STABILISATION

AN ECONOMIC POLICY FOR PRODUCERS & CONSUMERS

BY

E. M. H. LLOYD

Author of "Experiments in State Control"

1923

LONDON: GEORGE ALLEN & UNWIN LTD.
RUSKIN HOUSE, 40 MUSEUM STREET, W.C. 1

PREFACE

In the first part of this book I have contrasted the economic achievements of the war period with the subsequent paralysis of trade and production, and have attempted to answer the questions how far the slump was inevitable and what has been its chief cause. This leads to an examination of the important new doctrine, now officially endorsed by the thirty-one Governments assembled at the Genoa Conference, that the general level of prices, and consequently the general state of trade and employment, can be to a large extent stabilised by appropriate action on the part of the Central Banks.

The other topic with which I deal, viz., international control of raw materials and foodstuffs, though still regarded with disfavour by monetary experts and orthodox economists, is not, of course, a new idea. At the time of the Armistice and during the succeeding boom it was widely advocated in the interests of consuming countries. But so far as I am aware, advocates of the "pooling" of raw materials and foodstuffs have never worked out the monetary implications of this policy; nor have they put it forward as a remedy for "over-production" during a slump as well as for "world shortage" during a boom.

Monetary experts like Dr. Cassel, who have shown that it is both necessary and possible to regulate the value of gold by international co-operation, have enabled me to make good the former gap in the argument ; and for the latter I am indebted to directors of rubber companies, the President of Standard Oil, the International Miners' Federation, and the protagonists of agriculture throughout the world.

The idea of eliminating unnecessary price fluctuations and the promotion of "orderly marketing" (to use the American phrase), whether by producers' co-operation, by commercial combination, or by State intervention, is increasingly popular in producing countries, and possesses, I believe, a sound theoretical justification. I am aware that the generalised theory of price stabilisation, which I have outlined, is incompletely worked out and is subject to practical limitations and difficulties of a most formidable kind ; but if trusts, monopolies, price-fixing associations, co-operative organisations, and Government "pools" extend their operations over a much wider area, the orthodox "laws of supply and demand" will become less and less adequate and helpful, either as an account of what happens, or as a guide to constructive action. It is for this reason that I have briefly examined an alternative hypothesis, under which price regulation takes the place of the higgling of the market, and supply and demand are adjusted by deliberate planning.

E. M. H. L.

CONTENTS

STABILISATION

CHAPTER I

INTRODUCTORY

FOUR years ago, when it was still possible to believe that the achievements of war organisation had shown the way by which the world's economic system could be rebuilt on stable foundations, many of the experts who held official positions on Inter-Allied bodies, dealing with finance, shipping, food and raw materials, attempted to forecast the economic future and to evolve a policy for what was called the "transition period" between war and peace—a period that was variously estimated to last between six months and five years. The question they debated was whether during this period it was wiser to trust to the free play of economic forces or to attempt to control them by planning and organisation. The issue was the old one between *laisser faire* and collectivism; but as the majority were sceptical as to the possibility or desirability of a permanent policy of collectivism, the discussions proceeded on the assumption that the object was to restore such a normal equilibrium of economic forces that Government control and international co-operation could safely be removed. As a result of the discussions, general agreement was reached in favour of continuing a modified system of co-operation and control, until such time as the world had recovered from the tremendous dislocation of trade and production which the war had brought about.

This view was shared by many of the business men most closely associated with Inter-Allied control. One big industrialist stated that in his opinion international co-operation and control ought to be continued for five years after the war. He feared that premature decontrol would lead to chaos in the foreign exchanges and paralysing fluctuations in price-levels ; that until some degree of stability had been reached, trade would be a perpetual gamble ; and that unless some form of centralised supervision and direction was maintained, economic forces might be set in motion which would have disastrous repercussions on society, involving the complete discredit, if not the ultimate collapse, of the capitalist system.

The sequel is well known. On the one hand, the provisions of the Treaties, which bankrupted the ex-enemy states by wholly impossible indemnities, and shattered the economic unity of Central Europe by creating half a dozen new tariff walls and as many new paper currencies, rendered the task of economic reconstruction infinitely more difficult ; and on the other hand, the violent reaction of American and British financial and commercial interests against any form of international control of finance and raw materials, and the widespread and carefully fostered delusion amongst all classes of society that Government control was the one obstacle in the way of universal cheapness and prosperity, reinforced the natural inclination of the Big Four at Paris not to bother their heads at all about such uninteresting and complicated questions as food, currency and the restoration of productivity. As Mr. Keynes says in a well-known passage of *The Economic Consequences of the Peace*: "The fundamental economic problem of a Europe starving and disintegrating before their eyes was the one question in which it was impossible to arouse the interest of the Four."[1] They could not be brought to consider "the economic future of the States whose destiny they were handling."[2]

