THE RETURN TO THE GOLD STANDARD

1. Auri Sacra Fames (Sept. 1930)

The choice of gold as a standard of value is chiefly based on tradition. In the days before the evolution of Representative Money, it was natural, for reasons which have been many times told, to choose one or more of the metals as the most suitable commodity for holding a store of value or a command of purchasing power.

Some four or five thousand years ago the civilised world settled down to the use of gold, silver, and copper for pounds, shillings, and pence, but with silver in the first place of importance and copper in the second. The Mycenaeans put gold in the first place. Next, under Celtic or Dorian influences, came a brief invasion of iron in place of copper over Europe and the northern shores of the Mediterranean. With the Achaemenid Persian Empire, which maintained a bimetallic standard of gold and silver at a fixed ratio (until Alexander overturned them), the world settled down again to gold, silver, and copper, with silver once more of

predominant importance; and there followed silver's long hegemony (except for a certain revival of the influence of gold in Roman Constantinople), chequered by imperfectly successful attempts at gold-and-silver bimetallism, especially in the eighteenth century and the first half of the nineteenth, and only concluded by the final victory of gold during the fifty years before the war.

Dr. Freud relates that there are peculiar reasons deep in our subconsciousness why gold in particular should satisfy strong instincts and serve as a symbol. The magical properties, with which Egyptian priestcraft anciently imbued the yellow metal, it has never altogether lost. Yet, whilst gold as a store of value has always had devoted patrons, it is, as the sole standard of purchasing power, almost a parvenu. In 1914 gold had held this position in Great Britain *de jure* over less than a hundred years (though *de facto* for more than two hundred), and in most other countries over less than sixty. For except during rather brief intervals gold has been too scarce to serve the needs of the world's principal medium of currency. Gold is, and always has been, an extraordinarily scarce commodity. A modern liner could convey across the Atlantic in a single voyage all the gold which has been dredged or mined in seven thousand years. At intervals of five hundred or a thousand years a new source of supply has been discovered—the latter half of the nineteenth century was one of these epochs—and a

temporary abundance has ensued. But as a rule, generally speaking, there has been not enough.

Of late years the *auri sacra fames* has sought to envelop itself in a garment of respectability as densely respectable as was ever met with, even in the realms of sex or religion. Whether this was first put on as a necessary armour to win the hard-won fight against bimetallism and is still worn, as the gold-advocates allege, because gold is the sole prophylactic against the plague of fiat moneys, or whether it is a furtive Freudian cloak, we need not be curious to inquire. But we may remind the reader of what he well knows—namely, that gold has become part of the apparatus of conservatism and is one of the matters which we cannot expect to see handled without prejudice.

One great change, nevertheless—probably, in the end, a fatal change—has been effected by our generation. During the war individuals threw their little stocks into the national melting-pots. Wars have sometimes served to disperse gold, as when Alexander scattered the temple hoards of Persia or Pizarro those of the Incas. But on this occasion war concentrated gold in the vaults of the Central Banks; and these Banks have not released it. Thus, almost throughout the world, gold has been withdrawn from circulation. It no longer passes from hand to hand, and the touch of the metal has been taken away from men's greedy palms. The little household gods, who dwelt in purses

and stockings and tin boxes, have been swallowed by a single golden image in each country, which lives underground and is not seen. Gold is out of sight—gone back again into the soil. But when gods are no longer seen in a yellow panoply walking the earth, we begin to rationalise them; and it is not long before there is nothing left.

Thus the long age of Commodity Money has at last passed finally away before the age of Representative Money. Gold has ceased to be a coin, a hoard, a tangible claim to wealth, of which the value cannot slip away so long as the hand of the individual clutches the material stuff. It has become a much more abstract thing—just a standard of value; and it only keeps this nominal status by being handed round from time to time in quite small quantities amongst a group of Central Banks, on the occasions when one of them has been inflating or deflating its managed representative money in a different degree from what is appropriate to the behaviour of its neighbours. Even the handing round is becoming a little old-fashioned, being the occasion of unnecessary travelling expenses, and the most modern way, called "ear-marking," is to change the ownership without shifting the location. It is not a far step from this to the beginning of arrangements between Central Banks by which, without ever formally renouncing the rule of gold, the quantity of metal actually buried in their vaults may come to stand, by a modern alchemy, for

what they please, and its value for what they choose. Thus gold, originally stationed in heaven with his consort silver, as Sun and Moon, having first doffed his sacred attributes and come to earth as an autocrat, may next descend to the sober status of a constitutional king with a cabinet of Banks; and it may never be necessary to proclaim a Republic. But this is not yet—the evolution may be quite otherwise. The friends of gold will have to be extremely wise and moderate if they are to avoid a Revolution.

2. Alternative Aims in Monetary Policy (1923)[1]

The instability of money has been compounded, in most countries except the United States, of two elements: the failure of the national currencies to remain stable in terms of what was supposed to be the standard of value, namely gold; and the failure of gold itself to remain stable in terms of purchasing power. Attention has been mainly concentrated (*e.g.* by the Cunliffe Committee) on the first of these two factors. It is often assumed that the restoration of the gold standard, that is to say, of the convertibility of each national currency at a fixed rate in terms of gold, must be, in any case, our objective; and that the main question of controversy is whether national currencies should be restored to their pre-war gold value or to some lower value nearer to the present facts; in other words, the choice between *Deflation* and *Devaluation*.

This assumption is hasty. If we glance at the course of prices during the last five years, it is obvious that the United States, which has

[1] [*I.e.* prior to the restoration of the Gold Standard in Great Britain.]

enjoyed a gold standard throughout, has suffered as severely as many other countries, that in the United Kingdom the instability of gold has been a larger factor than the instability of the exchange, that the same is true even of France, and that in Italy it has been nearly as large. On the other hand, in India, which has suffered violent exchange fluctuations, the standard of value has been more stable than in any other country.

We should not, therefore, by fixing the exchanges get rid of our currency troubles. It is even possible that this step might weaken our control. The problem of stabilisation has several sides, which we must consider one by one:

1. Devaluation *versus* Deflation. Do we wish to fix the standard of value, whether or not it be gold, near the existing value? Or do we wish to restore it to the pre-war value?

2. Stability of Prices *versus* Stability of Exchange. Is it more important that the value of a national currency should be stable in terms of purchasing power, or stable in terms of the currency of certain foreign countries?

3. The Restoration of a Gold Standard. In the light of our answers to the first two questions, is a gold standard, however imperfect in theory, the best available method for attaining our ends in practice?

(i) *Devaluation* versus *Deflation*

The policy of reducing the ratio between the volume of a country's currency and its requirements of purchasing power in the form of money, so as to increase the exchange value of the currency in terms of gold or of commodities, is conveniently called *Deflation*.

The alternative policy of stabilising the value of the currency somewhere near its present value, without regard to its pre-war value, is called *Devaluation*.

Up to the date of the Genoa Conference of April 1922, these two policies were not clearly distinguished by the public, and the sharp opposition between them has been only gradually appreciated. Even now (October 1923) there is scarcely any European country in which the authorities have made it clear whether their policy is to stabilise the value of their currency or to raise it. Stabilisation at the existing level has been recommended by International Conferences; and the actual value of many currencies tends to fall rather than to rise. But, to judge from other indications, the heart's desire of the State Banks of Europe, whether they pursue it successfully, as in Czecho-Slovakia, or unsuccessfully, as in France, is to *raise* the value of their currencies.

The simple arguments against Deflation fall under two heads.

In the first place, Deflation is not *desirable*, because it effects, what is always harmful, a

change in the existing Standard of Value, and redistributes wealth in a manner injurious, at the same time, to business and to social stability. Deflation, as we have already seen, involves a transference of wealth from the rest of the community to the rentier class and to all holders of titles to money; just as Inflation involves the opposite. In particular it involves a transference from all borrowers, that is to say from traders, manufacturers, and farmers, to lenders, from the active to the inactive.

But whilst the oppression of the taxpayer for the enrichment of the rentier is the chief lasting result, there is another, more violent, disturbance during the period of transition. The policy of gradually raising the value of a country's money to (say) 100 per cent above its present value in terms of goods amounts to giving notice to every merchant and every manufacturer, that for some time to come his stock and his raw materials will steadily depreciate on his hands, and to every one who finances his business with borrowed money that he will, sooner or later, lose 100 per cent on his liabilities (since he will have to pay back in terms of commodities twice as much as he has borrowed). Modern business, being carried on largely with borrowed money, must necessarily be brought to a standstill by such a process. It will be to the interest of everyone in business to go out of business for the time being; and of everyone who is contemplating expenditure to postpone his orders so long as he can. The wise man will

be he who turns his assets into cash, withdraws from the risks and the exertions of activity, and awaits in country retirement the steady appreciation promised him in the value of his cash. A probable expectation of Deflation is bad enough; a certain expectation is disastrous. For the mechanism of the modern business world is even less adapted to fluctuations in the value of money upwards than it is to fluctuations downwards.

In the second place, in many countries, Deflation, even were it desirable, is not *possible*; that is to say, Deflation in sufficient degree to restore the currency to its pre-war parity. For the burden which it would throw on the taxpayer would be insupportable. This practical impossibility might have rendered the policy innocuous, if it were not that, by standing in the way of the alternative policy, it prolongs the period of uncertainty and severe seasonal fluctuation, and even, in some cases, can be carried into effect sufficiently to cause much interference with business. The fact, that the restoration of their currencies to the pre-war parity is still the declared official policy of the French and Italian Governments, is preventing, in those countries, any rational discussion of currency reform. All those—and in the financial world they are many—who have reasons for wishing to appear "correct," are compelled to talk foolishly. In Italy, where sound economic views have much influence and which may be nearly ripe for currency reform, Signor Mussolini has threatened

to raise the lira to its former value. Fortunately for the Italian taxpayer and Italian business, the lira does not listen even to a dictator and cannot be given castor oil. But such talk can postpone positive reform; though it may be doubted if so good a politician would have propounded such a policy, even in bravado and exuberance, if he had understood that, expressed in other but equivalent words, it was as follows: "My policy is to halve wages, double the burden of the National Debt, and to reduce by 50 per cent the prices which Sicily can get for her exports of oranges and lemons."

If the restoration of many European currencies to their pre-war parity with gold is neither desirable nor possible, what are the forces or the arguments which have established this undesirable impossibility as the avowed policy of most of them? The following are the most important:

1. *To leave the gold value of a country's currency at the low level to which war has driven it is an injustice to the rentier class and to others whose income is fixed in terms of currency, and practically a breach of contract; whilst to restore its value would meet a debt of honour.*

The injury done to pre-war holders of fixed interest-bearing stocks is beyond dispute. Real justice, indeed, might require the restoration of the purchasing power, and not merely the gold value, of their money incomes, a measure which no one in fact proposes; whilst nominal justice

has not been infringed, since these investments were not in gold bullion but in the legal tender of the realm. Nevertheless, if this class of investors could be dealt with separately, considerations of equity and the expedience of satisfying reasonable expectation would furnish a strong case.

But this is not the actual situation. The vast issues of War Loans have swamped the pre-war holdings of fixed interest-bearing stocks, and Society has largely adjusted itself to the new situation. To restore the value of pre-war holdings by Deflation means enhancing at the same time the value of war and post-war holdings, and thereby raising the total claims of the rentier class not only beyond what they are entitled to, but to an intolerable proportion of the total income of the community. Indeed justice, rightly weighed, comes down on the other side. Much the greater proportion of the money contracts still outstanding were entered into when money was worth more nearly what it is worth now than what it was worth in 1913. Thus, in order to do justice to a minority of creditors, a great injustice would be done to a great majority of debtors.

When, therefore, the depreciation of the currency has lasted long enough for Society to adjust itself to the new values, Deflation is even worse than Inflation. Both are "unjust" and disappoint reasonable expectation. But whereas Inflation, by easing the burden of national debt and stimulating enterprise, has a little to throw

into the other side of the balance, Deflation has nothing.

2. *The restoration of a currency to its pre-war gold value enhances a country's financial prestige and promotes future confidence.*

Where a country can hope to restore its pre-war parity at an early date, this argument cannot be neglected. This might be said of Great Britain, Holland, Sweden, Switzerland, and (perhaps) Spain, but of no other European country. The argument cannot be extended to those countries which, even if they could raise somewhat the value of their legal-tender money, could not possibly restore it to its old value. It is of the essence of the argument that the *exact* pre-war parity should be recovered. It would not make much difference to the financial prestige of Italy whether she stabilised the lira at 100 to the £ sterling or at 60; and it would be much better for her prestige to stabilise it definitely at 100 than to let it fluctuate between 60 and 100.

This argument is limited, therefore, to those countries the gold value of whose currencies is within (say) 5 or 10 per cent of their former value. Its force in these cases depends, I think, upon what answer we give to the problem discussed below, namely, whether we intend to pin ourselves in the future, as in the past, to an unqualified gold standard. If we still prefer such a standard to any available alternative, and if future "confidence" in our currency is to depend not on the stability of its purchasing power

but on the fixity of its gold value, then it may be worth our while to stand the racket of Deflation to the extent of 5 or 10 per cent. This view is in accordance with that expressed by Ricardo in analogous circumstances a hundred years ago. If, on the other hand, we decide to aim for the future at stability of the price level rather than at a fixed parity with gold, in that case *cadit quaestio*.

3. *If the gold value of a country's currency can be increased, labour will profit by a reduced cost of living, foreign goods will be obtainable cheaper, and foreign debts fixed in terms of gold* (e.g. *to the United States*) *will be discharged with less effort.*

This argument, which is pure delusion, exercises quite as much influence as the other two. If the franc is worth more, wages, it is argued, which are paid in francs, will surely buy more, and French imports, which are paid for in francs, will be so much cheaper. No! If francs are worth more they will buy more labour as well as more goods,—that is to say, wages will fall; and the French exports, which pay for the imports, will, measured in francs, fall in value just as much as the imports. Nor will it make in the long run any difference whatever in the amount of goods the value of which England will have to transfer to America to pay her dollar debts whether in the end sterling settles down at four dollars to the pound or at its pre-war parity. The burden of this debt depends on the value of gold, in terms of which it is fixed,

not on the value of sterling. It is not easy, it seems, for men to apprehend that their money is a mere intermediary, without significance in itself, which flows from one hand to another, is received and is dispensed, and disappears when its work is done from the sum of a nation's wealth.

(ii) *Stability of Prices* versus *Stability of Exchange*

Since, subject to certain qualifications, the rate of exchange of a country's currency with the currency of the rest of the world (assuming for the sake of simplicity that there is only one external currency) depends on the relation between the internal price level and the external price level, it follows that the exchange cannot be stable unless *both* internal *and* external price levels remain stable. If, therefore, the external price level lies outside our control, we must submit either to our own internal price level or to our exchange being pulled about by external influences. If the external price level is unstable, we cannot keep *both* our own price level *and* our exchanges stable. And we are compelled to choose.

