soothing influence was increased when it was known that two distinguished American representatives, Messrs. Stimson and Mellon, would attend the conference.

Its discussions, however, merely demonstrated the helplessness of the politicians in trying to mend an evil that was chiefly political in origin. This fact, and their own consequent responsibility, they in effect, admitted by stating in the *communiqué* that they produced, that "lack of confidence in Germany was not justified by the budgetary and economic situation." But having thus confessed that the trouble was a statesmen's job, they handed it back to the bankers, merely suggesting that the £20 millions credit to the Reichsbank should be renewed at due date for three months, that concerted measures should be taken by financial institutions to maintain the volume of credits granted to Germany, and that the B.I.S. should set up a committee to inquire concerning Germany's further credit needs and the possibility of converting short-term into long-term credits. And then they went home, without having succeeded in relieving by one jot or tittle the political tension that was the root cause of the mischief.

And so the bankers got to work again and after an immense amount of labour and discussion devised a scheme for carrying out the suggestion made—or rather echoed, for they had not originated it—by the statesmen ;

namely, that the bankers and money-lenders of all countries that had lent money to Germany should agree that the aggregate amount lent by each country should not be diminished during a period of six months. This scheme was successfully concluded on August 19, and was known as the "standstill agreement." It gave a breathing space to Germany and, incidentally and indirectly, knocked England off the gold standard.

## CHAPTER V

### THE COLLAPSE OF THE GOLD STANDARD

The Cash-Grabbing Mania—Its Extent and Virulence—Its Effects in America—Diverted from Germany, turns to England—England's Disordered Finances—Political Criticisms—The May Report—Did They Cause the Run?—External Panic—M. Rist's Testimony—England's Efforts to Save the Pound—Borrowing Abroad—Change of Government—Balancing the Budget—The Run Continues—The "Naval Mutiny"—The Fall of the Pound—Its Consequences—The Gold Standard Shattered.

It has been shown in previous chapters how two chief causes had reduced the world's monetary system to a farce. These were political bitterness and apprehension, and the misuse by the United States of its suddenly acquired domination in world finance. These causes had dried up the international capital market, or rather had reversed its flow. Instead of a fertilising stream, as it had been in pre-War times, pouring out more than £300 millions year by year to quicken enterprise and develop-

ment and provide purchasing power to the growing countries, it had become a yawning sewer, down which panic-stricken holders of international securities were throwing bonds and stocks and shares and turning them into cash at prices which, by their inevitably rapid fall, increased the general apprehension. Continental and American banks that had lent money against the pledge of these discredited bonds increased the embarrassments of their customers by calling in loans ; and their customers, knowing how many bad debts the banks were reaping in the process, and knowing also, or believing, that the banks themselves were losing heavily on their investments, increased the embarrassments of the banks by taking their money away and locking it up in safe deposit vaults or putting it into some hole or corner in their own homes. In such an atmosphere no monetary system, however cunningly devised and wisely administered, could save mankind from its own folly.

America had led the way down this dance of disaster. She has been severely blamed, especially by her own domestic critics, for having ignored her responsibilities as world creditor, in marked contrast with the policy of England when holding that position.

Professor Rogers of Yale, in his book, *America Weighs her Gold*, says, "We are neither knaves nor care-free morons, but simply children. It is not a matter of shirking our international responsibilities; we do not even know that we have any. To most of us, foreign peoples and their problems are still as remote as the 'unfortunate' heathen for whom we used to contribute our pennies in Sunday school. In such a spirit and from such a point of view the average American regards his international obligations."

But what else was to be expected of a people largely composed of the descendants of those who had left Europe and the British Isles in order to better themselves economically and politically? It was natural enough for them to think that America is the only country that matters, and to be slow in learning that even America cannot prosper unless she shares her prosperity with the rest of the world. And so her inhabitants, intoxicated with the exuberance of their own immeasurable possibilities, produced that stock exchange boom and collapse that was the beginning of the trouble.

And then political fear took up the running, beginning with the Hitler election,

and making French investors all the more apprehensive and inclined to hoard, and making the French Government slow in consenting to the relief of Germany. We have seen how the London Conference of statesmen in August 1931 broke up having achieved nothing and having merely handed back the German problem to be dealt with by the bankers ; and we shall see as we go on how often the bankers have—so far in vain—reminded the statesmen that the problem is political, and that unless they can give the Continent peace and confidence the banker-watchman waketh but in vain.

In the meantime, as recorded at the end of the last chapter, the bankers did succeed, after prolonged and difficult discussions, in giving a breathing space to Germany through the "standstill agreement," which stopped the run on Germany. But this was like quenching a fire in one corner of a blazing building, with the result that the fire breaks out all the more fiercely in another. In the then prevalent temper of bankers and their customers in most countries of the world, they had to run on somebody. The cash-grabbing craving had become too general.