To-day we are still in the "transition period." The economic state of Europe is as chaotic and unstable as it was four years ago; and the economic state of this country and of America is in some respects worse. There are signs that the reaction against all forms of Government intervention is spending itself; and the interests that were loudest in their denunciations of Government control, when it meant the limitation of their profits, are now demanding Government intervention by way of guarantees, export credits and stabilisation of the exchanges, in order to save them from bankruptcy. The issue is no longer between individualism and collectivism. The satisfaction of individual purposes is seen to be bound up with, and conditioned by, the achievement of certain fundamental collective purposes; and the welfare of one nation or group of nations is gradually being recognised as intimately dependent on the stability and prosperity of other nations. One may say that the necessity for some degree of Government control and of international co-operation is admitted by all except extreme individualists. The

[1] P. 211. [2] P. 212.

practical problem, on which there is little agreement even among socialists, is the right degree and the right form of governmental intervention, nationally and internationally, in economic affairs.

In the following pages an attempt will be made to crystallise and give precision to some of the ideas current in progressive circles on one part of this vast field of discussion. That part is the extremely complicated and little explored sphere of commerce and finance. Producers and wage-earners are realising more and more that beyond the industrial problem, that is, questions of wages, hours, conditions of work, and the relations of employers and employed, there is a commercial and financial problem—questions of prices, cost of living, credit, currency, exchanges and foreign trade. During the last few years there have been unprecedented price fluctuations, first up and then down. Three years ago we were at the peak of an exaggerated boom, accompanied by all the usual symptoms of a boom—high wages, steady employment, high prices, stimulation of production, speculation and profiteering. Now we are slowly recovering from an unparalleled slump, which has been accompanied by the usual symptoms in an aggravated form—falling prices, unemployment, reduction of wages, restriction of production, losses and bankruptcies. These vast movements, which threaten to wreck the foundations of civilised life in highly industrialised countries like England, originate from obscure and multitudinous happenings which no man can confidently predict or effectively control. Even the privileged few, who take counsel together in the inmost sanctums of world finance and commerce, seem to be powerless to stem the onrush of these commercial cyclones that go sweeping over the world, leaving ruin and destitution in their wake.

The essence of competitive economy, we are told, is that no man or group of men can control the free play of economic forces. But if competitive economy has such disastrous results, is there no alternative? Is there no means by which the blind economic forces which sweep over the world can be regulated and controlled? Surely by some form of collective organisation it should be possible to secure greater stability and security, if not a reasonably sure guarantee of a civilised standard of life for all. This is the challenge that progressive thought has to meet.

CHAPTER II

THE COLLAPSE OF WORLD TRADE AND ITS CONSEQUENCES

It is sometimes held that if only reparations and Inter-Allied indebtedness and a few other outstanding political questions could be satisfactorily settled, Europe would rapidly recover and the world would soon return to normal conditions. If by this is meant a normal standard of comfort and security for bankers, merchants and manufacturers, it may be true; for the sufferings of this class have not assumed tragic proportions even during the abnormal conditions of the last eight years. But that the settlement of political conflicts, or even the revision of the Treaties, would restore tolerable conditions for the European masses is becoming less likely every day. Blind forces have been set in motion which cannot be so easily turned back; the economic system has received too many shattering blows, first from the war and then from the peace, and its recuperative powers are less elastic than they were even three years ago. The real danger which threatens Europe, and indeed the whole world, is that after the political maëlstrom has subsided and vindictive nationalism has done its worst, a new economic equilibrium will be reached at a permanently lower level of prosperity. There are indications which suggest that economic laws, if left to themselves, will decree a standard of production and consumption throughout the world below the pre-war level for many years to come.

The American banker, Mr. Frank Vanderlip, gave recently a graphic picture of the economic future of this country.[1] This is the gist of what he said. It amounted to a virtual death sentence for British trade and industry.

Europe is gradually settling down into a group of twenty or more predominantly agricultural and self-supporting States. These States will not be able to afford purchases abroad on the pre-war scale; they will take fewer manufactured goods, fewer raw materials, and fewer foodstuffs from Great Britain, from the Dominions and from the outside world. The Dominions, South America and the Far East will consequently sell less and buy less; they will meet their own needs for manufactured goods partly by cheap imports from Europe and partly from their own industries, which are growing up every year. Great Britain will become a fifth wheel to the coach, an unnecessary cog in the machine; or at least her predominance as the world's workshop and banking centre, to which she owed her prosperity in the nineteenth century, will be destroyed.