In pre-war days, when almost the whole world was on a gold standard, we had all plumped for stability of exchange as against stability of prices, and we were ready to submit to the social consequences of a change of price level for causes quite outside our control, con-

nected, for example, with the discovery of new gold mines in foreign countries or a change of banking policy abroad. But we submitted, partly because we did not dare trust ourselves to a less automatic (though more reasoned) policy, and partly because the price fluctuations experienced were in fact moderate. Nevertheless, there were powerful advocates of the other choice. In particular, the proposals of Professor Irving Fisher for a Compensated Dollar, amounted, unless all countries adopted the same plan, to putting into practice a preference for stability of internal price level over stability of external exchange.

The right choice is not necessarily the same for all countries. It must partly depend on the relative importance of foreign trade in the economic life of the country. Nevertheless, there does seem to be in almost every case a presumption in favour of the stability of prices, if only it can be achieved. Stability of exchange is in the nature of a convenience which adds to the efficiency and prosperity of those who are engaged in foreign trade. Stability of prices, on the other hand, is profoundly important for the avoidance of the various evils described above. Contracts and business expectations, which presume a stable exchange, must be far fewer, even in a trading country such as England, than those which presume a stable level of internal prices. The main argument to the contrary seems to be that exchange stability is an easier aim to attain, since it only requires

that the same standard of value should be adopted at home and abroad; whereas an internal standard, so regulated as to maintain stability in an index number of prices, is a difficult scientific innovation, never yet put into practice.

At any rate the unthinking assumption, in favour of the restoration of a fixed exchange as the one thing to aim at, requires more examination than it sometimes receives. Especially is this the case if the prospect that a majority of countries will adopt the same standard is still remote. When by adopting the gold standard we could achieve stability of exchange with almost the whole world, whilst any other standard would have appeared as a solitary eccentricity, the solid advantages of certainty and convenience supported the conservative preference for gold. Nevertheless, even so, the convenience of traders and the primitive passion for solid metal might not, I think, have been adequate to preserve the dynasty of gold, if it had not been for another, half-accidental circumstance; namely, that for many years past gold had afforded not only a stable exchange but, on the whole, a stable price level also. In fact, the choice between stable exchanges and stable prices had not presented itself as an acute dilemma. And when, prior to the development of the South African mines, we seemed to be faced with a continuously falling price level, the fierceness of the bimetallic controversy testified to the discontent provoked as soon as the

existing standard appeared seriously incompatible with the stability of prices.

Indeed, it is doubtful whether the pre-war system for regulating the international flow of gold would have been capable of dealing with such large or sudden divergencies between the price levels of different countries as have occurred lately. The fault of the pre-war régime, under which the rates of exchange between a country and the outside world were fixed, and the internal price level had to adjust itself thereto (*i.e.* was chiefly governed by external influences), was that it was too slow and insensitive in its mode of operation. The fault of the post-war régime, under which the price level mainly depends on internal influences (*i.e.* internal currency and credit policy) and the rates of exchange with the outside world have to adjust themselves thereto, is that it is too rapid in its effect and over-sensitive, with the result that it may act violently for merely transitory causes. Nevertheless, when the fluctuations are large and sudden, a quick reaction is necessary for the maintenance of equilibrium; and the necessity for quick reaction has been one of the factors which have rendered the pre-war method inapplicable to post-war conditions, and have made every one nervous of proclaiming a final fixation of the exchange.

A fluctuating exchange means that relative prices can be knocked about by the most fleeting influences of politics and of sentiment, and by the periodic pressure of seasonal trades. But

it also means that this method is a most rapid and powerful corrective of real disequilibria in the balance of international payments arising from whatever causes, and a wonderful preventive in the way of countries which are inclined to spend abroad beyond their resources.

Thus when there are violent shocks to the pre-existing equilibrium between the internal and external price levels, the pre-war method is likely to break down in practice, simply because it cannot bring about the readjustment of internal prices *quick enough*. Theoretically, of course, the pre-war method must be able to make itself effective sooner or later, provided the movement of gold is allowed to continue without restriction until the inflation or deflation of prices has taken place to the necessary extent. But in practice there is usually a limit to the rate and to the amount by which the actual currency or the metallic backing for it can be allowed to flow abroad. If the supply of money or credit is reduced faster than social and business arrangements allow prices to fall, intolerable inconveniences result.

(iii) *The Restoration of a Gold Standard*

Our conclusions up to this point are, therefore, that, when stability of the internal price level and stability of the external exchanges are incompatible, the former is generally preferable; and that on occasions when the dilemma is acute the preservation of the former at the

expense of the latter is, fortunately perhaps, the line of least resistance.

The restoration of the gold standard (whether at the pre-war parity or at some other rate) certainly will not give us complete stability of internal prices, and can only give us complete stability of the external exchanges if all other countries also restore the gold standard. The advisability of restoring it depends, therefore, on whether, on the whole, it will give us the best working compromise obtainable between the two ideals.

The advocates of gold, as against a more scientific standard, base their cause on the double contention that in practice gold has provided and will provide a reasonably stable standard of value and that in practice, since governing authorities lack wisdom as often as not, a managed currency will, sooner or later, come to grief. Conservatism and scepticism join arms—as they often do. Perhaps superstition comes in too; for gold still enjoys the prestige of its smell and colour.

The considerable success with which gold maintained its stability of value in the changing world of the nineteenth century was certainly remarkable. After the discoveries of Australia and California it began to depreciate dangerously, and before the exploitation of South Africa it began to appreciate dangerously. Yet in each case it righted itself and retained its reputation.

But the conditions of the future are not those

of the past. We have no sufficient ground for expecting the continuance of the special conditions which preserved a sort of balance before the war. For what are the underlying explanations of the good behaviour of gold during the nineteenth century?

In the first place, it happened that progress in the discovery of gold mines roughly kept pace with progress in other directions—a correspondence which was not altogether a matter of chance, because the progress of that period, since it was characterised by the gradual opening up and exploitation of the world's surface, not unnaturally brought to light *pari passu* the remoter deposits of gold. But this stage of history is now almost at an end. A quarter of a century has passed by since the discovery of an important deposit. Material progress is more dependent now on the growth of scientific and technical knowledge, of which the application to gold-mining may be intermittent. Years may elapse without great improvement in the methods of extracting gold; and then the genius of a chemist may realise past dreams and forgotten hoaxes, transmuting base into precious like Subtle, or extracting gold from sea-water as in the Bubble. Gold is liable to be either too dear or too cheap. In either case, it is too much to expect that a succession of accidents will keep the metal steady.

But there was another type of influence which used to aid stability. The value of gold has not depended on the policy or the decisions of a

single body of men; and a sufficient proportion of the supply has been able to find its way, without any flooding of the market, into the Arts or into the hoards of Asia for its marginal value to be governed by a steady psychological estimation of the metal in relation to other things. This is what is meant by saying that gold has "intrinsic value" and is free from the dangers of a "managed" currency. The *independent variety* of the influences determining the value of gold has been in itself a steadying influence. The arbitrary and variable character of the proportion of gold reserves to liabilities maintained by many of the note-issuing banks of the world, so far from introducing an incalculable factor, was an element of stability. For when gold was relatively abundant and flowed towards them, it was absorbed by their allowing their ratio of gold reserves to rise slightly; and when it was relatively scarce, the fact that they had no intention of ever utilising their gold reserves for any practical purpose permitted most of them to view with equanimity a moderate weakening of their proportion. A great part of the flow of South African gold between the end of the Boer War and 1914 was able to find its way into the central gold reserves of European and other countries with the minimum effect on prices.

But the war has effected a great change. Gold itself has become a "managed" currency. The West, as well as the East, has learnt to hoard gold; but the motives of the United

States are not those of India. Now that most countries have abandoned the gold standard, the supply of the metal would, if the chief user of it restricted its holdings to its real needs, prove largely redundant. The United States has not been able to let gold fall to its "natural" value, because it could not face the resulting depreciation of its standard. It has been driven, therefore, to the costly policy of burying in the vaults of Washington what the miners of the Rand have laboriously brought to the surface. Consequently gold now stands at an "artificial" value, the future course of which almost entirely depends on the policy of the Federal Reserve Board of the United States. The value of gold is no longer the resultant of the chance gifts of Nature and the judgement of numerous authorities and individuals acting independently. Even if other countries gradually return to a gold basis, the position will not be greatly changed. The tendency to employ some variant of the gold-exchange standard and the probably permanent disappearance of gold from the pockets of the people are likely to mean that the strictly *necessary* gold reserves of the Central Banks of the gold-standard countries will fall considerably short of the available supplies. The actual value of gold will depend, therefore, on the policy of three or four of the most powerful Central Banks, whether they act independently or in unison. If, on the other hand, pre-war conventions about the use of gold in reserves and in circulation were to be restored—which

is, in my opinion, the much less probable alternative—there might be, as Professor Cassel has predicted, a serious shortage of gold, leading to a progressive appreciation in its value.

Nor must we neglect the possibility of a partial demonetisation of gold by the United States through a closing of its mints to further receipts of gold. The present policy of the United States in accepting unlimited imports of gold can be justified, perhaps, as a temporary measure, intended to preserve tradition and to strengthen confidence through a transitional period. But, looked at as a permanent arrangement, it could hardly be judged otherwise than as a foolish expense. If the Federal Reserve Board intends to maintain the value of the dollar at a level which is irrespective of the inflow or outflow of gold, what object is there in continuing to accept at the mints gold which is not wanted, yet costs a heavy price? If the United States mints were to be closed to gold, everything, except the actual price of the metal, could continue precisely as before.

Confidence in the future stability of the value of gold depends therefore on the United States being foolish enough to go on accepting gold which it does not want, and wise enough, having accepted it, to maintain it at a fixed value. This double event might be realised through the collaboration of a public understanding nothing with a Federal Reserve Board understanding everything. But the position is precarious; and not very attractive to any country which is still

in a position to choose what its future standard is to be.

This discussion of the prospects of the stability of gold has partly answered by anticipation the second principal argument in favour of the restoration of an unqualified gold standard, namely that this is the only way of avoiding the dangers of a "managed" currency.

It is natural, after what we have experienced, that prudent people should desiderate a standard of value which is independent of Finance Ministers and State Banks. The present state of affairs has allowed to the ignorance and frivolity of statesmen an ample opportunity of bringing about ruinous consequences in the economic field. It is felt that the general level of economic and financial education amongst statesmen and bankers is hardly such as to render innovations feasible or safe; that, in fact, a chief object of stabilising the exchanges is to strap down Ministers of Finance.

These are reasonable grounds of hesitation. But the experience on which they are based is by no means fair to the capacities of statesmen and bankers. The non-metallic standards of which we have experience have been anything rather than scientific experiments coolly carried out. They have been a last resort, involuntarily adopted, as a result of war or inflationary taxation, when the State finances were already broken or the situation out of hand. Naturally in these circumstances such practices have been the accompaniment and the prelude of disaster. But

we cannot argue from this to what can be achieved in normal times. I do not see that the regulation of the standard of value is essentially more difficult than many other objects of less social necessity which we attain successfully.

If, indeed, a providence watched over gold, or if Nature had provided us with a stable standard ready-made, I would not, in an attempt after some slight improvement, hand over the management to the possible weakness or ignorance of Boards and Governments. But this is not the situation. We have no ready-made standard. Experience has shown that in emergencies Ministers of Finance cannot be strapped down. And—most important of all—in the modern world of paper currency and bank credit there is no escape from a "managed" currency, whether we wish it or not;—convertibility into gold will not alter the fact that the value of gold itself depends on the policy of the Central Banks.

It is worth while to pause a moment over the last sentence. It differs significantly from the doctrine of gold reserves which we learnt and taught before the war. We used to assume that no Central Bank would be so extravagant as to keep more gold than it required or so imprudent as to keep less. From time to time gold would flow out into the circulation or for export abroad; experience showed that the quantity required on these occasions bore some rough proportion to the Central Bank's liabilities; a decidedly higher proportion than this

would be fixed on to provide for contingencies and to inspire confidence; and the creation of credit would be regulated largely by reference to the maintenance of this proportion. The Bank of England, for example, would allow itself to be swayed by the tides of gold, permitting the inflowing and outflowing streams to produce their "natural" consequences unchecked by any ideas as to preventing the effect on prices. Already before the war the system was becoming precarious by reason of its artificiality. The "proportion" was by the lapse of time losing its relation to the facts and had become largely conventional. Some other figure, greater or less, would have done just as well.[1] The War broke down the convention; for the withdrawal of gold from actual circulation destroyed one of the elements of reality lying behind the convention, and the suspension of convertibility destroyed the other. It would have been absurd to regulate the bank-rate by reference to a "proportion" which had lost all its significance; and in the course of the past ten years a new policy has been evolved. The bank-rate is now employed, however incompletely and experimentally, to regulate the expansion and deflation of credit in the interests of business stability and the steadiness of prices. In so far as it is employed to procure stability of the dollar exchange, where this is inconsistent with stability of internal prices, we have a relic

[1] *Vide*, for what I wrote about this in 1914, *The Economic Journal*, xxiv. p. 621.

of pre-war policy and a compromise between discrepant aims.

Those who advocate the return to a gold standard do not always appreciate along what different lines our actual practice has been drifting. If we restore the gold standard, are we to return also to the pre-war conceptions of bank-rate, allowing the tides of gold to play what tricks they like with the internal price level, and abandoning the attempt to moderate the disastrous influence of the credit-cycle on the stability of prices and employment? Or are we to continue and develop the experimental innovations of our present policy, ignoring the "bank ratio" and, if necessary, allowing unmoved a piling up of gold reserves far beyond our requirements or their depletion far below them?

In truth, the gold standard is already a barbarous relic. All of us, from the Governor of the Bank of England downwards, are now primarily interested in preserving the stability of business, prices, and employment, and are not likely, when the choice is forced on us, deliberately to sacrifice these to the outworn dogma, which had its value once, of £3 : 17 : 10½ per ounce. Advocates of the ancient standard do not observe how remote it now is from the spirit and the requirements of the age. A regulated non-metallic standard has slipped in unnoticed. *It exists.* Whilst the economists dozed, the academic dream of a hundred years, doffing its cap and gown, clad in paper rags, has crept

into the real world by means of the bad fairies—always so much more potent than the good—the wicked Ministers of Finance.