In a letter published by the *Morning Post*

of January 5, 1932, from its Washington correspondent, he relates stories of an old woman who had buried dollar bills in a cabbage patch, an iceman who had hidden his money in an old horse-collar, till he found that his horse was chewing up the collar and was just going to swallow the notes, a man who had hidden his money in a stove, until a sudden cold spell led his wife to light a fire and the dollars went up in smoke, and so on. All very amusing, but the cumulative effect of this relapse into economic barbarism by a country so rich and with its wealth so well distributed as America, was terrific. From the *Times* of January 7, 1932, we learn that, according to information furnished to the Banking and Currency Committee of the United States Senate, the total assets of American banks which had been closed since October 1929 amounted to more than 2,000 million dollars (£400 millions at par), and that 2,290 banks closed in 1931. As to the extent of the hoarding and its effects, another Washington message, published in the *Times* of January 14, 1932, tells us that : “ One of the largest banks in the country has calculated that the bank deposits of the United States have decreased by over 2,000 million dollars since September, and the

assumption is that this amount represents the total present hoarding of the American people. It is asserted, moreover, that every dollar of money represents ten dollars of potential credit and that credit facilities have consequently been reduced by 20,000 million dollars. Small wonder, if this is true, that the same great bank reports the country to be full of people who want to borrow money for legitimate purposes but can find no lenders."

With these things happening in the country in which banking facilities are, perhaps, more widely used in normal times than anywhere else, it is not surprising that on the Continent, where banking conditions have always been more or less medieval, hoarding of notes and even of gold has been immensely stimulated by political fears added to financial funk and the unsavoury terrors produced by both breeding together in lecherous fertility. A French banker lately in London reported that the most active business institutions abroad were those that had *coffres forts* to let and were besieged by queues of anxious hoarders. Dr. Robert Eisler, in his book *This Money Maze*, which gives a very interesting account of Continental conditions during the crisis, relates that "the safe-

guards provided by the gold bullion law against an internal rush are being undermined in France, small capitalists begin to band together in saving clubs for the purpose of collectively exchanging the legal minimum of 215,500 francs against one ingot of gold." He adds that the Swiss cantonal banks are reported to be hoarding gold and that a Dutch joint-stock bank was known to have converted all its cash reserves into bullion. Cash-grabbing, when on this universal scale, is, of course, the negation of all banking, which works on the principle that the cash demand of one customer will be balanced by the cash deposit of another, and that a large proportion of the funds deposited with banks may safely be lent. It is by this lending business that banks justify their existence. By it they finance trade and enterprise, and any bank that kept a store of cash sufficient to meet all its liabilities would be failing to fulfil its true function. Consequently any bank that is doing its job properly is bound to fail if the cash-grabbers make big enough demands on it and if at the same time it is unable, owing to panic conditions, to sell securities, call in loans, or borrow from other institutions.

So it proved with England when the run

on Germany became a run on London, as it did in July, 1931. England was the only country in which there had been no trace or suspicion of banking weakness or panic. Her public finances were seriously disordered, according to her high ideals and careful practice in this matter ; and owing to the existence in office of a Labour Government whose methods were open to criticism, the Opposition press and politicians had been, as is usual on such occasions, making rather more than the most of this opportunity, and maintaining that a spendthrift Government was driving the country towards bankruptcy, and so on. They made effective use of some observations uttered in January 1931 by Sir Richard Hopkins, a distinguished Treasury official, in examination by the Unemployment Insurance Commission : he pointed out that the extent to which unemployment benefit was being paid out of borrowed money was relieving current State obligations at the expense of the future, and that this was the "ordinary and well-recognised sign of an unbalanced Budget."

And then at the end of July, 1931, just after Parliament had adjourned, appeared the report of a Committee on National

Expenditure presided over by Sir George May, which said that "to produce a properly balanced Budget in 1932 including the usual provision for redemption of debt a deficiency of the sum of £119,000,000, say £120,000,000, has to be made good by fresh taxation or by economy." Commenting on this statement, which it described as sensational, the *Economist* of August 8, 1931, observed: "The need for radical retrenchment is so urgent that we sympathise with the obvious aim of the Committee to make the public's flesh creep. Nevertheless, for the sake of those who are not closely conversant with financial statistics, it is necessary to point out that this suggested figure of £120 millions deficit rather overpaints the gloom of the immediate budgetary prospect. The casual reader might deduce that actual national expenditure threatens to exceed actual national revenue by £120 millions in 1932-3. Happily the position is not anything like as bad as that. For accepting the Committee's own figures, £50 millions of the threatened deficit is accounted for by sinking fund applications and £40 millions by borrowings for the Unemployment Insurance Fund, which the Committee—in profound disagreement with the Chancellor

of the Exchequer—insist upon regarding as equivalent to Treasury borrowings for current expenditure.”