This may mean that between ten and twenty per cent. of our population will have to emigrate or starve. That is the considered prophecy of an international financier who looks beneath the surface of things to the hidden economic forces which are inexorably remoulding the channels of trade and production.

[1] *What Next in Europe?*

These are gloomy prognostications. They rest on the assumption that the world's trade and production will for many years ahead fall below the pre-war level. What evidence is there that lends support to this assumption? During the war, in spite of the cutting off of Central Europe from the markets of the world, there was no very pronounced decrease in the production of staple raw materials and foodstuffs. Owing to the vast consumption for military purposes and the unlimited purchasing power created by the belligerent Governments, the production of staple crops and raw materials was well maintained and even, in the case of many metals, increased. Then came the period of the post-armistice boom, when traders, assisted by further credit inflation, mistook Europe's real needs for effective purchasing power, and bought in a frenzy of speculation in anticipation of filling a perpetual vacuum. The rise of prices stimulated an increase of production; but in the absence of any indication on the part of Europe that she was really going to recover, pay her debts, and continue buying indefinitely, the Federal Reserve Board and the Bank of England became alarmed, put on the screw, and brought down the precarious house of cards with a crash. It was then that the real danger became evident. The succeeding slump was so severe that throughout four-fifths of the world trade and production became unprofitable, and dropped during 1921 below the normal pre-war level.

One of the best indices of the volume of world trade is provided by the jute crop, which is used in the form of bags and packing material for every variety of article, and has been called the "brown paper of wholesale commerce." The annual consumption before the war was close on ten million bales. The 1921 crop was not more than six million bales, and exports of raw jute from India during that year were less than half the normal pre-war exports. The 1922 crop is estimated at only 4,240,000 bales. The American cotton crop in 1921 was a little over eight million bales compared with a normal thirteen million, and the combined exports of the six principal cotton producing countries were 30 per cent. less than in 1913. Wool production in the Argentine in 1922 is the lowest for twenty years. According to a United States Commerce Report of July 28, 1922, the number of sheep has fallen from forty-five million in 1918 to between twenty-five and thirty-five million in 1922. This decline is attributed to the low prices for wool since 1920.[1]

The worst evil of the financial deflation and trade stagnation of the last two years is not the immediate losses and unemployment which it has caused, but the permanently depressing influence it is likely to have on the production of staple crops and raw materials. And the important point to note is that without deliberate stabilisation of production by some form of collective action on a world-wide scale, the possibility of which will be considered later, no rapid recovery is possible. If economic forces are left to take their natural course, it will take many years before the world's production has returned to its pre-war level. The average rate of economic progress during the hundred years before the war is said to have been not more than

[1] The above figures are taken, except where otherwise stated, from the Reports of the International Institute of Agriculture.

3 per cent. per annum. At this rate it might take the world fifteen or twenty years to recover even to the level of pre-war prosperity. Such chronic impoverishment can only mean a perpetuation of destitution among large masses of the wage-earning classes of Europe, in this country as much as in Germany; a lower standard of life for all, except possibly for Russian peasants and American millionaires; cut-throat competition between manufacturing countries for foreign markets; suicidal efforts to economise by cutting down education and housing and health services; in short, an international "poverty competition" between the producing countries of the world, each seeking to produce more cheaply, to work longer hours and to pay lower wages than any of its rivals.

Such a prospect is by no means an improbable picture. Against the free-play of blind economic forces working in this way trade unionism, unemployment insurance, Trade Boards, Whitley Councils, all the palliatives that presuppose a normal functioning of trade, would be without avail. Are we justified in rejecting this picture as too highly drawn? No one can say, but few would deny that this has been the tendency during the last two years. Whether probable or improbable, the fact is that we have no reasonable ground for security, so long as our fate is left to depend on the free-play of blind economic forces whose strength and course no man can forecast or control. If we are to get any security or confidence in the future, still more if we are to entertain a reasonable hope of tolerable conditions in this country, we must invoke something of the forethought, imagination, intelligence and organising ability which was applied to economic problems during the war. The motive of self-preservation, as we saw during the war, may accomplish miracles ; if I ask the reader to reject the pessimistic conclusion, it is only because I believe that similar miracles, though on a less ambitious scale, are still possible in peace.