For these reasons enlightened advocates of the restoration of gold, such as Mr. Hawtrey, do not welcome it as the return of a "natural" currency, and intend, quite decidedly, that it shall be a "managed" one. They allow gold back only as a constitutional monarch, shorn of his ancient despotic powers and compelled to accept the advice of a Parliament of Banks. The adoption of the ideas present in the minds of those who drafted the Genoa Resolutions on Currency is an essential condition of Mr. Hawtrey's adherence to gold. He contemplates "the practice of continuous co-operation among central banks of issue" (Res. 3), and an international convention, based on a gold exchange standard, and designed "with a view to preventing undue fluctuations in the purchasing power of gold" (Res. 11).[1] But he is *not* in favour of resuming the gold standard irrespective of "whether the difficulties in regard to the future purchasing power of gold have been provided against or not." "It is not easy," he admits, "to promote international action, and, should it fail, the wisest course for the time being might be to concentrate on the stabilisation of sterling in terms of commodities, rather than tie the pound to a metal the vagaries of which cannot be foreseen."[2]

It is natural to ask, in face of advocacy of

[1] *Monetary Reconstruction*, p. 132. [2] *Loc. cit.* p. 22.

this kind, why it is necessary to drag in gold at all. Mr. Hawtrey lays no stress on the obvious support for his compromise, namely the force of sentiment and tradition, and the preference of Englishmen for shearing a monarch of his powers rather than of his head. But he adduces three other reasons: (1) that gold is required as a liquid reserve for the settlement of international balances of indebtedness; (2) that it enables an experiment to be made without cutting adrift from the old system; and (3) that the vested interests of gold producers must be considered. These objects, however, are so largely attained by my own suggestions in the following section that I need not dwell on them here.

On the other hand, I see grave objections to reinstating gold in the pious hope that international co-operation will keep it in order. With the existing distribution of the world's gold the reinstatement of the gold standard means, inevitably, that we surrender the regulation of our price level and the handling of the credit cycle to the Federal Reserve Board of the United States. Even if the most intimate and cordial co-operation is established between the Board and the Bank of England, the preponderance of power will still belong to the former. The Board will be in a position to disregard the Bank. But if the Bank disregard the Board, it will render itself liable to be flooded with, or depleted of, gold, as the case may be. Moreover, we can be confident beforehand that there

will be much suspicion amongst Americans (for that is their disposition) of any supposed attempt on the part of the Bank of England to dictate their policy or to influence American discount rates in the interests of Great Britain. We must also be prepared to incur our share of the vain expense of bottling up the world's redundant gold.

It would be rash in present circumstances to surrender our freedom of action to the Federal Reserve Board of the United States. We do not yet possess sufficient experience of its capacity to act in times of stress with courage and independence. The Federal Reserve Board is striving to free itself from the pressure of sectional interests; but we are not yet certain that it will wholly succeed. It is still liable to be overwhelmed by the impetuosity of a cheap money campaign. A suspicion of British influence would, so far from strengthening the Board, greatly weaken its resistance to popular clamour. Nor is it certain, quite apart from weakness or mistakes, that the simultaneous application of the same policy will always be in the interests of both countries. The development of the credit cycle and the state of business may sometimes be widely different on the two sides of the Atlantic.

Therefore, since I regard the stability of prices, credit, and employment as of paramount importance, and since I feel no confidence that an old-fashioned gold standard will even give us the modicum of stability that it used to give,

I reject the policy of restoring the gold standard on pre-war lines. At the same time, I doubt the wisdom of attempting a "managed" gold standard jointly with the United States, on the lines recommended by Mr. Hawtrey, because it retains too many of the disadvantages of the old system without its advantages, and because it would make us too dependent on the policy and on the wishes of the Federal Reserve Board.

3. Positive Suggestions for the Future Regulation of Money (1923)

A sound constructive scheme must provide:

I. A method for regulating the supply of currency and credit with a view to maintaining, so far as possible, the stability of the internal price level; and

II. A method for regulating the supply of foreign exchange so as to avoid purely temporary fluctuations caused by seasonal or other influences and not due to a lasting disturbance in the relation between the internal and the external price level.

I believe that in Great Britain the ideal system can be most nearly and most easily reached by an adaptation of the actual system which has grown up, half haphazard, since the war.

I. My first requirement in a good constructive scheme can be supplied merely by a development of our existing arrangements on more deliberate and self-conscious lines. Hitherto the Treasury and the Bank of England have looked forward to the stability of the dollar exchange (preferably at the pre-war parity) as their objective. It is not clear whether they

intend to stick to this irrespective of fluctuations in the value of the dollar (or of gold); whether, that is to say, they would sacrifice the stability of sterling prices to the stability of the dollar exchange in the event of the two proving to be incompatible. At any rate, my scheme would require that they should adopt the stability of sterling prices as their *primary* objective—though this would not prevent their aiming at exchange stability also as a secondary objective by co-operating with the Federal Reserve Board in a common policy. So long as the Federal Reserve Board was successful in keeping dollar prices steady the objective of keeping sterling prices steady would be identical with the objective of keeping the dollar sterling exchange steady. My recommendation does not involve more than a determination that, in the event of the Federal Reserve Board failing to keep dollar prices steady, sterling prices should not, if it could be helped, plunge with them merely for the sake of maintaining a fixed parity of exchange.

If the Bank of England, the Treasury, and the Big Five were to adopt this policy, to what criteria should they look respectively in regulating bank-rate, Government borrowing, and trade-advances? The first question is whether the criterion should be a precise, arithmetical formula or whether it should be sought in a general judgement of the situation based on all the available data. The pioneer of price-stability as against exchange-stability, Professor

Irving Fisher, advocated the former in the shape of his "compensated dollar," which was to be automatically adjusted by reference to an index number of prices without any play of judgement or discretion. He may have been influenced, however, by the advantage of propounding a method which could be grafted as easily as possible on to the pre-war system of gold reserves and gold ratios. In any case, I doubt the wisdom and the practicability of a system so cut and dried. If we wait until a price movement is actually afoot before applying remedial measures, we may be too late. "It is not the *past* rise in prices but the *future* rise that has to be counteracted."[1] It is characteristic of the impetuosity of the credit cycle that price movements tend to be cumulative, each movement promoting, up to a certain point, a further movement in the same direction. Professor Fisher's method may be adapted to deal with long-period trends in the value of gold but not with the, often more injurious, short-period oscillations of the credit cycle. Nevertheless, whilst it would not be advisable to postpone action until it was called for by an actual movement of prices, it would promote confidence, and furnish an objective standard of value, if, an official index number having been compiled of such a character as to register the price of a standard composite commodity, the authorities were to adopt this composite commodity as their standard of value in the sense that they

[1] Hawtrey, *Monetary Reconstruction*, p. 105.

would employ all their resources to prevent a movement of its price by more than a certain percentage in either direction away from the normal, just as before the war they employed all their resources to prevent a movement in the price of gold by more than a certain percentage. The precise composition of the standard composite commodity could be modified from time to time in accordance with changes in the relative economic importance of its various components.

As regards the criteria, other than the actual trend of prices, which should determine the action of the controlling authority, it is beyond the scope of this essay to deal adequately with the diagnosis and analysis of the credit cycle. The more deeply our researches penetrate into this subject, the more accurately shall we understand the right time and method for controlling credit-expansion by bank-rate or otherwise. But in the meantime we have a considerable and growing body of general experience upon which those in authority can base their judgements. Actual price-movements must of course provide the most important datum; but the state of employment, the volume of production, the effective demand for credit as felt by the banks, the rate of interest on investments of various types, the volume of new issues, the flow of cash into circulation, the statistics of foreign trade and the level of the exchanges must all be taken into account. The main point is that the *objective* of the authorities, pursued

with such means as are at their command, should be the stability of prices.

II. How can we best combine this primary object with a maximum stability of the exchanges? Can we get the best of both worlds—stability of prices over long periods and stability of exchanges over short periods? It is the great advantage of the gold standard that it overcomes the excessive sensitiveness of the exchanges to temporary influences. Our object must be to secure this advantage, if we can, without committing ourselves to follow big movements in the value of gold itself.

I believe that we can go a long way in this direction if the Bank of England will take over the duty of regulating the price of gold, just as it already regulates the rate of discount. "Regulate," but not "peg." The Bank of England should have a buying and a selling price for gold, just as it did before the war, and this price might remain unchanged for considerable periods, just as bank-rate does. But it would not be fixed or "pegged" once and for all, any more than bank-rate is fixed. The Bank's rate for gold would be announced every Thursday morning at the same time as its rate for discounting bills, with a difference between its buying and selling rates corresponding to the pre-war margin between £3:17:10½ per oz. and £3:17:9 per oz.; except that, in order to obviate too frequent changes in the rate, the difference might be wider than 1½d. per oz.—say, ½ to 1 per cent. A willingness on the part

of the Bank both to buy and to sell gold at rates fixed for the time being would keep the dollar-sterling exchange steady within corresponding limits, so that the exchange rate would not move with every breath of wind but only when the Bank had come to a considered judgement that a change was required for the sake of the stability of sterling prices.

If the bank-rate and the gold-rate in conjunction were leading to an excessive influx or an excessive efflux of gold, the Bank of England would have to decide whether the flow was due to an internal or to an external movement away from stability. To fix our ideas, let us suppose that gold is flowing outwards. If this seemed to be due to a tendency of sterling to depreciate in terms of commodities, the correct remedy would be to raise the bank-rate. If, on the other hand, it was due to a tendency of gold to appreciate in terms of commodities, the correct remedy would be to raise the gold-rate (*i.e.* the buying price for gold). If, however, the flow could be explained by seasonal, or other passing influences, then it should be allowed to continue (assuming, of course, that the Bank's gold reserves were equal to any probable calls on them) unchecked, to be redressed later on by the corresponding reaction.

It would effect an improvement in the technique of the system here proposed, without altering its fundamental characteristics, if the Bank of England were to quote a daily price, not only for the purchase and sale of gold for immediate

delivery, but also for delivery three months forward. The difference, if any, between the cash and forward quotations might represent either a discount or a premium of the latter on the former, according as the bank desired money rates in London to stand below or above those in New York. The existence of the forward quotation of the Bank of England would afford a firm foundation for a free market in forward exchange, and would facilitate the movement of funds between London and New York for short periods, in much the same way as before the war, whilst at the same time keeping down to a minimum the actual movement of gold bullion backwards and forwards.

The reader will observe that I retain for gold an important rôle in our system. As an ultimate safeguard and as a reserve for sudden requirements, no superior medium is yet available. But I urge that it is possible to get the benefit of the advantages of gold without irrevocably binding our legal-tender money to follow blindly all the vagaries of gold and future unforseeable fluctuations in its real purchasing power.

4. The Speeches of the Bank Chairmen (1924–1927)

(i) February 1924

We have an admirable custom in this country by which once a year the overlords of the Big Five desist for a day from the thankless task of persuading their customers to accept loans, and, putting on cap and gown, mount the lecturer's rostrum to expound the theory of their practice; —a sort of *Saturnalia*, during which we are all ephemerally equal with words for weapons. These occasions are of great general interest. But they are more than this. They have a representative significance;—they hold up, as it were, financial fashion-plates. What have they found to say this year about Monetary Policy?

Only one, Mr. Walter Leaf, of the Westminster Bank, has refrained himself entirely. Each of the other four has had something to say. They fall into a pair of couples: one of which, Mr. Beaumont Pease of Lloyds Bank and Sir Harry Goschen of the National Provincial Bank, feel that there is something improper, or at any rate undesirable, in thinking or speaking about these things at all; and the other of which,

Mr. Goodenough of Barclays Bank and Mr. McKenna of the Midland Bank, so far from deprecating discussion, join in it boldly.

Mr. Pease, as I have said, deprecates thinking, or—as he prefers to call it—"the expenditure of mental agility." He desires "straightly to face the facts instead of to find a clever way round them," and holds that, in matters arising out of the Quantity Theory of Money, as between brains and character, "certainly the latter does not come second in order of merit." In short, the gold standard falls within the sphere of morals or of religion, where free-thought is out of place. He goes on to say: "As far as any ordinary joint-stock bank is concerned, I do not think it determines its policy consciously on pure monetary grounds. That is to say, its chief concern is to meet the requirements of trade as they arise, regardless of adhesion to any particular theory. Its actions are not the cause of trade movements; they follow after and do not precede them." I think that this, broadly speaking, is a correct account of the matter, and Mr. Pease's emphasis on it is the most valuable part of his speech. It is precisely this automatic element in the reactions of the joint-stock banks which makes the policy of the Bank of England about the volume of the banks' balances and the rate of discount so all-important. In conclusion, Mr. Pease does not propose to take any particular steps at present towards establishing any particular standard. Nevertheless he is "hopeful that we

may gradually get back to our gold standard, which, in spite of some defects and difficulties, has, as a matter of fact, worked well in the past."

Sir Harry Goschen goes one better than Mr. Pease in a delightful passage which deserves to be quoted in full:—

> I cannot help thinking that there has been lately far too much irresponsible discussion as to the comparative advantages of Inflation and Deflation. Discussions of this kind can only breed suspicion in the minds of our neighbours as to whether we shall adopt either of these courses, and, if so, which. I think we had better let matters take their natural course.

Is it more appropriate to smile or to rage at these artless sentiments? Best of all, perhaps, just to leave Sir Harry to take his natural course.

Leaving, then, these impeccable Spinsters, we come, in the speeches of Mr. Goodenough and Mr. McKenna, to rational, even *risqué* conversation. In immediate policy there is a large measure of agreement between them. They agree that monetary policy is capable of determining the level of prices, that our destiny is therefore in our own hands, and that the right course to pursue requires much thought and discussion. Mr. Goodenough, however, lays greater stress on the bank-rate, and Mr. McKenna on the amount of the cash resources in the hands of the banks. They are opposed to any revival at the present time of the Cunliffe Committee's policy of Deflation. They both look to internal conditions, and not to the foreign exchanges, as the criterion for expand-

ing or contracting credit; with this difference, however, that Mr. McKenna would look chiefly to the level of employment, whilst Mr. Goodenough would be more influenced by the stability of internal prices. "To sum up my views on the currency question," the latter says, "I feel that our aim should be to maintain as nearly as possible the existing equilibrium between currency and commodities. . . ." Neither of them, however, would be much disturbed by a moderate rise of prices, provided (in the case of Mr. McKenna) that the productive resources of the country had not yet reached the limit of their capacity, and (in the case of Mr. Goodenough) that the rise was due neither to the speculative withholding of commodities nor to British prices rising relatively to American prices. About our ultimate objective, Mr. McKenna does not speak; but there is nothing in his speech to suggest that he would not be in favour of pursuing permanently the policy, which he recommends for the present, of "steering a middle course between Inflation and Deflation," *i.e.* of aiming, like Mr. Goodenough, at a general stability of prices within certain limits, and of deliberately employing monetary policy to mitigate the evils of the credit cycle: "Ups and downs in trade we are bound to have, but wise monetary policy can always prevent the cyclical movement from going to extremes. The speculative excesses of an inflationary boom and the cruel impoverishment of a prolonged slump can both be

avoided. They are not necessary evils to which we must submit as things without understandable or preventable causes." Mr. Goodenough, on the other hand, whilst desisting from the pursuit of the gold standard for the time being, continues the passage from his speech quoted above—"... although always we should keep in mind our ultimate aim, which is a return to a gold standard." Meanwhile, he puts his hopes on an inflationary movement in America just sufficient to bring sterling back to its former parity with gold, without any disturbance to its present parity with commodities.