It certainly was strange that a Committee including two eminent accountants and presided over by a distinguished actuary should talk about a “deficiency” of £120 millions when more than £50 millions of the contemplated expenditure was to be devoted to debt redemption, which is not expenditure in any sense of the word except as vulgarly used. It is true that they mentioned debt redemption, but the Press headlines inevitably left it out. This May report, of course, was a glorious text for more Jeremiads from the Opposition, all of which were taken at their face value, and a good deal more, by foreign critics, who also greedily lapped up all that they were told about the decline in England’s balance of international payments.

In fact, many people believe that the May report, owing to the mistrust of British finance that it created abroad, drove England off the gold standard. This view, I think; under-rates the intelligence of the foreign cash-grabbers. It was not the prospect of a Budget deficit that made them run on London. They knew that the United States had already actually scored a deficit of £180

millions, but they were not (as yet) running on New York ; and afterwards, when England had got a new Government and it had rushed through, early in September, an Economy Bill and a new Budget that was going to balance, these measures of financial reform did not stop the run on London. It began in the middle of July before the May report had been published, and by the time this famous document had appeared the Bank of England had already lost £30 millions of gold in a fortnight and was appealing to New York and Paris for a credit of £50 millions—half from the Bank of France and half from the Federal Reserve bank of New York—and being promptly accommodated.

In favour of this view that foreign panic, due to foreign conditions, drove England off the gold standard, and that England's disordered finances and adverse balance of payments had little, if anything, to do with the fall of the pound, one can cite distinguished foreign authority. M. Charles Rist, a well-known monetary expert and at one time Vice-President of the Bank of France, wrote in the *Economist* of October 3, 1931, as follows :—

“ The pound has fallen, like a good soldier,

fighting for the stability of the currencies of Central Europe. It was because London had a large part of its resources immobilised in Germany and Austria that it was impossible during recent months to make good the withdrawals of foreign balances from London by calling in foreign credits. In a word, London was having to 'carry' not only its own currency, but that of a large part of Europe. The pound fell as a result of unjustifiable panic; the forces which led to its fall were largely external to England itself. In my opinion the financial crisis would never have become so acute as it did had it not been for the recrudescence in Europe during the past year of a policy of nationalism which superimposed on an already serious economic crisis a universal sense of political uncertainty."

It is true that M. Rist, with that habit of self-contradiction that is so unfortunately rife among great economists, has since published an article in *l'Information* of January 21, 1932, in which he charges England with having caused the whole crisis—the drain of gold to America in 1920–25, America's ill-considered foreign lending and speculative boom, etc.—by England's vain ambition (*prétention*) to bring the pound back to its

old gold parity, instead of devaluing it in 1920. It may be true that England made a mistake at that time by being too honest and too anxious not to rob her creditors, but it is a large order to suppose that any action of England's would have effectively checked America's ebullitions. They proceeded not from America's gold accumulations, which the Federal Reserve banks did their best to sterilise, but from America's juvenile joy in her war-gotten wealth and unbounded confidence in her own future. Of the two M. Rists, the "man of October 3," writing when the facts of the pound's fall were fresh, seems by far the more convincing witness.

On the same side we can cite the circular for September 1931 of the National City Bank of New York, which said that "of the various influences combining to unsettle sterling, the most immediate has doubtless been nervousness induced by the general situation in Europe." It relates that "when the financial crisis first broke out in Central Europe, London had stood like a bulwark of strength against the spread of the disorder," and that as the crisis spread, London itself eventually became involved. It alludes to the May report as "rather a shock to British credit," and as having given additional

impetus to the tendency for funds to leave England.

But in normal times such items as an unbalanced Budget, at a time when such a complaint was common throughout the world, or an adverse balance of payments, in the case of a country like England, with investments abroad still worth more than 3,000 million pounds, would have produced nothing worse than a headshake or two. Every one knew that England could and would balance her Budget when she set about it, and that she had a rich store of untapped taxable capacity in her great volume of imports, nearly all of which came in free of duty. London was the handiest place for frightened people to get money from quickly ; and so Continental panic, which England had strained herself in trying to allay, and the cash-grabbing mania that was prevalent in all other countries, toppled her off the gold standard.

She can also, I think, fairly claim that when the run came she did her very utmost to save the pound. As already related, the Bank of England at the end of July raised a credit of £50 millions in Paris and New York. When it was found that this assistance did not stop the run, Ministers were fetched

back from their holiday and measures for balancing the Budget, to suit the views of possible foreign lenders, were taken in hand and led to the break-up of the Labour Government, owing to the opposition of the majority of its members to the reduction of unemployment benefit. On August 24 a new Government was formed, composed of members of all three parties—Labour, Conservative, and Liberal; Parliament was summoned to meet on September 8 to pass a new Budget and an Economy Bill; and on August 28 it was announced that the Government had arranged for a credit of £80 millions in New York and Paris.