CHAPTER III

THE LESSONS OF WAR ORGANISATION

IN the previous chapter I have given a sketch of the sort of gloomy prognostications often made by financiers and economists, who are able to look beneath the surface of things and detect some of the real forces underlying present economic tendencies. I have by no means exhausted all the plausible grounds for pessimism. Some say the world is over-populated ; that the world's food and fuel resources are becoming exhausted ; that war and famine are necessary evils, in order to get rid of surplus population ; that it is impossible to provide freedom and leisure and education for the masses of the people, since there is not enough wealth to go round to satisfy everybody's wants ; and that the only way to keep alive a feeble spark of culture and civilisation for the few is to keep the many permanently on the verge of starvation. The hard work of the world, so these pessimists say, can only be done if the workers are spurred on by hunger and fear.

I do not propose to deal with these ultimate objections. It may be that the Life Force has blundered, that human nature is not adapted, and never will be adapted, to a life of association and co-operation, and that the best thing, as Mr. Shaw suggested recently in a Christmas message to a Prague newspaper, would be for God to admit His failure, "scrap the lot," and start again. Progressive minds, by which I mean for the most part young minds, which naturally regard themselves as immune from the follies and crimes of their elders, will refuse to submit to this death-sentence. Man has evolved because the young have a natural tendency to reject the wisdom of the old and to try new experiments. The experiments are not always new, and rarely succeed. But so long as human life lasts there will always be experiments, and even if they do not come off, they are sometimes worth trying.

As a basis, then, for possible experiments, let us examine the experience of national and international organisation, by which economic "laws" were modified and controlled during the war. This will form a useful contrast to set beside the picture of helpless *laisser faire* which was given in the last chapter.

The war demonstrated a new and astounding power to control what had hitherto been regarded as the inexorable laws of the economic system. Without any revolutionary changes in the political constitution or the ownership of capital, the economic system was radically transformed. Instead of working primarily for a multitude of conflicting individual purposes, it was made to function for two predominantly social purposes: first, the prosecution of the war, and, secondly, the maintenance of a civilised standard of life for the whole population. So successful was this transformation that, on the whole, the standard of life of the mass of the population was well maintained, and even for some sections improved, in spite of the immense military effort required to carry on the war. In every belligerent country millions of the most efficient workers were taken from trade and production, and thousands of millions of pounds' worth of labour and capital were expended in non-productive and destructive ways. In this country alone five million men were taken from productive processes. Economically considered, the Army was an army of unemployed. But these five million unemployed were better fed, better clothed, and for a time better educated than they had ever been before. On a single day in the Somme offensive five million pounds' worth of shells were fired at the enemy. The productive capacity of the iron and steel industry is said to have been increased by 50 per cent. In a single year the production of blankets in this country for the Army alone exceeded the total production of blankets recorded in the Census of Production of 1911. There was less destitution, less unemployment, less pauperism and less crime than there are at the present time. These facts constitute a challenge to the system of competitive economy which cannot be disposed of by easy generalisations about the incompetence and mismanagement of Government departments. The achievements of war administration are not disparaged, but rather made the more remarkable by allegations of waste and inefficiency. What the critic overlooks is that the production of consumable and capital goods during the war surpassed anything ever dreamed of before the war. The productive power of this country alone was shown to be so vast that on a conservative estimate it would appear possible to produce all the essential needs of the population, and pay for all necessary imports, with less than half the work we now devote to this unambitious end without ever getting any nearer to its accomplishment.

This amazing result was not achieved to any large extent by "living on capital." The National Debt does not, of course, represent a capital loss so far as it is held at home. Against a considerable degree of depreciation of former capital in the form of roads, railways, houses, and to a less extent factories, must be set the large amount of new machinery installed and new factories built, much of which, it is true, though not all, is of little use for peace purposes. The net result is well summarised in Sir Arthur Salter's volume on *Allied Shipping Control*[1]:

> At a moderate estimate and allowing for the production of persons who were idle before the war, between a half and two-thirds of the productive capacity of the country was withdrawn into combatant or other war service. And yet throughout the war Great Britain sustained the whole of her military effort and maintained her civilian population at a standard of life which was never intolerably low, and for some periods and for some classes was perhaps as comfortable as in the time of peace. She did this without, on balance, drawing any aid from other countries. She imported, on borrowed money from America, less than she supplied on loaned money to her Allies. . . . She therefore maintained the whole of the current consumption both of her war effort and of her civilian population with a mere remnant of her productive power by means of current production.

Nor was there any special virtue in the inflationary methods by which the war was financed.

[1] P. 19.

As has often been pointed out, inflation was merely a grossly unfair form of taxation, which fell with special severity on bond-holders and persons with fixed incomes, and conferred unreasonable profits on merchants, speculators and shareholders. In theory, inflation was altogether unnecessary; in practice, if taxation had been increased, and Government control of prices and distribution had been enforced earlier, the expansion of credit and currency and the general rise in prices would have been far less. Inflation worked no miracles; the goods produced during the war were produced and paid for by the work done during the war. On balance, inflation hindered rather than facilitated the national effort.