What is the net result of these speeches? They strengthen greatly the hands of the Currency Reformers who believe that the stability of the internal price level and the damping down of the credit cycle are desirable and attainable objects. They are also reassuring, since they show that two of the most influential figures in the City have clearly in mind all the points of immediate practical importance, and can be relied on to use their influence in the right direction. Mr. McKenna and Mr. Goodenough are both in sympathy with the above aims. Nor would it be fair to say that the Spinsters are definitely opposed to these ideas. (There would be just as much impropriety for them, just as much mental agility required, to think one thing as to think another. Their simplicity is quite impartial.) If they could be led gently by the hand beyond their copy-book maxims of "looking facts firmly in the face"

and "economy and hard work," it might be found that they, too, had no objection to a deliberate attempt to keep prices steady and trade on an even keel, and that, whilst they feel at first the same distaste towards any proposal to "tamper" with "the natural course" of prices as they might feel towards an attempt to settle the sex of a child before birth, they are not really prepared to insist on their instinctive preference for having these matters settled by some method of pure chance.

(ii) February 1925

Once more the Bank chairmen have held up for our inspection their financial fashion-plates. The captions vary; but the plates are mostly the same. The first displays marriage with the gold standard as the most desired, the most urgent, the most honourable, the most virtuous, the most prosperous, and the most blessed of all possible states. The other is designed to remind the intending bridegroom that matrimony means heavy burdens from which he is now free; that it is for better, for worse; that it will be for him to honour and obey; that the happy days, when he could have the prices and the bank-rate which suited the housekeeping of his bachelor establishment, will be over—though, of course, he will be asked out more when he is married; that Miss G. happens to be an American, so that in future the prices of grape-fruit and pop-corn are likely to be more

important to him than those of eggs and bacon; and, in short, that he had better not be too precipitate. Some of our chairmen were like him who, being asked whether he believed that, when he was dead, he would enjoy perfect bliss eternally, replied that of course he did, but would rather not discuss such an unpleasant subject.

Like last year there are two distinct issues,—the abstract merits of the gold standard, and the date and the mode of our return to it. The first is a question about which, as Mr. McKenna justly said, "we are still in the stage of inquiry rather than of positive opinion, and there is no formulated body of doctrine generally regarded as orthodox." The supporters of Monetary Reform, of which I, after further study and reflection, am a more convinced adherent than before, as the most important and significant measure we can take to increase economic welfare, must expound their arguments more fully, more clearly, and more simply, before they can overwhelm the forces of old custom and general ignorance. This is not a battle which can be won or lost in a day. Those who think that it can be finally settled by a sharp hustle back to gold mistake the situation. That will be only the beginning. The issue will be determined, not by the official decisions of the coming year, but by the combined effects of the actual experience of what happens after that and the relative clearness and completeness of the arguments of the opposing parties. Readers of the

works, for example, of the great Lord Overstone, will remember how many years it took, and what bitter and disastrous experiences, before the monetary reformers of a hundred years ago established the pre-war policy of bank-rate and bank-reserves (which, in its day, was a great advance), in the teeth of the opposition of the Bank of England.

The other issue is of practical and immediate importance. Last year it was a question of whether it was prudent to hasten matters by deliberate Deflation; this year it is a question of whether it is prudent to hasten matters by a removal of the embargo against the export of gold. This year, like last year, the bankers, faced with the practical problem, are a little nervous. I think that this nervousness is justified for the following reasons.

In common with many others, I have long held the opinion that monetary conditions in the United States were likely, sooner or later, to bring about a rising price level and an incipient boom; and also that it would be our right policy in such circumstances to employ the usual methods to curb our own price level and to prevent credit conditions here from following in the wake of those in America. The result of this policy, if it was successful, would be a gradual improvement of the sterling exchange; and it would not need a very violent boom in America to justify a rise of the sterling exchange at least as high as the pre-war parity. I have, therefore, maintained for two years past that a

return of sterling, sooner or later, towards its pre-war parity would be both a desirable and a probable consequence of a sound monetary policy on the part of the Bank of England coupled with a less sound one on the part of the Federal Reserve Board.

What has actually happened? In the spring of 1923 boom conditions in the United States seemed to be developing; but largely through the action of the Federal Reserve Board, the movement was stopped. Since July 1924, however, there has been a strong and sustained upward movement, which—subject always to the policy of the Federal Reserve Board—is expected to go further. The earlier upward movement of American prices was duly followed by an improvement in sterling exchange; and the relapse by a relapse. Similarly, the movement of American prices during the past six months has been accompanied by the improvement in sterling exchange, which has caught the popular attention. As Mr. McKenna pointed out, sterling prices have been a little steadier than dollar prices, and this greater steadiness has involved, as its necessary counterpart, some unsteadiness in the exchange.

The movement of the past six months, however, has been complicated by abnormal factors. The improvement in sterling exchange is more than can be accounted for by our monetary policy. It is true that short-money rates have been maintained at an effective ½ per cent above those in New York, and that British prices have

risen somewhat less than American prices. But it is generally agreed that these influences have not been strong enough to account for everything. The Board of Trade returns indicate that there has been a movement of funds on capital account in the past year (and most of it, probably, in the second half of the year) from New York to London of the order of magnitude of £100,000,000. This is due (in proportions difficult to calculate) to the return of foreign balances previously held in London, to American investment in Europe resulting from the greater confidence engendered by the Dawes Scheme coming on the top of an investment boom in Wall Street, and to speculative purchases of sterling in the expectation of its improving in value relatively to the dollar. This unprecedented movement introduces a precarious element into the situation;—we cannot expect that it will continue on the same scale, and it may, at any time, be partly reversed. We require an interval, therefore, to readjust our liabilities either by a recovery of exports relatively to imports or by establishing a rate of interest on permanent loans high enough to check the present (in my judgement excessive) flow of new foreign investment outwards. At present we are in danger of lending long (*e.g.* to Australia) what we have borrowed short from New York. The strength of our pre-war position lay in the fact that (through the bill market) we had lent large sums short, which we could call in. At the present time this position

is partly, though perhaps only temporarily, reversed;—which, in itself, is one reason for caution.

What is going to happen next? There are two leading alternatives. It may be that the Federal Reserve Board will come to the conclusion that the incipient boom conditions in the United States are getting dangerous, and will take the position firmly in hand, just as they did two years ago. This, almost certainly, is what the Board ought to do. In this event, the situation would be back again very nearly where it was eighteen months ago, and we should be faced, as we were then, with the alternative of relatively steady sterling prices with the dollar exchange below parity, or of stern Deflation in the effort to keep exchange at parity. A premature announcement of the removal of the embargo on the free export of gold would commit us in advance to the latter alternative,—the alternative which we deliberately rejected two years ago. This is what the fanatics desire. But with our unemployment figures what they still are, it would not be wise.

The other alternative is that the Federal Reserve Board will allow matters to pursue their present course, in which event we may expect that dollar prices will advance a good deal further. During part of 1924 the Board's open-market policy was decidedly inflationary, and has been largely responsible for the sharp rise of prices already experienced. At the present moment their policy is more cautious;

but there is no clear indication that they have any steady or considered policy. It may be that misplaced sympathy with our efforts to raise the sterling exchange will be a factor tending to postpone action on their part; and if they delay much longer, boom conditions may become definitely established. In this event we need have no difficulty in raising sterling to pre-war parity. A firm monetary policy, designed to check a sympathetic rise of sterling prices, ought, without any positive Deflation, to do the trick. But it does not follow that the embargo should, therefore, be removed. To link sterling prices to dollar prices at a moment in the credit cycle when the latter were near their peak as the result of a boom which we had not fully shared would ask for trouble. For when the American boom broke we should bear the full force of the slump. The conditions in which we can link sterling prices to dollar prices without immediate risk to our own welfare will only exist when the mean level of dollar prices appears to be *stabilised* at a somewhat higher level than in recent times.

The removal of the embargo amounts to an announcement that sterling *is* at parity with the dollar and will remain so. I suggest that the right order of procedure is to establish the fact first and to announce it afterwards, rather than to make the announcement first and to chance the fact. Thus the removal of the embargo should be the last stage in the restoration of

pre-war conditions, not the first one. The only prudent announcement on the subject would be to the effect that the embargo will not be removed until after sterling has been at parity for some considerable time, and until all the fundamental adjustments consequent upon this have duly taken place. At the same time—if we want to return to parity—steps should be taken to achieve the *fact* by raising bank-rate and checking foreign issues. I—without attaching any importance whatever to a return to parity—believe that there is much to be said for these measures in the interests of the stabilisation of our own situation. I do not believe that a somewhat higher bank-rate would do any harm, in view of the present tendencies of the price level, to the volume of trade and employment, and that, in any case, the maintenance of our own equilibrium will soon require the support of a higher rate. Several of the bankers declared that they were in favour of removing the embargo, provided this did not involve a risk of raising the bank-rate. Unless this was merely a polite way of saying that they were not in favour of removing the embargo, I do not follow their analysis of the present situation.

It would be useless for me to attempt in the space at my disposal to give the reasons for wishing to maintain permanently a Managed Currency. The most important of them flow from my belief that fluctuations of trade and employment are at the same time the greatest and the most remediable of the economic

diseases of modern society, that they are mainly diseases of our credit and banking system, and that it will be easier to apply the remedies if we retain the control of our currency in our own hands. But whilst avoiding these fundamental questions I may mention, in conclusion, one practical argument which is also connected with what I have said above.

A gold standard means, in practice, nothing but to have the same price level and the same money rates (broadly speaking) as the United States. The whole object is to link *rigidly* the City and Wall Street. I beg the Chancellor of the Exchequer and the Governor of the Bank of England and the nameless others who settle our destiny in secret to reflect that this may be a dangerous proceeding.

The United States lives in a vast and unceasing crescendo. Wide fluctuations, which spell unemployment and misery for us, are swamped for them in the general upward movement. A country, the whole of whose economic activities are expanding, year in, year out, by several per cent per annum, cannot avoid, and at the same time can afford, temporary maladjustments. This was our own state during a considerable part of the nineteenth century. Our rate of progress was so great that stability in detail was neither possible nor essential. This is not our state now. Our rate of progress is slow at the best, and faults in our economic structure, which we could afford to overlook whilst we were racing forward and which the United States

can still afford to overlook, are now fatal. The slump of 1921 was even more violent in the United States than here, but by the end of 1922 recovery was practically complete. We still, in 1925, drag on with a million unemployed. The United States may suffer industrial and financial tempests in the years to come, and they will scarcely matter to her; but we, if we share them, may almost drown.

And there is a further consideration. Before the war we had lent great sums to the whole world which we could call in at short notice; our American investments made us the creditors of the United States; we had a surplus available for foreign investment far greater than that of any other country; with no Federal Reserve system, American banking was weak and disorganised. We, in fact, were the predominant partner in the Gold Standard Alliance. But those who think that a return to the gold standard means a return to these conditions are fools and blind. We are now the debtors of the United States. Their foreign investments last year were double ours, and their true net balance available for such investment was probably ten times ours. They hold six times as much gold as we do. The mere *increase* in the deposits of the banks of the Federal Reserve System in the past year has been not far short of half our *total* deposits. A movement of gold or of short credits either way between London and New York, which is only a ripple for them, will be an Atlantic roller for us. A change of fashion on

the part of American bankers and investors towards foreign loans, of but little consequence to them, may shake us. If gold and short credits and foreign bonds can flow without restriction or risk of loss backwards and forwards across the Atlantic, fluctuations of given magnitude will produce on us effects altogether disproportionate to the effects on them. It suits the United States that we should return to gold, and they will be ready to oblige us in the early stages. But it would be a mistake to believe that in the long run they will, or ought to, manage their affairs to suit our convenience.

What solid advantages will there be to set against these risks? I do not know. Our bankers speak of "psychological" advantages. But it will be poor consolation that "nine people out of ten" expected advantages, if none in fact arrive.

That our Bank chairmen should have nothing better to cry than "Back to 1914," and that they should believe that this represents the best attainable, is not satisfactory. The majority of those who are studying the matter are becoming agreed that faults in our credit system are at least partly responsible for the confusions which result in the paradox of unemployment amidst dearth. The "Big Five" have vast responsibilities towards the public. But they are so huge and, in some ways, so vulnerable, that there is a great temptation to them to cling to maxims, conventions, and routine; and when their chairmen debate fundamental economic problems,

they are most of them on ground with which they are unfamiliar. It is doubtful, nevertheless, whether too much conservatism on these matters and too little of the spirit of inquiry will redound, in the long run, to their peace or security. Individualistic Capitalism in England has come to the point when it can no longer depend on the momentum of mere expansion; and it must apply itself to the scientific task of improving the structure of its economic machine.

(iii) February 1927[1]

The voices of our old friends the Bank chairmen herald the approach of spring. They have spoken this year—with the exception of Sir Harry Goschen, who sees "no reason to be downhearted," and, as in former years, cannot "remember a time when, throughout the industries of the country, there was such a feeling of expectation and, indeed, optimism"—in somewhat chastened tones. Mr. Beaumont Pease has done a useful service by publishing some important figures analysing the business of Lloyds Bank, which inaugurate a new policy of giving information instead of withholding it. Mr. Walter Leaf made some sound observations on the tendency of business towards amalgamation and, at the same time, of shareholdings towards diffusion, and on the necessity of the State taking some responsibility for guiding this inevitable evolution along the right lines. But

[1] [After the Return to Gold.]

none of them except Mr. McKenna—and on one point of detail Mr. Goodenough—had anything to say about the future of monetary policy. So leaving Sir Harry Goschen to chirrup in the bushes, let us join Mr. McKenna in an attempt to dig a few inches below the surface of the soil.

Mr. McKenna reminded us of the overwhelming prosperity of the United States as against our own depression during the past five years. He declared that in the "wide divergence between English and American monetary policy, we have at least a partial explanation of the phenomenon." He found the measure of this divergence of policy in the expansion and contraction respectively of the bank deposits in the two countries, namely, as follows:—

(Volume of Deposits in 1922 = 100)

	United States.	Great Britain.
1922 . . .	100	100
1923 . . .	107	94
1924 . . .	115	94
1925 . . .	127	93
1926 . . .	131	93

He explained in some detail what is fundamental, yet too little understood, that the volume of bank deposits in Great Britain does not depend, except within narrow limits, on the depositors or on the Big Five, but on the policy of the Bank of England. And he concluded that we can scarcely expect a materially increased scale of production and employment in this country until the Bank of England revises its policy.