England thus had borrowed abroad £130 millions in all, purely to protect the pound, since she had no need of foreign money for any other purpose. She had got rid of a Government that had been conspicuous in extravagance, though not much more so than its predecessors, and replaced it with one pledged to reverse her whole financial policy and restore that order in her finances that was so glaringly absent in those of her neighbours who were lending her the money. There was also a probability that almost amounted to certainty that she would take measures to balance her international

trade account by the abandonment of the free trade policy, which many of her inhabitants cherished with more than religious fervour. If her own weaknesses had caused the run, surely it would have been stayed by these proofs of her determination to forswear sack and live cleanly.

But this did not happen. The new Government had an ample majority in Parliament, and on September 10 brought in a Budget which by big cuts in expenditure and heavy additions to taxation that was already heavier than any other country's, wiped the blots off England's financial scutcheon not only for the current year, but also for the year that was to follow. But the run only went on faster, because the cash-grabbers thought that if they did not get their money out before the foreign credits were exhausted, they would never be able to do so—which was certainly true, if they all went on taking it.

This dreary farce was played all the faster owing to talk about a General Election, though when it came, at the end of October, it gave Mr. Ramsay MacDonald's National Government the biggest majority that had ever been seen in England. And the last straw on the back of the golden camel was a

refusal of duty by a few sailors, who were discontented about a cut which they, with other members of the fighting and civil services, had suffered in their pay under the new Economy Bill. This "naval mutiny," as it was called, was seized on abroad as a portentous and terrifying event. Foreign observers had naturally forgotten that there had been a real naval mutiny at the Nore just before Nelson sank a French fleet in the bay of Aboukir. Their memories were fresh of mutinies at Kiel and Petrograd that heralded revolutions in Germany and Russia, and they jumped to the conclusion that all was over with England and the British Empire. "Our navy," said a determined English opponent of the gold standard, "has once more saved the country."

These things happened at the middle of September, and all through the week ending on September 19 there was acute panic on the Continental bourses and in Wall Street, and withdrawals of foreign money from London went on at a furious pace. On September 18, when the foreign credits were practically exhausted, the United States and French Governments were consulted as to the possibility of more accommodation. Their replies, as the Chancellor of the

Exchequer told the House of Commons, were friendly and sympathetic, but afforded no prospect of assistance on the necessary scale. More than £200 millions had been paid out by the London market since the middle of July, being provided by the foreign credits (amounting to £130 millions), by exports of gold, and by drafts on the Bank of England's stock of foreign currencies. No more credits were to be had. No more gold could be shipped because the Bank of England's remaining stock had to be kept with a view to the repayment of the foreign credits. The pound sterling "took the count" and on September 21, 1931, the Bank of England was released by Parliament from its obligation to meet its notes in gold.

Could anything more have been done to save the pound? Some of us in England, resenting the spectacle of the Bank of England and the British Government going hat in hand to foreign banks and Governments and begging for assistance, thought at the time that a good deal more than enough was done; that if none of these efforts had been made, other countries, to which the saving of the pound was more important than it was to England, would have supported it unsolicited; and that if they had not done so, the pound would

have gone without all these mendicancies. But on the whole, no doubt, it was right in the interest of England's good name as an honest debtor to try begging rather than bluffing, so that she might claim to have done all that was possible.

Even as it was, certain foreign critics have told us that if the Bank of England had offered more tempting terms to foreign moneylenders by putting up its rate during the time when the pound was toppling, the pound might have been saved. Such criticisms have been, as far as I have been able to collect them, uttered solely by academic voices, professors or economists. Any office boy in a business house would tell these eminent theorists that a debtor whose power to pay is doubted is much more likely to frighten money away than to attract it by bidding fancy prices for accommodation. But an ounce of fact is worth many tons of argument. During the run on Germany the Reichsbank raised its rate on June 13 to 7 per cent. and on July 15 to 10 per cent. without producing the smallest effect on the craving of the cash-grabbers to get money out of Germany if they could.

Another suggestion, perhaps even more absurd in the conditions then prevalent, was

that England might have done as she did during the War and "mobilised" some of her holdings of foreign securities. In the state of raging panic that afflicted all the foreign Bourses and stock exchanges at that time, it is really preposterous to suppose that England, with her own credit strained as far as it would go, could have found a syndicate of foreign lenders ready to lend, on the security of heavily depreciated oversea investments, the three or four hundred millions that might or might not have sufficed to meet all the demands of the cash-grabbers.