Whilst I do not agree with Mr. McKenna in every detail of his argument, I am certain that the broad lines of his diagnosis are correct. He has done a service by his persistent efforts to educate the public and his colleagues to the vital importance of some fundamental principles of monetary policy of which the truth is as certain as the day, but to which the City is blind as night.

Nevertheless, he has on this occasion shirked, in my opinion, half the problem. How far and subject to what conditions is a reversal of the Bank of England's policy consistent with maintaining the gold standard? Is the Bank of England in its new-forged golden fetters as free an agent as Mr. McKenna's policy requires?

What matters is, not some abstraction called the general level of prices, but the relationships between the various price levels which measure the value of our money for different purposes. Prosperity, in so far as it is governed by monetary factors, depends on these various price levels being properly adjusted to one another. Unemployment and trade depression in Great Britain have been due to a rupture of the previous equilibrium between the sterling price level of articles of international commerce and the internal value of sterling for the purposes on which the average Englishman spends his money-income. Moreover, in proportion as we are successful in moving towards the new equilibrium of lower sterling prices all round, we increase the burden of the National Debt and

aggravate the problem of the Budget. If the Bank of England and the Treasury were to succeed in reducing the sheltered price level to its former equilibrium with the unsheltered price level, they would *ipso facto* have increased the real burden of the National Debt by about £1,000,000,000 as compared with two years ago.

Now Mr. McKenna seems to assume that the disequilibrium which admittedly existed two years ago has since disappeared. "To-day," he tells us, "such questions have only historic significance." But the evidence does not support this view. So far from having disappeared, the disparity between the price levels is actually *greater* than it was two years ago.

How, then, have we lived in the meantime? The real ground of the optimism on the lips of the Bank chairmen is to be found, I think, in the fact that there has been no strain on our resources which we have not been able to meet. Is this so great a paradox as it appears? Or so comforting?

We have undoubtedly balanced the difference in our account partly by drawing on the large margin of safety which we used to possess, and partly, during the Coal Strike, by increasing our short-loan indebtedness to the rest of the world. Before the war we probably had a favourable balance on international account, apart from capital transactions, of something like £300,000,000 per annum measured in sterling at its present value. The war and the fall in the value of fixed money payments may

have reduced this annual surplus to about £225,000,000; *i.e.* this is what our surplus would be to-day if our export trades were as flourishing as in 1913. Let us suppose that as the result of our relatively high level of internal prices we have lost £200,000,000 of exports gross, namely, about a quarter of the whole, or (say) £150,000,000 net, *i.e.* after deducting that part of the lost exports which would have consisted of imported raw material, and that we consequently have unemployed (say) 1,000,000 men who would otherwise, directly or indirectly, have been producing these exports. All these figures are, of course, very rough illustrations of what is reasonably probable, not scientific estimates of statistical facts.

How does our international balance-sheet then stand? We still have a surplus of £75,000,000 per annum. Provided, therefore, we do not invest abroad more than this sum, we are in equilibrium. We can continue permanently with our higher level of sheltered prices, with a quarter of our foreign trade lost, and with a million men unemployed, but also with some surplus still left for the City of London to invest abroad, and, as the crown of all, the gold standard entirely unthreatened. The gold standard may have reduced the national wealth, as compared with an alternative monetary policy, by £150,000,000 a year. Never mind! "Our economic reserves of strength," as Mr. Leaf puts it, "are far greater than any of us supposed." "We are

tougher than we thought," in the words of the Chancellor of the Exchequer. In short, we can afford it!

The special losses of the Coal Strike period are not allowed for in the above. They seem to have amounted to round £100,000,000, and to have been met by increasing our short-loan indebtedness, partly with the aid of the usual time-lag in the settlement of adverse balances, and partly by a relatively attractive rate of discount drawing foreign balances to London.

In determining the future of our National Policy, we have three alternatives before us:—

(1) We can seek at all costs to restore the pre-war equilibrium of large exports and large foreign investments. The return to gold has rendered this impossible without an all-round attack on wages, such as the Prime Minister has repudiated, or a considerable rise of external gold prices which we wait for in vain.

(2) We can continue indefinitely in the pseudo-equilibrium described above with trade depressed and a million unemployed. This pseudo-equilibrium has been the result, though probably not the intention, of the Bank of England's policy up to date. I see no convincing reason why it should not be continued for some time yet. Mr. Norman may have an awkward period ahead owing to the delayed results of the Coal Strike. But even if the worst comes, a partial reimposition of the embargo on foreign investments might be enough.

(3) The third course consists in accepting the

loss of export trade and a corresponding reduction of foreign investment and in diverting the labour previously employed in the former and the savings previously absorbed in the latter to the task of improving the efficiency of production and the standard of life at home. If the return to gold has the effect in the end of bringing about this result, it may have been a blessing in disguise. For this course has manifold advantages which I must not stop to enumerate at the end of a long article. I believe that a further improvement in the standard of life of the masses is dependent on our taking it.

This brings us back to Mr. McKenna. I assume that his object in advocating an expansion of credit is to absorb the unemployed in a general crescendo of home industry and indirectly to help a little the export industries also by the economies of full-scale production. In short, he favours the third course. For he can hardly hope to lower the sheltered price level or to effect an adequate economy in manufacturing costs by expanding credit. As on some previous occasions, Mr. McKenna has done less than justice to his own ideas by pretending to greater confidence in the effects of the return to gold than he really has.

Now, within the limitations of the gold standard, this is a very difficult policy, and—in view of the £100,000,000 which we may still owe on account of the Coal Strike—possibly a dangerous one. If Mr. McKenna were Governor of the Bank of England with a free hand, I

believe it to be probable that he could greatly reduce the numbers of the unemployed whilst maintaining gold parity. But can we expect Mr. Norman to do so, moving within the limitations of his own mentality?

5. THE ECONOMIC CONSEQUENCES OF MR. CHURCHILL (1925)[1]

(i) *The Misleading of Mr. Churchill*

The policy of improving the foreign-exchange value of sterling up to its pre-war value in gold from being about 10 per cent below it, means that, whenever we sell anything abroad, either the foreign buyer has to pay 10 per cent *more in his money* or we have to accept 10 per cent *less in our money*. That is to say, we have to reduce our sterling prices, for coal or iron or shipping freights or whatever it may be, by 10 per cent in order to be on a competitive level, unless prices rise elsewhere. Thus the policy of improving the exchange by 10 per cent involves a reduction of 10 per cent in the sterling receipts of our export industries.

Now, if these industries found that their expenses for wages and for transport and for rates and for everything else were falling 10 per cent at the same time, they could afford to cut their prices and would be no worse off than before. But, of course, this does not happen. Since they use, and their employees consume, all kinds of

[1] [Written immediately after the Return to Gold.]

articles produced at home, it is impossible for them to cut their prices 10 per cent, unless wages and expenses in home industries generally have fallen 10 per cent. Meanwhile the weaker export industries are reduced to a bankrupt condition. Failing a fall in the value of gold itself, nothing can retrieve their position except a general fall of all internal prices and wages. Thus Mr. Churchill's policy of improving the exchange by 10 per cent was, sooner or later, a policy of reducing every one's wages by 2s. in the £. He who wills the end wills the means. What now faces the Government is the ticklish task of carrying out their own dangerous and unnecessary decision.

The movement away from equilibrium began in October last (1924) and has proceeded, step by step, with the improvement of the exchange —brought about first by the anticipation, and then by the fact, of the restoration of gold, and not by an improvement in the intrinsic value of sterling.[1] The President of the Board of Trade has asserted in the House of Commons that the effect of the restoration of the gold standard upon our export trade has been "all to the good." The Chancellor of the Exchequer has expressed the opinion that the return to the

[1] This view was shared by the Treasury Committee on the Currency, who reported that the exchange improvement of last autumn and spring could not be maintained if we did not restore the gold standard; in other words, the improvement in the exchange prior to the restoration of gold was due to a speculative anticipation of this event and to a movement of capital, and not to an intrinsic improvement in sterling itself.

gold standard is no more responsible for the condition of affairs in the coal industry than is the Gulf Stream. These statements are of the feather-brained order. It is open to Ministers to argue that the restoration of gold is worth the sacrifice and that the sacrifice is temporary. They can also say, with truth, that the industries which are feeling the wind most have private troubles of their own. When a *general* cause operates, those which are weak for other reasons are toppled over. But because an epidemic of influenza carries off only those who have weak hearts, it is not permissible to say that the influenza is "all to the good," or that it has no more to do with the mortality than the Gulf Stream has.

The effect has been the more severe because we were not free from trouble a year ago. Whilst, at that date, sterling wages and sterling cost of living were in conformity with values in the United States, they were already too high compared with those in some European countries. It was also probable that certain of our export industries were overstocked both with plant and with labour, and that some transference of capital and of men into home industries was desirable and, in the long run, even inevitable. Thus we already had an awkward problem; and one of the arguments against raising the international value of sterling was the fact that it greatly aggravated, instead of mitigating, an existing disparity between internal and external values, and that, by committing us to a period

of Deflation, it necessarily postponed active measures of capital expansion at home, such as might facilitate the transference of labour into the home trades. British wages, measured in gold, are now 15 per cent higher than they were a year ago. The gold cost of living in England is now so high compared with what it is in Belgium, France, Italy, and Germany that the workers in those countries can accept a gold wage 30 per cent lower than what our workers receive without suffering at all in the amount of their real wages. What wonder that our export trades are in trouble!

Our export industries are suffering because they are the *first* to be asked to accept the 10 per cent reduction. If *every one* was accepting a similar reduction at the same time, the cost of living would fall, so that the lower money wage would represent nearly the same real wage as before. But, in fact, there is no machinery for effecting a simultaneous reduction. Deliberately to raise the value of sterling money in England means, therefore, engaging in a struggle with each separate group in turn, with no prospect that the final result will be fair, and no guarantee that the stronger groups will not gain at the expense of the weaker.

The working classes cannot be expected to understand, better than Cabinet Ministers, what is happening. Those who are attacked first are faced with a depression of their standard of life, because the cost of living will not fall until all the others have been successfully attacked too;

and, therefore, they are justified in defending themselves. Nor can the classes which are first subjected to a reduction of money wages be guaranteed that this will be compensated later by a corresponding fall in the cost of living, and will not accrue to the benefit of some other class. Therefore they are bound to resist so long as they can; and it must be war, until those who are economically weakest are beaten to the ground.

This state of affairs is not an inevitable consequence of a decreased capacity to produce wealth. I see no reason why, with good management, real wages need be reduced on the average. It is the consequence of a misguided monetary policy.

These arguments are not arguments against the gold standard as such. That is a separate discussion which I shall not touch here. They are arguments against having restored gold in conditions which required a substantial readjustment of all our money values. If Mr. Churchill had restored gold by fixing the parity lower than the pre-war figure, or if he had waited until our money values were adjusted to the pre-war parity, then these particular arguments would have no force. But in doing what he did in the actual circumstances of last spring, he was just asking for trouble. For he was committing himself to force down money wages and all money values, without any idea how it was to be done. Why did he do such a silly thing?

Partly, perhaps, because he has no instinct-

ive judgement to prevent him from making mistakes; partly because, lacking this instinctive judgement, he was deafened by the clamorous voices of conventional finance; and, most of all, because he was gravely misled by his experts.

His experts made, I think, two serious mistakes. In the first place, I suspect that they miscalculated the degree of the maladjustment of money values which would result from restoring sterling to its pre-war gold parity, because they attended to index numbers of prices which were irrelevant or inappropriate to the matter in hand. If you want to know whether sterling values are adjusting themselves to an improvement in the exchange, it is useless to consider, for example, the price of raw cotton in Liverpool. This *must* adjust itself to a movement of the exchange, because, in the case of an imported raw material, the parity of international values is necessarily maintained almost hour by hour. But it is not sensible to argue from this that the money wages of dockers or of charwomen and the cost of postage or of travelling by train also adjust themselves hour by hour in accordance with the foreign exchanges. Yet this, I fancy, is what the Treasury did. They compared the usual wholesale index numbers here and in America, and—since these are made up to the extent of at least two-thirds from the raw materials of international commerce, the prices of which necessarily adjust themselves to the exchanges—the true dis-

parity of internal prices was watered down to a fraction of its true value. This led them to think that the gap to be bridged was perhaps 2 or 3 per cent, instead of the true figure of 10 or 12 per cent, which was the indication given by the index numbers of the cost of living, of the level of wages, and of the prices of our manufactured exports—which indexes are a much better rough-and-ready guide for this purpose, particularly if they agree with one another, than are the index numbers of wholesale prices.

But I think that Mr. Churchill's experts also misunderstood and underrated the technical difficulty of bringing about a general reduction of internal money values. When we raise the value of sterling by 10 per cent we transfer about £1,000,000,000 into the pockets of the rentiers out of the pockets of the rest of us, and we increase the real burden of the National Debt by some £750,000,000 (thus wiping out the benefit of all our laborious contributions to the Sinking Fund since the war). This, which is bad enough, is inevitable. But there would be no other bad consequences if only there was some way of bringing about a simultaneous reduction of 10 per cent in all other money payments; when the process was complete we should each of us have nearly the same real income as before. I think that the minds of his advisers still dwelt in the imaginary academic world, peopled by City editors, members of Cunliffe and Currency Committees *et hoc genus*

omne, where the necessary adjustments follow "automatically" from a "sound" policy by the Bank of England.

The theory is that depression in the export industries, which are admittedly hit first, coupled if necessary with dear money and credit restriction, *diffuse* themselves evenly and fairly rapidly throughout the whole community. But the professors of this theory do not tell us in plain language how the diffusion takes place.

Mr. Churchill asked the Treasury Committee on the Currency to advise him on these matters. He declared in his Budget speech that their report "contains a reasoned marshalling of the arguments which have convinced His Majesty's Government." Their arguments—if their vague and jejune meditations can be called such—are there for any one to read. What they ought to have said, but did not say, can be expressed as follows:—

"Money wages, the cost of living, and the prices which we are asking for our exports have not adjusted themselves to the improvement in the exchange, which the expectation of your restoring the gold standard, in accordance with your repeated declarations, has already brought about. They are about 10 per cent too high. If, therefore, you fix the exchange at this gold parity, you must either gamble on a rise in gold prices abroad, which will induce foreigners to pay a higher gold price for our exports, or you are committing yourself to a

policy of forcing down money wages and the cost of living to the necessary extent.

"We must warn you that this latter policy is not easy. It is certain to involve unemployment and industrial disputes. If, as some people think, real wages were already too high a year ago, that is all the worse, because the amount of the necessary wage reductions in terms of money will be all the greater.

"The gamble on a rise in gold prices abroad may quite likely succeed. But it is by no means certain, and you must be prepared for the other contingency. If you think that the advantages of the gold standard are so significant and so urgent that you are prepared to risk great unpopularity and to take stern administrative action in order to secure them, the course of events will probably be as follows:

"To begin with, there will be great depression in the export industries. This in itself will be helpful, since it will produce an atmosphere favourable to the reduction of wages. The cost of living will fall somewhat. This will be helpful too, because it will give you a good argument in favour of reducing wages. Nevertheless, the cost of living will not fall sufficiently, and, consequently, the export industries will not be able to reduce their prices sufficiently until wages have fallen in the sheltered industries. Now wages will not fall in the sheltered industries merely because there is unemployment in the unsheltered industries, therefore you will have to see to it that there is unemployment

in the sheltered industries also. The way to do this will be by credit restriction. By means of the restriction of credit by the Bank of England you can deliberately intensify unemployment to any required degree until wages *do* fall. When the process is complete the cost of living will have fallen too, and we shall then be, with luck, just where we were before we started.

"We ought to warn you, though perhaps this is going a little outside our proper sphere, that it will not be safe politically to admit that you are intensifying unemployment deliberately in order to reduce wages. Thus you will have to ascribe what is happening to every conceivable cause except the true one. We estimate that about two years may elapse before it will be safe for you to utter in public one single word of truth. By that time you will either be out of office or the adjustment, somehow or other, will have been carried through."

(ii) *The Balance of Trade and the Bank of England*

The effect of a high exchange is to diminish the sterling prices both of imports and of exports. The result is both to encourage imports and to discourage exports, thus turning the balance of trade against us. It is at this stage that the Bank of England becomes interested; for if nothing was done we should have to pay the adverse balance in gold. The Bank of England has applied, accordingly, two effective remedies.

The first remedy is to put obstacles in the way of our usual lending abroad by means of an embargo on foreign loans and, recently, on Colonial loans also; and the second remedy is to encourage the United States to lend us money by maintaining the unprecedented situation of a bill rate 1 per cent higher in London than in New York.

The efficacy of these two methods for balancing our account is beyond doubt—I believe that they might remain efficacious for a considerable length of time. For we start with a wide margin of strength. Before the war our capacity to lend abroad was, according to the Board of Trade, about £181,000,000, equivalent to £280,000,000 at the present price level; and even in 1923 the Board of Trade estimated our net surplus at £102,000,000. Since new foreign investments bring in no immediate return, it follows that we can reduce our exports by £100,000,000 a year, without any risk of insolvency, provided we reduce our foreign investments by the same amount. So far as the maintenance of the gold standard is concerned, it is a matter of indifference whether we have £100,000,000 worth of foreign investment or £100,000,000 worth of unemployment. If those who used to produce exports lose their job, nevertheless, our financial equilibrium remains perfect, and the Governor of the Bank of England runs no risk of losing gold, provided that the loans, which were formerly paid over in the shape of those exports, are curtailed to

an equal extent. Moreover, our credit as a borrower is still very good. By paying a sufficiently high rate of interest, we can not only meet any deficit but the Governor can borrow, in addition, whatever quantity of gold it may amuse him to publish in his weekly return.

The President of the Board of Trade calculates that, during the year ended last May, it is probable that there was no actual deficit on our trade account, which was about square. If this is correct, there must be a substantial deficit now. In addition, the embargo on foreign investment is only partially successful. It cannot hold back all types of foreign issues and it cannot prevent British investors from purchasing securities direct from New York. It is here, therefore, that the Bank of England's other remedy comes in. By maintaining discount rates in London at a sufficient margin above discount rates in New York, it can induce the New York money market to lend a sufficient sum to the London money market to balance both our trade deficit and the foreign investments which British investors are still buying in spite of the embargo. Besides, when once we have offered high rates of interest to attract funds from the New York short-loan market, we have to continue them, even though we have no need to increase our borrowings, in order to retain what we have already borrowed.

Nevertheless, the policy of maintaining money rates in London at a level which will attract and retain loans from New York does not really

differ in any important respect from the French policy, which we have so much condemned, of supporting the exchange with the help of loans from Messrs. J. P. Morgan. Our policy would only differ from the French policy if the high rate of discount was not only intended to attract American money, but was also part of a policy for restricting credit at home. This is the aspect to which we must now attend.

To pay for unemployment by changing over from being a lending country to being a borrowing country is admittedly a disastrous course, and I do not doubt that the authorities of the Bank of England share this view. They dislike the embargo on foreign issues, and they dislike having to attract short-loan money from New York. They may do these things to gain a breathing space; but, if they are to live up to their own principles, they must use the breathing space to effect what are euphemistically called "the fundamental adjustments." With this object in view there is only one step which lies within their power—namely, to restrict credit. This, in the circumstances, is the orthodox policy of the gold party; the adverse trade balance indicates that our prices are too high, and the way to bring them down is by dear money and the restriction of credit. When this medicine has done its work, there will no longer be any need to restrict foreign loans or to borrow abroad.

Now what does this mean in plain language? Our problem is to reduce money wages and,

through them, the cost of living, with the idea that, when the circle is complete, real wages will be as high, or nearly as high, as before. By what *modus operandi* does credit restriction attain this result?

In no other way than by the deliberate intensification of unemployment. The object of credit restriction, in such a case, is to withdraw from employers the financial means to employ labour at the existing level of prices and wages. The policy can only attain its end by intensifying unemployment without limit, until the workers are ready to accept the necessary reduction of money wages under the pressure of hard facts.

This is the so-called "sound" policy, which is demanded as a result of the rash act of pegging sterling at a gold value, which it did not—measured in its purchasing power over British labour—possess as yet. It is a policy, nevertheless, from which any humane or judicious person must shrink. So far as I can judge, the Governor of the Bank of England shrinks from it. But what is he to do, swimming, with his boat burnt, between the devil and the deep sea? At present, it appears, he compromises. He applies the "sound" policy half-heartedly; he avoids calling things by their right names; and he hopes—this is his best chance—that something will turn up.

The Bank of England works with so much secrecy and so much concealment of important statistics that it is never easy to state with precision what it is doing. The credit restriction

already in force has been effected in several ways which are partly independent. First, there is the embargo on new issues which probably retards the normal rate of the circulation of money; then in March the bank-rate was raised; more recently market-rate was worked up nearer to bank-rate; lastly—and far the most important of all—the Bank has manœuvred its assets and liabilities in such a way as to reduce the amount of cash available to the Clearing Banks as a basis for credit. This last is the essential instrument of credit restriction. Failing direct information, the best reflection of the amount of this restriction is to be found in the deposits of the Clearing Banks. The tendency of these to fall indicates some significant degree of restriction. Owing, however, to seasonal fluctuations and to the artificial character of the end-June returns, it is not yet possible to estimate with accuracy how much restriction has taken place in the last three months. So far as one can judge, the amount of direct restriction is not yet considerable. But no one can say how much more restriction may become necessary if we continue on our present lines.

Nevertheless, even these limited measures are responsible, in my opinion, for an important part of the recent intensification of unemployment. Credit restriction is an incredibly powerful instrument, and even a little of it goes a long way—especially in circumstances where the opposite course is called for. The policy of deliberately intensifying unemployment with

a view to forcing wage reductions is already partly in force, and the tragedy of our situation lies in the fact that, from the misguided standpoint which has been officially adopted, this course is theoretically justifiable. No section of labour will readily accept lower wages merely in response to sentimental speeches, however genuine, by Mr. Baldwin. We are depending for the reduction of wages on the pressure of unemployment and of strikes and lock-outs; and in order to make sure of this result we are deliberately intensifying the unemployment.

The Bank of England is *compelled* to curtail credit by all the rules of the gold standard game. It is acting conscientiously and "soundly" in doing so. But this does not alter the fact that to keep a tight hold on credit—and no one will deny that the Bank is doing that—necessarily involves intensifying unemployment in the present circumstances of this country. What we need to restore prosperity to-day is an easy credit policy. We want to encourage business men to enter on new enterprises, not, as we are doing, to discourage them. Deflation does not reduce wages "automatically." It reduces them by causing unemployment. The proper object of dear money is to check an incipient boom. Woe to those whose faith leads them to use it to aggravate a depression!

I should pick out coal as being above all others a victim of our monetary policy. On the other hand, it is certainly true that the reason

why the Coal Industry presents so dismal a picture to the eye is because it has other troubles which have weakened its power of resistance and have left it no margin of strength with which to support a new misfortune.

In these circumstances the colliery owners propose that the gap should be bridged by a reduction of wages, irrespective of a reduction in the cost of living—that is to say, by a lowering in the standard of life of the miners. They are to make this sacrifice to meet circumstances for which they are in no way responsible and over which they have no control.

It is a grave criticism of our way of managing our economic affairs that this should seem to any one to be a reasonable proposal; though it is equally unreasonable that the colliery owner should suffer the loss, except on the principle that it is the capitalist who bears the risk. If miners were free to transfer themselves to other industries, if a collier out of work or underpaid could offer himself as a baker, a bricklayer, or a railway porter at a lower wage than is now current in these industries, it would be another matter. But notoriously they are not so free. Like other victims of economic transition in past times, the miners are to be offered the choice between starvation and submission, the fruits of their submission to accrue to the benefit of other classes. But in view of the disappearance of an effective mobility of labour and of a competitive wage level between different industries, I am not sure that they are not worse

placed in some ways than their grandfathers were.

Why should coal miners suffer a lower standard of life than other classes of labour? They may be lazy, good-for-nothing fellows who do not work so hard or so long as they should. But is there any evidence that they are more lazy or more good-for-nothing than other people?

On grounds of social justice, no case can be made out for reducing the wages of the miners. They are the victims of the economic Juggernaut. They represent in the flesh the "fundamental adjustments" engineered by the Treasury and the Bank of England to satisfy the impatience of the City fathers to bridge the "moderate gap" between \$4·40 and \$4·86. *They* (and others to follow) are the "moderate sacrifice" still necessary to ensure the stability of the gold standard. The plight of the coal miners is the first, but not—unless we are very lucky—the last, of the Economic Consequences of Mr. Churchill.

The truth is that we stand mid-way between two theories of economic society. The one theory maintains that wages should be fixed by reference to what is "fair" and "reasonable" as between classes. The other theory—the theory of the economic Juggernaut—is that wages should be settled by economic pressure, otherwise called "hard facts," and that our vast machine should crash along, with regard only to its equilibrium as a whole, and without

attention to the chance consequences of the journey to individual groups.

The gold standard, with its dependence on pure chance, its faith in "automatic adjustments," and its general regardlessness of social detail, is an essential emblem and idol of those who sit in the top tier of the machine. I think that they are immensely rash in their regardlessness, in their vague optimism and comfortable belief that nothing really serious ever happens. Nine times out of ten, nothing really serious does happen—merely a little distress to individuals or to groups. But we run a risk of the tenth time (and are stupid into the bargain) if we continue to apply the principles of an Economics which was worked out on the hypotheses of *laissez-faire* and free competition to a society which is rapidly abandoning these hypotheses.

(iii) *Is there a Remedy?*

The monetary policy announced in the Budget (of 1925) being the real source of our industrial troubles, it is impossible to recommend any truly satisfactory course except its reversal. Nevertheless, amongst the alternatives still open to this Government, some courses are better than others.

One course is to pursue the so-called "sound" policy vigorously, with the object of bringing about "the fundamental adjustments" in the orthodox way by further restricting credit and raising the bank-rate in the autumn if necessary,

thus intensifying unemployment and using every other weapon in our hands to force down money wages, trusting in the belief that, when the process is finally complete, the cost of living will have fallen also, thus restoring average real wages to their former level. If this policy can be carried through it will be, in a sense, successful, though it will leave much injustice behind it on account of the inequality of the changes it will effect, the stronger groups gaining at the expense of the weaker. For the method of economic pressure, since it bears most hardly on the weaker industries, where wages are already relatively low, tends to increase the existing disparities between the wages of different industrial groups.

The question is how far public opinion will allow such a policy to go. It would be politically impossible for the Government to admit that it was deliberately intensifying unemployment, even though the members of the Currency Committee were to supply them with an argument for it. On the other hand, it is possible for Deflation to produce its effects without being recognised. Deflation, once started ever so little, is cumulative in its progress. If pessimism becomes generally prevalent in the business world, the slower circulation of money resulting from this can carry Deflation a long way further, without the Bank having either to raise the bank-rate or to reduce its deposits. And since the public always understands particular causes better than general causes, the depression

will be attributed to the industrial disputes which will accompany it, to the Dawes Scheme, to China, to the inevitable consequences of the Great War, to tariffs, to high taxation, to anything in the world except the general monetary policy which has set the whole thing going.

Moreover, this course need not be pursued in a clear-cut way. A furtive restriction of credit by the Bank of England can be coupled with vague cogitations on the part of Mr. Baldwin (who has succeeded to the position in our affections formerly occupied by Queen Victoria) as to whether social benevolence does not require him to neutralise the effects of this by a series of illogical subsidies. Queen Baldwin's good heart will enable us to keep our tempers, whilst the serious work goes on behind the scenes. The Budgetary position will render it impossible for the subsidies to be big enough to make any real difference. And in the end, unless there is a social upheaval, "the fundamental adjustments" will duly take place.

Some people may contemplate this forecast with equanimity. I do not. It involves a great loss of social income whilst it is going on, and will leave behind much social injustice when it is finished. The best, indeed the only, hope lies in the possibility that in this world, where so little can be foreseen, something may turn up —which leads me to my alternative suggestions. Could we not *help* something to turn up?

There are just two features of the situation which are capable of being turned to our advan-

tage. The first is financial—if the value of gold would fall in the outside world, that would render unnecessary any important change in the level of wages here. The second is industrial—if the cost of living would fall *first*, our consciences would be clear in asking Labour to accept a lower money wage, since it would then be evident that the reduction was not part of a plot to reduce real wages.

When the return to the gold standard was first announced, many authorities agreed that we were gambling on rising prices in the United States. The rise has not taken place, so far.[1] Moreover, the policy of the Bank of England has been calculated to steady prices in the United States rather than to raise them. The fact that American banks can lend their funds in London at a high rate of interest tends to keep money rates in New York higher than they would be otherwise, and to draw to London, instead of to New York, the oddments of surplus gold in the world markets. Thus our policy has been to relieve New York of the pressure of cheap money and additional gold which would tend otherwise to force their prices upwards. The abnormal difference between money rates in London and New York is preventing the gold standard from working even according to its own principles. According to

[1] In my opinion, we need not yet abandon the hope that it will take place. The tendency of American prices is upwards, rather than downwards, and it only requires a match to set alight the dormant possibilities of inflation in the United States. This possibility is the one real ground for not being too pessimistic.

orthodox doctrine, when prices are too high in A as compared with B, gold flows out from A and into B, thus lowering prices in A and *raising them in B*, so that an upward movement in B's prices meets half-way the downward movement in A's.