The abandonment of the gold standard by England produced much more effect abroad than it did at home. The stolid calm of the British public was really amazing in view of all the horrors that had lately been prophesied as likely to happen if the pound went off gold—it had been told that the pound would go the way of the mark, that there would be panic and runs on banks, a wild upward rush in prices, food hoarding, and all the terrors of rampant inflation. These pictures seemed to me at the time to be wildly overdrawn, because I did not believe that the British public would lose its head; but they were drawn by responsible statesmen, and it is possible that they might have

come true if the fall of the pound had happened under a Government that did not possess the confidence of the propertied classes.

As it was, to the astonishment of Continental observers, the British banks all opened for business as usual on the day when gold payments were suspended, and there was not the smallest trace of an abnormal demand for cash. There was no rise in retail prices. In fact, as foreigners began to pour in goods in anticipation of import duties (till they were stopped by anti-dumping measures), many articles became cheaper ; and at the Christmas and New Year sales in the winter of 1931-2 bargains were offered at cut-throat prices, partly owing to the policy of dear money and ruthless economy that the authorities were still enforcing.

To the domestic consumer, the pound was thus as efficient as it had been before in providing him with things that he needed ; and this was the aspect of the matter to which he, like a sensible person, gave most attention. In fact, he showed a good deal more intelligence about it than many of his leaders. A candidate addressing a political meeting in the contest before the General Election produced a pound note and told the audience that it was now worth fifteen shillings ;

whereupon a working man at the back of the hall pulled out a handful of silver and said, "I'll give you fifteen and six for it, mister."

While, however, the pound thus maintained its value at home, its fall in exchange value abroad cut away the shackles in which British industry had been struggling since the pound had been screwed up in 1925 to the pre-War parity with gold. With the pound at 3 dols. 50 instead of 4 dols. 86 odd, Americans who sold to England £100 worth of goods only got 350 dollars for them instead of 486 dollars; and Americans who bought £100 worth of British goods could pay for them with 350 dollars instead of 486 dollars. Thus there was a substantial check to imports and spur to exports, and England was a good country to buy from and a bad one to sell to. British industry had for years suffered from the dumping of goods poured in by countries that put up all possible barriers and restrictions against British exports, and had been penalised by high taxation and local rates, profligate extravagance on the part of Governments and municipal authorities, high wages and trade union restrictions, and in some cases, obsolete plant and conditions that needed reconstruction for which the necessary capital could not,

under these circumstances, be procured. All these disabilities were lightened, at least for the time being, by the depreciation in the exchange value of the pound and its above-mentioned effects. Small wonder that British industry gave a sigh of hearty relief when its golden fetters were broken, and that it will need a good deal of persuading before it will go back to them—a fact to be remembered when we come to wonder what will be the next stage in monetary development.

With the fall of the pound the gold standard, as a world-wide system linking together the moneys of all the chief commercial countries, was shattered. Some countries had abandoned it before England, impelled by force of circumstances; others followed England's fall by voluntary suspension. In most of those that still maintain it in appearance, it is in fact suspended by exchange restrictions. It is only really effective in America and, perhaps, in France. And so the fall of the pound, though it has greatly assisted the competitive power of British industry, has put fresh difficulties in its way by depriving world trade of a stable means of payment. How is this benefit to be restored?

## CHAPTER VI

### IN THE MELTING POT

An Opportunity—The Bankers' Warnings—Political Obstacles—Failure of the Gold Standard—Difficulties in the Way of its Restoration—Interesting Possibilities—A Paper Standard now at Work—Its possible Development and Extension—Difficulties and Objections—The Prevalent Terror of Inflation—Hope from America—Confidence the Real Cure.

So there we are, with the world's money machine in the melting pot and the gold standard no longer working as its basis. This gives us a great opportunity for rebuilding the money machine on new and better lines or reconstructing the old one, if we can make sure that its working will not be reduced to a farce again, as it has been in the last two years.

But in the meantime there is a possibility that not only the money machine but our whole economic machinery and civilisation may find themselves in the melting pot, owing to delay on the part of the statesmen

in curing the world of the perverted nationalism that is at the root of the gold standard's failure. On this point they have had repeated warnings from the bankers, whose efforts to keep the machine going they have defeated by their helpless impotence.

In August 1931 a bankers' committee at Basle, appointed on the recommendation of the London conference of statesmen that had met and done nothing, pointed out in its report that "time is short. The body of the world's commerce has suffered a severe shock in one of its members. This has resulted in a partial paralysis which can only be cured by restoring the free circulation of money and of goods. We believe that this can be accomplished; but only if the Governments of the world will realise the responsibility that rests upon them, and will take prompt measures to restore confidence. Their action alone can restore it. We think it essential that, before the period of prolongation of credits recommended by the London Conference comes to an end, they should give to the world the assurance that international political relations are established on a basis of mutual confidence, which is the *sine qua non* of economic recovery."