At present the policy of the Bank of England prevents this from happening. I suggest, therefore, that they should reverse this policy. Let them reduce the bank-rate, and cease to restrict credit. If, as a result of this, the "bad" American money, which is now a menace to the London Money Market, begins to flow back again, let us pay it off in gold or, if necessary, by using the dollar credits which the Treasury and the Bank of England have arranged in New York. It would be better to pay in gold, because it would be cheaper and because the flow of actual gold would have more effect on the American price level. If we modified the rules which now render useless three-quarters of our stock of gold, we could see with equanimity a loss of £60,000,000 or £70,000,000 in gold—which would make a great difference to conditions elsewhere. There is no object in paying 4½ per cent interest on floating American balances which can leave us at any moment, in order to use these balances to buy and hold idle and immobilised gold.

Gold could not flow out on this scale, unless at the same time the Bank of England was abandoning the restriction of credit and was replacing the gold by some other asset, *e.g.*

Treasury Bills. That is to say, the Bank would have to abandon the attempt to bring about the fundamental adjustments by the methods of economic pressure and the deliberate intensification of unemployment. Therefore, taken by itself, this policy might be open to the criticism that it was staking too much on the expectation of higher prices in America.

To meet this, I suggest that Mr. Baldwin should face the facts frankly and sincerely, in collaboration with the Trade Union leaders, on the following lines.

So long as members of the Cabinet continue to pretend that the present movement to reduce wages has nothing to do with the value of money, it is natural that the working classes should take it as a concerted attack on real wages. If the Chancellor of the Exchequer is right in his view that his monetary policy has had no more to do with the case than the Gulf Stream, then it follows that the present agitations to lower wages are simply a campaign against the standard of life of the working classes. It is only when the Government have admitted the truth of the diagnosis set forth in these chapters that they are in a position to invite the collaboration of the Trade Union leaders on fair and reasonable terms.

As soon as the Government admit that the problem is primarily a monetary one, then they can say to Labour: "This is not an attack on real wages. We have raised the value of sterling 10 per cent. This means that money wages

must fall 10 per cent. But it also means, when the adjustment is complete, that the cost of living will fall about 10 per cent. In this case there will have been no serious fall in real wages. Now there are two alternative ways of bringing about the reduction of money wages. One way is to apply economic pressure and to intensify unemployment by credit restriction until wages are *forced down*. This is a hateful and disastrous way, because of its unequal effects on the stronger and on the weaker groups, and because of the economic and social waste whilst it is in progress. The other way is to effect a *uniform* reduction of wages by *agreement*, on the understanding that this shall not mean in the long run any fall in average real wages below what they were in the first quarter of this year. The practical difficulty is that money wages and the cost of living are interlocked. The cost of living cannot fall until *after* money wages have fallen. Money wages must fall *first* in order to allow the cost of living to fall. Can we not agree, therefore, to have a uniform initial reduction of money wages throughout the whole range of employment, including Government and Municipal employment, of (say) 5 per cent, which reduction shall not hold good unless, after an interval, it has been compensated by a fall in the cost of living?"

If Mr. Baldwin were to make this proposal the Trade Union leaders would probably ask him at once what he intended to do about money payments other than wages—rents,

profits, and interest. As regards rents and profits, he can reply that these are not fixed in terms of money, and will therefore fall, when measured in money, step by step with prices. The worst of this reply is that rents and profits, like wages, are sticky and may not fall quick enough to help the transition as much as they should. As regards the interest on bonds, however, and particularly the interest on the National Debt, he has no answer at all. For it is of the essence of any policy to lower prices that it benefits the receivers of interest at the expense of the rest of the community; this consequence of deflation is deeply embedded in our system of money contract. On the whole, I do not see how Labour's objection can be met, except by the rough-and-ready expedient of levying an additional income-tax of 1s. in the £ on all income other than from employments, which should continue until real wages had recovered to their previous level.[1]

If the proposal to effect a voluntary all-round reduction of wages, whilst sound in principle, is felt to be too difficult to achieve in practice, then, for my part, I should be inclined to stake everything on an attempt to raise prices in the outside world—that is on a reversal of the present policy of the Bank of England. This, I

[1] This will not prevent bondholders from gaining in the long run, if in the long run prices do not rise again. But such profits and losses to bondholders are an inevitable feature of an unstable monetary standard. Since, however, prices generally do rise in the long run, bondholders in the long run are losers, not gainers, from the system.

understand from their July *Monthly Review*, is also the recommendation of the high authorities of the Midland Bank.

That there should be grave difficulties in all these suggestions is inevitable. Any plan, such as the Government has adopted, for deliberately altering the value of money, must, in modern economic conditions, come up against objections of justice and expediency. They are suggestions to mitigate the harsh consequences of a mistake; but they cannot undo the mistake. They will not commend themselves to those pessimists who believe that it is the level of real wages, and not merely of money wages, which is the proper object of attack. I mention them because our present policy of deliberately intensifying unemployment by keeping a tight hold on credit, just when on other grounds it ought to be relaxed, so as to force adjustments by using the weapon of economic necessity against individuals and against particular industries, is a policy which the country would never permit if it knew what was being done.

6. Mitigation by Tariff[1]

(i) *Proposals for a Revenue Tariff*
(March 7, 1931)

Do you think it a paradox that we can continue to increase our capital wealth by adding both to our foreign investments and to our equipment at home, that we can continue to live (most of us) much as usual or better, and support at the same time a vast body of persons in idleness with a dole greater than the income of a man in full employment in most parts of the world—and yet do all this with one quarter of our industrial plant closed down and one quarter of our industrial workers unemployed? It would be not merely a paradox, but an impossibility, if our potential capacity for the creation of wealth were not much greater than it used to be. But this greater capacity does exist. It is to be attributed mainly to three

[1] [For some months before the collapse of the gold standard it had become obvious that this collapse was becoming inevitable unless special steps were taken to mitigate the gravity of our problem. Somewhat in desperation, I made various suggestions, and, amongst them, a proposal for a Tariff combined, if possible, with a bounty to exports. Mr. Snowden, endowed with more than a normal share of blindness and obstinacy, opposed his negative to all the possible alternatives, until, at last, natural forces took charge and put us out of our misery.]

factors—the ever-increasing technical efficiency of our industry (I believe that output per head is 10 per cent greater than it was even so recently as 1924), the greater economic output of women, and the larger proportion of the population which is at the working period of life. The fall in the price of our imports compared with that of our exports also helps. The result is that with three-fourths of our industrial capacity we can now produce as much wealth as we could produce with the whole of it a few years ago. But how rich we could be if only we could find some way of employing *four*-fourths of our capacity to-day!

Our trouble is, then, not that we lack the physical means to support a high standard of life, but that we are suffering a breakdown in organisation and in the machinery by which we buy and sell to one another.

There are two reactions to this breakdown. We experience the one or the other according to our temperaments. The one is inspired by a determination to maintain our standards of life by bringing into use our wasted capacity—that is to say, to expand, casting fear and even prudence away. The other, the instinct to contract, is based on the psychology of fear. How reasonable is it to be afraid?

We live in a society organised in such a way that the activity of production depends on the individual business man hoping for a reasonable profit, or at least, to avoid an actual loss. The margin which he requires as his necessary

incentive to produce may be a very small proportion of the total value of the product. But take this away from him and the whole process stops. This, unluckily, is just what has happened. The fall of prices relatively to costs, together with the psychological effect of high taxation, has destroyed the necessary incentive to production. This is at the root of our disorganisation. It may be unwise, therefore, to frighten the business man or torment him further. A forward policy is liable to do this. For reasoning by a false analogy from what is prudent for an individual who finds himself in danger of living beyond his means, he is usually, when his nerves are frayed, a supporter, though to his own ultimate disadvantage, of national contraction.

And there is a further reason for nervousness. We are suffering from *international* instability. Notoriously the competitive power of our export trades is diminished by our high standard of life. At the same time the lack of profits in home business inclines the investor to place his money abroad, whilst high taxation exercises a sinister influence in the same direction. Above all, the reluctance of other creditor countries to lend (which is the root-cause of this slump) places too heavy a financial burden on London. These, again, are apparent arguments against a forward policy; for greater activity at home due to increased employment will increase our excess of imports, and Government borrowing may (in their present mood) frighten investors.

Thus the *direct* effect of an expansionist policy must be to cause Government borrowing, to throw some burden on the Budget, and to increase our excess of imports. In every way, therefore—the opponents of such a policy point out—it will aggravate the want of confidence, the burden of taxation, and the international instability which, they believe, are at the bottom of our present troubles.

At this point the opponents of expansion divide into two groups—those who think that we must not only postpone all ideas of expansion, but must positively contract, by which they mean reduce wages and make large economies in the existing expenditure of the Budget, and those who are entirely negative and, like Mr. Snowden, dislike the idea of contraction (interpreted in the above sense) almost as much as they dislike the idea of expansion.

The policy of negation, however, is really the most dangerous of all. For, as time goes by, it becomes increasingly doubtful whether we *can* support our standard of life. With 1,000,000 unemployed we certainly can; with 2,000,000 unemployed we probably can; with 3,000,000 unemployed we probably cannot. Thus the negative policy, by allowing unemployment steadily to increase, must lead in the end to an unanswerable demand for a reduction in our standard of life. If we do nothing long enough, there will in the end be nothing else that we can do.

Unemployment, I must repeat, exists because employers have been deprived of profit. The loss of profit may be due to all sorts of causes. But, short of going over to Communism, there is no possible means of curing unemployment except by restoring to employers a proper margin of profit. There are two ways of doing this—by increasing the *demand* for output, which is the expansionist cure, or by decreasing the *cost* of output, which is the contractionist cure. Both of these try to touch the spot. Which of them is to be preferred?

To decrease the cost of output by reducing wages and curtailing Budget services may indeed increase foreign demand for our goods (unless, which is quite likely, it encourages a similar policy of contraction abroad), but it will probably diminish the domestic demand. The advantages to employers of a *general* reduction of wages are, therefore, not so great as they look. Each employer sees the advantage to himself of a reduction of the wages which he himself pays, and overlooks both the consequences of the reduction of the incomes of his customers and of the reduction of wages which his competitors will enjoy. Anyway, it would certainly lead to social injustice and violent resistance, since it would greatly benefit some classes of income at the expense of others. For these reasons a policy of contraction sufficiently drastic to do any real good may be quite impracticable.

Yet the objections to the expansionist remedy —the instability of our international position,

the state of the Budget, and the want of confidence—cannot be thus disposed of. Two years ago there was no need to be frightened. To-day it is a different matter. It would not be wise to frighten the penguins and arouse these frigid creatures to flap away from our shores with their golden eggs inside them. A policy of expansion sufficiently drastic to be useful might drive us off the gold standard. Moreover, two years ago the problem was mainly a British problem; to-day it is mainly international. No domestic cure to-day can be adequate by itself. An international cure is essential; and I see the best hope of remedying the international slump in the leadership of Great Britain. But if Great Britain is to resume leadership, she must be strong and believed to be strong. It is of paramount importance, therefore, to restore full confidence in London. I do not believe that this is difficult; for the real strength of London is being under-estimated to-day by foreign opinion, and the position is ripe for a sudden reversal of sentiment. For these reasons I, who opposed our return to the gold standard and can claim, unfortunately, that my Cassandra utterances have been partly fulfilled, believe that our exchange position should be relentlessly defended to-day, in order, above all, that we may resume the vacant financial leadership of the world, which no one else has the experience or the public spirit to occupy, speaking out of acknowledged strength and not out of weakness.

An advocate of expansion in the interests of domestic employment has cause, therefore, to think twice. I have thought twice, and the following are my conclusions.

I am of the opinion that a policy of expansion, though desirable, is not safe or practicable to-day, unless it is accompanied by other measures which would neutralise its dangers. Let me remind the reader what these dangers are. There is the burden on the trade balance, the burden on the Budget, and the effect on confidence. If the policy of expansion were to justify itself eventually by increasing materially the level of profits and the volume of employment, the net effect on the Budget and on confidence would in the end be favourable and perhaps very favourable. But this might not be the initial effect.

What measures are available to neutralise these dangers? A decision to reform the grave abuses of the dole, and a decision to postpone for the present all new charges on the Budget for social services in order to conserve its resources to meet schemes for the expansion of employment, are advisable and should be taken. But the main decision which seems to me to-day to be absolutely forced on any wise Chancellor of the Exchequer, whatever his beliefs about Protection, is the introduction of a substantial revenue tariff. It is certain that there is no other measure all the immediate consequences of which will be favourable and appropriate. The tariff which I have in mind would include

no discriminating protective taxes, but would cover as wide a field as possible at a flat rate or perhaps two flat rates, each applicable to wide categories of goods. Rebates would be allowed in respect of imported material entering into exports, but raw materials, which make up an important proportion of the value of exports, such as wool and cotton, would be exempt. The amount of revenue to be aimed at should be substantial, not less than £50,000,000 and, if possible, £75,000,000. Thus, for example, there might be import duties of 15 per cent on all manufactured and semi-manufactured goods without exception, and of 5 per cent on all food stuffs and certain raw materials, whilst other raw materials would be exempt.[1] I am prepared to maintain that the effect of such duties on the cost of living would be insignificant—no greater than the existing fluctuation between one month and another. Moreover, any conceivable remedy for unemployment will have the effect, and, indeed, will be intended, to raise prices. Equally, the effect on the cost of our exports, after allowing for the rebates which should be calculated on broad and simple lines, would be very small. It should be the declared intention of the Free Trade parties acquiescing in this decision to remove the duties in the event of world prices recovering to the level of 1929.

[1] [In a subsequent article I agreed that this precise scale of duties could not be relied on to produce so large a revenue as that suggested above, and that £40,000,000 was a safer estimate.]

Compared with any alternative which is open to us, this measure is unique in that it would at the same time relieve the pressing problems of the Budget and restore business confidence. I do not believe that a wise and prudent Budget can be framed to-day without recourse to a revenue tariff. But this is not its only advantage. In so far as it leads to the substitution of home-produced goods for goods previously imported, it will increase employment in this country. At the same time, by relieving the pressure on the balance of trade it will provide a much-needed margin to pay for the additional imports which a policy of expansion will require and to finance loans by London to necessitous debtor countries. In these ways, the buying power which we take away from the rest of the world by restricting certain imports we shall restore to it with the other hand. Some fanatical Free Traders might allege that the adverse effect of import duties on our exports would neutralise all this; but it would not be true.

Free Traders may, consistently with their faith, regard a revenue tariff as our iron ration, which can be used once only in emergency. The emergency has arrived. Under cover of the breathing space and the margin of financial strength thus afforded us, we could frame a policy and a plan, both domestic and international, for marching to the assault against the spirit of contractionism and fear.