At the end of December 1931 a bankers'

committee summoned (again at Basle) to consider Germany's plea that she could not pay the Young plan Reparation annuities, said in its report that "the German problem—which is largely responsible for the growing financial paralysis of the world—calls for concerted action which the Governments alone can take. . . . The adjustment of all inter-governmental debts (Reparations and other War debts) to the existing troubled situation of the world—and this adjustment should take place without delay if disaster is to be avoided—is the only lasting step capable of re-establishing confidence, which is the very condition of economic stability and real peace."

And at the end of January 1932 a bankers' committee that had been arranging, at Berlin, for a renewal of the "standstill agreement" observed that "the all-important thing is to restore the basis of credit. It is obvious that a settlement of Germany's international payments . . . is a vital element in this problem as, indeed, are the inter-Allied debts, which are in intimate economic connection with them. But these questions, though they profoundly affect private credit, cannot be solved by bankers. The Committee can only repeat that they endorse all

that has been said by both Basle committees on these problems. . . . The present extreme crisis must bring home to all peoples of the world the fact that all countries grow poor together. The obverse is as true. All countries grow rich together. A lightening of burdens and a greater freedom of trade enriching one country, will enrich all."

In other words, the bankers told the statesmen that no money machine could work in a world given over to cash-grabbing, that cash-grabbing was due, originally, to lack of political confidence, and that unless the statesmen could do their job and supply confidence, disaster must follow.

Nationalism gone wild was at the root of the mischief. It had made the Americans ignore their position as the leading creditor country and work that boom and collapse that began the trouble. It had helped to make the Germans vote for Hitler and alarm the French. It had made the French, angry and frightened, run on Germany and spoil the effect of the Hoover suspension and bring Germany to the edge of bankruptcy, at a time when, as the statesmen admitted at the London Conference, "lack of confidence in Germany was not justified by the budgetary and economic situation." And Germany's

danger, stopped by the "standstill," had started the run on London and driven England off the gold standard. After that even America, already bothered by the domestic run on her banks, began to receive some attention from Continental cash-grabbers, who took home, in gold, their balances in the United States. This movement was met by a measure referred to below.

But in answer to these appeals from bankers' committees, set to making bricks for recovery without the essential straw of confidence, the statesmen were precluded from taking any prompt action by a highly characteristic reason. In the countries chiefly responsible for the mischief, they were all obliged for the moment to consider the feelings of the electorate, with a view to approaching elections. A conference at Lausanne that was to have been held at the end of January 1932 to consider what was to be done about Reparations at the end of the Hoover moratorium could not be held, because :

(1) Dr. Brüning, with an eye on German elections, had found it necessary to say that Germany could pay nothing. (Which was certainly true at the moment, but might be

quite untrue in a few years.) He could not consent to a continuance of the Hoover suspension but wanted immediate revision, apparently implying cancellation.

(2) M. Laval, with an eye on French elections, was ready to prolong the Hoover suspension, but only if France was relieved from War debts to a corresponding extent, and maintained that the Young plan must stand.

(3) Mr. Hoover, though he had done his best to induce his countrymen to see that War debts could not be collected and needed revision, was obliged, with an eye on American elections, to drop his effort like a hot potato. American opinion rightly believed that if Europe reduced expenditure on armaments it could pay its debts, and ignored the fact that America had sucked in about half the world's gold and would not take payment in goods.

So there is a horrible deadlock, which may or may not be relieved when the statesmen, with their vision unclouded by problems of local politics, can turn to the question of international confidence. In the meantime one hears of grim possibilities, such as a combination of Germany with Russia to set Europe in a blaze.

If, however, the world can live through this electioneering interval, there may be a possibility, at the end of it, that Germany may admit that she can pay something some day, that France may consent to a revision of the Young plan, and that America may admit that her own policy and actions have made it necessary for War debts to be revised ; and then a new scheme may be devised on the basis of payments varying with the price level, or some other test that may be taken of the progress and activity of world trade. If prices were back at the 1928 level the whole problem would look different. Only a definite scheme, agreed to as reasonable by all the parties, can restore confidence. But it is quite possible for a scheme to be definite, but at the same time to depend for its operation on the state of the world's trade and prosperity.

Having thus seen that this money muddle is political in essence and cannot really be straightened out unless the statesmen will give the business world confidence and stability in international relations, we can go on to consider whether the gold standard can be restored, and if so, ought to be ; and if not, what sort of a substitute can be found for it.

It has been shown that the gold standard broke down not through any weakness in it but because two important creditor countries, for reasons over which the banking authorities had no control, refused to lend or spend abroad, so sucking in gold, depressing prices, ruining debtors, and producing panic. Everyone, probably, in England who thinks at all about these matters agrees that there can be no return to the gold standard as long as there is any danger that such things can happen again. But how can the world be assured that the evils lately wrought by America's inexperience and France's political fears may not be repeated owing to similar action by these or other countries, for similar or other reasons? How can we be sure that the creditor countries will open the doors of their markets wider, so that the debtors may have a chance of sending in their goods to pay their debts withal? Or that political fears will never again cause an outbreak of cash-grabbing that will once more reduce international banking to a mixture of farce and tragedy?