If, on the other hand, Free Traders reject

hese counsels of expediency, the certain result vill be to break the present Government and o substitute for it, in the confusion of a Crisis of Confidence, a Cabinet pledged to a full pro-ectionist programme.

(ii) *On the Eve of Gold Suspension* (Sept. 10, 1931)

The moral energies of the nation are being directed into wrong channels, and serious troubles are ahead of us unless we apply our minds with more effect than hitherto to the analysis of the real character of our problems.

The exclusive concentration on the idea of "Economy," national, municipal, and personal—meaning by this the negative act of withholding expenditure which is now stimulating the forces of production into action—may, if under the spur of a sense of supposed duty it is carried far, produce social effects so shocking as to shake the whole system of our national life.

There is scarcely an item in the Economy Programme of the May Report—whether or not it is advisable on general grounds—which is not certain to increase unemployment, to lower the profits of business, and to diminish the yield of the revenue; so much so that I have calculated that economies of £100,000,000 may quite likely reduce the net Budget deficit by not more than £50,000,000, and we are just hoodwinking ourselves (unless our real object is to *pretend* to balance the Budget for the benefit

of foreign financiers) if we suppose that we can make the economies under discussion without any repercussions on the number of the unemployed to be supported or on the yield of the existing taxes.

Yet if we carry "Economy" of every kind to its logical conclusion, we shall find that we have balanced the Budget at nought on both sides, with all of us flat on our backs starving to death from a refusal, for reasons of economy, to buy one another's services.

The Prime Minister has said that it is like the war over again, and many people believe him. But this is exactly the opposite of the truth. During the war it was useful to refrain from any avoidable expenditure because this would release resources for the insatiable demands of military operations. What are we releasing resources for to-day? To stand at street corners and draw the dole.

When we already have a great amount of unemployment and unused resources of every description, economy is only useful from the national point of view *in so far as it diminishes our consumption of imported goods*. For the rest, its fruits are entirely wasted in unemployment, business losses, and reduced savings. But it is an extraordinarily indirect and wasteful way of reducing imports.

If we throw men out of work and reduce the incomes of Government employees so that those directly and indirectly affected cannot afford to buy so much imported food, to this extent the

country's financial position is eased. But this is not likely to amount to more than 20 per cent of the total economies enforced. The remaining 80 per cent is wasted, and represents either a mere transference of loss or unemployment due to a refusal of British citizens to purchase one another's services.

What I am saying is absolutely certain, yet I doubt if one in a million of those who are crying out for economy have the slightest idea of the real consequences of what they demand.

This is not to deny that there is a Budget problem. Quite the contrary. The point is that the state of the Budget is mainly a symptom and a consequence of other causes, that economy is in itself liable to aggravate rather than to remove these other causes, and that consequently the Budget problem, attacked merely along the lines of economy, is probably insoluble.

What are our troubles fundamentally due to? Very largely to the world depression, immediately to the unbelievable rashness of High Finance in the City, and originally to the policy of returning to the Gold Standard without the slightest appreciation of the nature of the difficulties which this involved. To say that our problem is a Budget problem is like saying that the German problem is a Budget problem, forgetting all about Reparations.

Now as regards the world depression, there is at the moment absolutely nothing that we can do, for we have now lost the power of international initiative which we seemed to be

regaining last May. The results of unsound international banking by the City are also, for the time being, irreparable. The choice left to us was whether or not to adhere to the present gold parity of the exchanges.

This was decided in the affirmative for reasons which I understand but with which I do not agree. The decision was taken in a spirit of hysteria and without a calm consideration of the alternative before us. Ministers have given forecasts of what might have been expected if we had taken a different course which could not survive ten minutes' rational discussion.

I believe that we shall come to regret this decision, just as we already regret most of the critical decisions taken during the last ten years by the persons who form the present Cabinet.

But that is not the point at this moment. The decision to maintain the gold standard at all costs has been taken. The point is that the Cabinet and the public seem to have no clear idea as to what has to be done to implement its own decision, apart from the obvious necessity of raising a foreign loan for immediate requirements; which simply has the effect of replacing money which we had previously borrowed in terms of sterling, by money borrowed in terms of francs and dollars. But they cannot suppose that we can depend permanently on foreign loans. The rest of the problem is primarily concerned with improving our current balance of trade on income account. This is what the Cabinet ought to be thinking about.

There are only two possible lines of attack on this. The one (which is the milder measure open to us) consists in direct measures to restrict imports (and, if possible, subsidise exports); the other is a reduction of all money wages within the country. We may have to attempt both in the end, if we refuse to devaluate.

But the immediate question is which to try first. Now the latter course, if it were to be adequate, would involve so drastic a reduction of wages and such appallingly difficult, probably insoluble, problems, both of social justice and practical method, that it would be crazy not to try first the effects of the alternative, and much milder, measure of restricting imports.

It happens that this course also has other important advantages. It will not only relieve the strain on the foreign exchanges. It would also do more than any other single measure to balance the Budget; and it is the only form of taxation open to us which will actually increase profits, improve employment, and raise the spirits and the confidence of the business community.

Finally, it is the only measure for which there is (sensibly enough) an overwhelming support from public opinion. It is credibly reported that the late Cabinet were in favour of a tariff in the proportion of three to one. It looks as if the present Cabinet may favour it in the proportion of four to one. The only third alternative Cabinet is unanimously for it. But

sacrifice being the order of the day, we have in the spirit of self-immolation conceived the brilliant contrivance of a "National" Government, the basis of which is that every member of it agrees, so long as it lasts, to sacrifice what he himself believes to be the only sound solution for our misfortunes.

For if we rule out Devaluation, which I personally now believe to be the right remedy, but which is not yet the policy of any organised party in the State, there are three possible lines of procedure.

The first is to take the risks of brisk home development, as being preferable to enforced idleness.

The second is to organise a general reduction of wages, and, in the interests of social justice, of other money-incomes as well, so far as this is feasible.

The third is a drastic restriction of imports.

The "National" Government is pledged, if I understand the position rightly, to avoid all three. Their policy is to reduce the standard of life of as many people as are within their reach in the hope that some small portion of the reductions of standard will be at the expense of imports. Deliberately to prefer this to a direct restriction of imports is to be *non compos mentis*.

(iii) *After the Suspension of Gold*

(A letter to *The Times*, Sept. 28, 1931)

Until recently I was urging on Liberals[1] and others the importance of accepting a general tariff as a means of mitigating the effects of the obvious disequilibrium between money-costs at home and abroad. But the events of the last week have made a great difference. At the present gold-value of sterling British producers are probably in many directions among the cheapest in the world. In these circumstances we cannot continue as if nothing had happened. It is impossible to have a rational discussion about tariffs so long as the currency question is altogether unsolved. For until we know more about the probable future level of sterling in relation to gold, and, above all, until we know how many other countries are going to follow our example, it is impossible to say what our competitive position is going to be.

May I urge that the immediate question for attention is not a tariff but the currency question? It is the latter which is urgent and important. It is at present a non-party issue on which none of the political parties has taken up a dogmatic attitude. It is suitable, therefore, for non-party handling. It is most certainly unsuitable for a General Election. It offers immense opportunities for leadership by

[1] [Not all my Free Trade friends proved to be so prejudiced as I had thought. For after a Tariff was no longer necessary, many of them were found voting for it.]

this country. We are probably in a position to carry the whole of the Empire and more than half of the rest of the world with us, and thus rebuild the financial supremacy of London on a firm basis. Meanwhile, proposals for high protection have ceased to be urgent. To throw the country into a turmoil over them to the neglect of this other more urgent and important problem would be a wrong and foolish thing. Let us give our whole attention and our united energies to devising a sound international currency policy for ourselves and the rest of the world. For it is futile to suppose that we can recover our former prosperity without such a policy, or that tariffs can be any substitute for it. When the currency question has been settled, then we can return to protection and to our other domestic issues with a solid basis to go upon; and that will be the time for a General Election.

7. The End of the Gold Standard (Sept. 27, 1931)[1]

There are few Englishmen who do not rejoice at the breaking of our gold fetters. We feel that we have at last a free hand to do what is sensible. The romantic phase is over, and we can begin to discuss realistically what policy is for the best.

It may seem surprising that a move which had been represented as a disastrous catastrophe should have been received with so much enthusiasm. But the great advantages to British trade and industry of our ceasing artificial efforts to maintain our currency above its real value were quickly realised.

The division of inside opinion was largely on a different point. The difficult question to decide was one of honour. The City of London considered that it was under an obligation of *honour* to make every possible effort to maintain the value of money in terms of which it had accepted large deposits from foreigners, even though the result of this was to place an intolerable strain on British industry. At what

[1] [On Sept. 21, 1931, the Gold Standard in Great Britain was suspended.]

point—that was the difficult problem—were we justified in putting our own interests first?

As events have turned out, we have got the relief we needed, and, at the same time, the claims of honour have been, in the judgement of the whole world, satisfied to the utmost. For the step was not taken until it was unavoidable. In the course of a few weeks the Bank of England paid out £200,000,000 in gold or its equivalent, which was about half the total claims of foreigners on London, and did this at a time when the sums which London had re-lent abroad were largely frozen. No banker could do more. Out of the ashes the City of London will rise with undiminished honour. For she has played the game up to the limits of quixotry, even at the risk of driving British trade almost to a standstill.

No wonder, then, that we feel some exuberance at the release, that Stock Exchange prices soar, and that the dry bones of industry are stirred. For if the sterling exchange is depreciated by, say, 25 per cent, this does as much to restrict our imports as a tariff of that amount; but whereas a tariff could not help our exports, and might hurt them, the depreciation of sterling affords them a bounty of the same 25 per cent by which it aids the home producer against imports.

In many lines of trade the British manufacturer to-day must be the cheapest producer in the world in terms of gold. We gain these advantages without a cut of wages and without

industrial strife. We gain them in a way which is strictly fair to every section of the community, without any serious effects on the cost of living. For less than a quarter of our total consumption is represented by imports; so that sterling would have to depreciate by much more than 25 per cent before I should expect the cost of living to rise by as much as 10 per cent. This would cause serious hardship to no one, for it would only put things back where they were two years ago. Meanwhile there will be a great stimulus to employment.

I make no forecast as to the figure to which sterling may fall in the next few days, except that it will have to fall for a time appreciably below the figure which cool calculators believe to represent the equilibrium. There will then be speculation and profit-taking in favour of sterling to balance speculation and panic selling on the other side. Our authorities made a great mistake in allowing sterling to open so high, because the inevitable gradual fall towards a truer level must sap confidence and produce on the ignorant the impression of a slide which cannot be stayed. Those who were guilty of undue optimism will quite likely succumb to undue pessimism. But the pessimism will be as unfounded as the optimism was. The equilibrium value of sterling is the same as it was a month ago. There are tremendous forces to support sterling when it begins to fall too far. There is no risk, in my judgement, of a catastrophic fall.

These, in brief, are the consequences in Great Britain. How will the rest of the world be influenced? Not in a uniform way. Let us take first the debtor countries to whom Great Britain has in the past lent large sums in sterling, and from whom interest is due in sterling, such as Australia, Argentina, and India. To these countries the depreciation of sterling represents a great concession. A smaller quantity of their goods will be sufficient to meet their sterling liabilities. The interest due to Great Britain from abroad, which is fixed in sterling, amounts to about £100,000,000 a year. In respect of this sum Great Britain now plays the part of a reasonable creditor who moderates his claim in view of so great a change in the situation as the recent catastrophic fall in commodity prices.

When we try to calculate the effect on other manufacturing countries, whose competition we are now in a better position to meet, the effect is more complex. A large part of the world will, I expect, follow Great Britain in reducing the former gold value of their money. There are already signs in many countries that no great effort will be made to maintain the gold parity. In the last few days Canada, Italy, Scandinavia have moved in our direction. India and the Crown Colonies, including the Straits Settlements, have automatically followed sterling. Australia and the whole of South America had already abandoned the effort to maintain exchange parity. I shall be astonished if Germany

delays long before following our example. Will Holland deal final ruin to the rubber and sugar industries of the Dutch Indies by keeping them tied to gold? There will be strong motives driving a large part of the world our way. After all, Great Britain's plight, as the result of the deflation of prices, is far less serious than that of most countries.

Now, in so far as this is the case, we and all the countries following our example will gain the benefits of higher prices. But none of us will secure a competitive advantage at the expense of the others. Thus the competitive disadvantage will be concentrated on those few countries which remain on the gold standard. On these will fall the curse of Midas. As a result of their unwillingness to exchange their exports except for gold their export trade will dry up and disappear until they no longer have either a favourable trade balance or foreign deposits to repatriate. This means in the main France and the United States. Their loss of export trade will be an inevitable, a predictable, outcome of their own action. These countries, largely for reasons resulting from the war and the war settlements, are owed much money by the rest of the world. They erect tariff barriers which prevent the payment of these sums in goods. They are unwilling to lend it. They have already taken nearly all the available surplus gold in the whole world. There remained, in logic, only one way by which the rest of the world could maintain its solvency and self-

respect; namely, to cease purchasing these countries' exports. So long as the gold standard is preserved—which means that the prices of international commodities must be much the same everywhere—this involved a competitive campaign of deflation, each of us trying to get our prices down faster than the others, a campaign which had intensified unemployment and business losses to an unendurable pitch.

But as soon as the gold exchange is ruptured the problem is solved. For the appreciation of French and American money in terms of the money of other countries makes it impossible for French and American exporters to sell their goods. The recent policy of these countries could not, if it was persistently pursued, end in any other way. They have willed the destruction of their own export industries, and only they can take the steps necessary to restore them. The appreciation of their currencies must also embarrass gravely their banking systems. The United States had, in effect, set the rest of us the problem of finding some way to do without her wheat, her copper, her cotton, and her motor-cars. She set the problem, and, as it had only one solution, that solution we have been compelled to find.

Yet this is quite the opposite of the note on which I wish to end. The solution to which we have been driven, though it gives immediate relief to us and transfers the strain to others, is in truth a solution unsatisfactory for every one. The world will never be prosperous without

a trade recovery in the United States. Peace and confidence and a harmonious economic equilibrium for all the closely interrelated countries of the globe is the only goal worth aiming at.

I believe that the great events of the last week may open a new chapter in the world's monetary history. I have a hope that they may break down barriers which have seemed impassable. We need now to take intimate and candid conference together as to the better ordering of our affairs for the future. The President of the United States turned in his sleep last June. Great issues deserve his attention. Yet the magic spell of immobility which has been cast over the White House seems still unbroken. Are the solutions offered us always to be too late? Shall we in Great Britain invite three-quarters of the world, including the whole of our Empire, to join with us in evolving a new currency system which shall be stable in terms of commodities? Or would the gold standard countries be interested to learn the terms, which must needs be strict, on which we should be prepared to re-enter the system of a drastically reformed gold standard?