In the light of these difficulties, the shock given to the gold standard by the fall of the pound and the consequent obstacles to its economical working in the future are of

minor importance. But they are real. For most central banks had a balance in London in order to economise gold, and lost heavily in consequence—the Bank of France lost over £20 millions. This loss, inflicted on those who supported the pound to the last, was the worst result of its fall. If the gold standard were restored central banks, once bit twice shy, might all want to keep their reserves in gold in their own vaults. This would cause an exaggerated demand for the metal, unless in the meantime they had all agreed to reduce their reserve ratios and requirements, and were prepared to act up to this policy.

Such are some of the difficulties in the way of the restoration of the gold standard. They come to this, that it can only be restored if the world can shed all its after-War bitter-nesses and bad tempers and become sane and civilised. In addition to these obstacles is the fact that British industry suffered dreary years under the gold standard, owing to its own inability to adapt itself to it, and now ascribes that unpleasant experience not to its own inadaptability but to the gold standard. When it is told that the mistake that caused its inconvenience was England's return to the old gold parity too soon, it is apt to suspect that the same sort of mistake may be made again.

At the moment the gold standard is distinctly an unpopular memory in British business circles.

In any case, however, it is clear that a long time must pass before restoration of the gold standard can be even considered; and in that interval all kinds of interesting things may happen. One is that the gold standard may restore itself, through America and France being so saturated with the metal that they may not only cease the suction process but disgorge their accumulations. If the rest of the world abandoned gold, it might pour into the laps of these two creditors not only all its stocks of the metal but also all the yearly produce of the non-American gold mines and also the hoards of India, amounting to more than £600 millions, which have been coming out at the rate of thirty millions in three months since the fall of the pound, and of the rupee which is linked to it, made sales of gold profitable to its Indian holders. Such a process must surely, in time, oblige France and America to play the gold standard game, expand credit, raise prices, and save the situation in so far as monetary measures can save it.

Or again, it is possible that these two countries may find their foreign trade and

(in the case of France) tourist business so ruined by the relative dearness of their moneys that an adverse balance of payments may oblige them to disgorge their golden heaps and distribute them among poorer countries that may make better use of them.

But these possibilities are so vague and elusive that the stage is left open for those who regard a gold or any metallic standard as a discredited barbarism, the one claim of which—that it did its work well on the whole—has been shattered by recent events. With these critics are ranged those who recognise that only a sane world is fit for a gold standard and are looking for some sort of arrangement that will serve as a padded room in which the world, as it now is, may foam at the mouth and bang its head against walls without hurting itself too much.

From this point of view, Mr. Keynes' scheme of a paper currency controlled so as to keep prices level acquires new attractions and possibilities. When originally suggested it was thought to be too clever, and most of us hoped that the gold standard would work again with something like its pre-War success. Now it is clear that though a managed paper currency runs many dangers of mismanagement and abuse, these dangers

are certainly no worse—and perhaps not as bad—as the horrors and absurdities perpetrated by panic-stricken cash-grabbers under the gold standard. Thanks to its provisions they were able by turning their claims on Germany and then on England into gold at a fixed price to reduce Germany to a “standstill agreement” and knock England off gold. With a paper currency standard, those who had claims on England in the form of pounds due to them could only turn them into so many pounds’ worth of goods or services, or securities or gold or foreign moneys that were offered for sale in England ; and there would be no question of a fixed price, as was the case with gold : every bargain would be settled as between willing buyer and willing seller.

“How,” it may be asked, “would any foreigner be induced to sell things to England with all this uncertainty before him as to what he was going to be able to get with the pounds fetched by the sale ?” And the answer is easy, that in fact foreigners are pouring goods into England as fast as England will buy on exactly these terms, and have been doing so ever since she went off the gold standard. The possibility of a paper basis for England’s money has been brought

much nearer by the fact that it is at the present moment not only possible but actually at work. How well it will work we have plenty of time to learn.

But what of the British exporter, so sorely let and hindered by exchange restrictions abroad and the uncertainty about the value in pounds of any foreign money that he may earn by his sales? This question of exchange stability is, of course, a serious crux to be faced by those who propose to provide the world with a new international currency that is to be an improvement on the gold standard. Something can evidently be done by arrangements between the central banks of any countries that adopt the new standard to keep, by the grant of mutual credits, their moneys sufficiently stable in relation to one another.

It is, in fact, suggested that arrangements of this kind should at once, or as soon as possible, be taken in hand by England and her Dominions and other countries that have abandoned the gold standard. Such a paper-money league, definitely formed with a view to combined working to maintain stability, would evidently have, in this fact, an advantage over the loose union of gold standard countries as it formerly existed. For the

gold union was not a union at all, but just a collection of countries that all used gold, and handled it with a degree of co-operation that varied with political and other influences. In the paper union, on the other hand, every member would join definitely with a view to working with the others in exchange regulation ; and this co-operation might evidently be extended to questions of trade and tariffs, and might be a useful influence in bringing the world back to sanity. At the same time the paper union evidently might arrange for working arrangements between itself and the gold standard countries.

Such pleasant possibilities are easy to depict on paper, but the difficulties in the way of their realisation are formidable. The mere task of controlling the internal price level by control of the volume of money is a large enough order ; for who can be sure as to what the public will do with the money or how fast it will turn it over ? And variations in velocity of circulation may make a big difference to the price level. But the problem of a managed paper money has been brought out of the realm of speculation and right into the realities of the market place by the fact that it is now actually at work in England, and that England, with or

without the co-operation of other countries that are in the same boat, is forced by circumstances to see how it can work.

New monetary schemes of divers kinds are, in these days, as plentiful as blackberries in autumn. An ingenious one is put forward in Dr. Eisler's book, already mentioned, on *This Money Maze*. With its two kinds of money, current and *banco*, it seems to me to be too complicated, and I find this view endorsed by practical business men. Also, in its international aspect, it appears to require an extent of international co-operation which, if only it could be secured, would enable mankind to work the gold, or almost any other, standard with ease and comfort.

Other schemes, notably one fathered by Mr. J. F. Darling, in his pamphlet on *Monetary Leadership*, include the restoration of silver to its old partnership with gold. Any proposal by which silver can be raised and steadied in price deserves the most careful consideration, in view of the bad effect of its fall on Eastern trade and the buying power of many millions of impoverished cultivators. But it ought to be possible to effect this by agreement among the Governments whose sales of demonetized

silver have been the chief cause of the fall ; and if the monetary problem is to be complicated by a revival of the Bimetallist controversy, Heaven knows how many years we shall take before arriving at a solution. It is true that we are told that gold is going to be too scarce to do its work as backing for the increased volume of currency required by expanding trade ; but if more rational views about the ratio of metal to paper can be adopted and acted on, the Golden Calf could be slimmed to a more athletic and efficient figure and do his work instead of eating his head off.

In the meantime, all countries are trying to outdo one another in cutting expenses, cutting wages, and cutting imports, by way of curing a crisis in which cheapness and glutted\* markets are the most serious symptoms. All the world is in such a terrible state of terror lest it should be suspected of indulging in inflation, that it threatens to drive itself into bankruptcy. If inflation means the sort of nightmare that happened in Germany after the War, this fear is evidently justified ; but it is surely possible to expand credit for legitimate business without rushing into such disastrous extremes. Inflation merely means a rise in prices due to

monetary causes, and a rise in prices is exactly what is wanted to cure the effects of a catastrophic fall that has brought most of the world to the edge of ruin. If the present level of prices is to be permanent, there will have to be a general scaling down of debts, public and private, involving a shock to the credit system from which it might never recover.

Why then all this horror of inflation if properly controlled, as it evidently could be in England, as was shown by the refusal of the public to lose its head, in spite of all that it had been told by its political leaders, at the time of the fall of the pound? Freed from her gold fetters, England has a splendid chance to lead the world back to sanity under a Government enjoying the confidence of industry and business, and with growing evidence of returning foreign confidence in the pound; but her chief pre-occupation, at least up to the middle of February 1932, seems to have been to check by dear money and other restrictions any possibility of the rise in prices that is the only alternative to general collapse. Since then, however, there has been a welcome change in policy.

America appears to be going to try to put prices up, while loudly protesting that there

is to be no inflation. With a Reconstruction Finance Corporation, ready to lend \$2,000,000,000, and a reform of the Federal Reserve note issue which is estimated to be going to set free \$1,000,000,000 of gold, and, as a gentleman said in Congress, enable France to "take her gold and go to Hell with it," \* America surely ought to regain her confidence in her banks, and in her own recuperative power, and regain her business nerve. Mr. Henry Ford is doing his best at the industrial end of the problem, and has announced that his company is prepared to risk "everything that we have got" in an endeavour to turn the tide of depression.†

If these efforts succeed and raise the prices of wheat, copper, rubber, tea, coffee, oil, and other commodities and materials, the whole position would be altered as in the twinkling of an eye. If we could get prices back to the 1928 level, most of the ruined debtors and defaulting states would be on their legs again.

But whatever is done about money will not help much without political confidence abroad—if we had that, money would come out of hoards on the Continent and in

\* *Times*, February 17, 1932.

† *Times*, February 29, 1932.

America and pour into markets for commodities and securities. It would then be seen that almost any sort of money machine will work, more or less, as long as international goodwill and sanity are behind it. Which is no reason for not trying to make the money machine as good and efficient as possible.

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