One important factor, however, on the side of finance which did contribute to this result was that the volume of purchasing power was not limited by any such irrelevant consideration as the amount of gold held by the banks in this country or the United States. There was no slump in prices or contraction of the monetary circulation owing to the necessity of safeguarding gold reserves. When fresh purchasing power was required, it was always forthcoming. Purchasing power did not lag behind production; it was always in advance, for the most part excessively in advance. The importance of this fact will be appreciated when we come to consider the monetary problems of to-day.

More important, however, than the absence of arbitrary restrictions on the creation of fresh purchasing power, were the means by which the distribution of purchasing power was made to correspond with real social needs—in other words, the methods by which production and consumption were deliberately adjusted in such a way as to promote the general interest of the community.

This problem was immensely simplified during the war owing to the fact that so large a proportion of the national production was required for military purposes. If to-day the supreme national object was to produce the maximum quantity of shells, guns, battleships, aeroplanes and poison gas, there would be no difficulty in adjusting production to supply those needs. The Government, on behalf of the community, would order the goods required, and the producers would be assured of a guaranteed market. But besides equipping the Army, the Government found it necessary during the war to take upon itself to an ever-growing extent the supply of the necessaries of life to the civilian population. National organisations were created for the purpose of guaranteeing the supply and controlling the prices and distribution of food, fuel, and to some extent clothing, for the whole community; and in order to achieve this object, it was found necessary to make arrangements with other Governments for centralising the purchase and distribution of foodstuffs and raw materials on a world-wide scale. The ascertained requirements of each country were purchased on their behalf by international bodies, and producing countries throughout the world were guaranteed an assured market for their exportable surplus.

At the time of the Armistice there were many responsible statesmen and men of affairs who advocated the retention of much of this international machinery, at any rate for so long as economic conditions were unsettled by the after-effects of war. These plans were frustrated, as we have seen, not merely by the general dislike of State interference, but by a still more formidable obstacle —the canons of orthodox finance. Economic problems after the war have been treated as primarily financial and monetary problems. We must now, therefore, turn our attention to the monetary aspect of the problem.

CHAPTER IV

THE MONETARY PROBLEM

THE real trouble at the present time is that, whereas during the war finance was the servant, it is now the master. During the war finance was never the limiting factor. If certain goods and services were required, they were produced, regardless of the manner in which the money was raised. An almost reckless disregard was shown for sound currency policy and the first principles of public finance and taxation, with the result that in every belligerent country, while trade and production were stimulated, the value of the monetary unit was constantly being debased. This dishonest inflationary policy was not inevitable ; if the policy of conscription of wealth, which the Labour Party advocated, had been fairly and consistently applied, there would have been no need for the Government to borrow from the banks and issue vast amounts of paper currency. The process of inflation was itself, indeed, one method of conscripting wealth ; but while it took more than half of the accumulated savings and annual income of persons with fixed incomes derived from trustee securities, it transferred the bulk of the proceeds, not to the community, but to a small class of privileged profiteers.

This gross injustice cannot be undone. The wrongs inflicted by inflation cannot be redressed by reversing the process and ruining producers for the benefit of holders of War Loan. And yet this is the road along which this and every other country has been urged to travel by most of the financial leaders of the world. We are beginning to realise that just as during the war finance was a bad servant, so now it is a bad master.

In the search for a sound monetary policy, it is vital to bear in mind that finance is a means and not an end in itself. Monetary policy must be considered in all its bearings; it is not sufficient to leave it to bankers and Treasury officials living secluded lives far removed from the anxieties and tragedies which their action or inaction may inflict on millions of helpless victims. A "sound" financial policy may in certain circumstances be a disastrously unsound social policy. And it is vitally important that those who suffer most should be able to criticise intelligently the general policy of financial specialists.

An excellent survey of some of the problems involved has been made since the war in the Reports on the Cost of Living, published by the Parliamentary Committee of the Trades Union Congress. The Interim Report on Money and Prices, published in August, 1920, starts off by explaining what is called the Quantity Theory of Money.

The general level of prices depends upon the relation between money (i.e., purchasing power) and the goods and services available for sale. If the supply of currency is increased, then with a given volume of goods and services for sale, the value of "money" relatively to goods and services declines, or, in other words, the value of goods and services—i.e., prices—increase. On the other hand, if commodities and services increase relatively to purchasing power, their value diminishes and prices fall. . . . An expansion of purchasing power, if commodities are not increased, results in increased competition amongst buyers. An expansion of the supply of goods, if purchasing power is not increased, results in increased competition amongst sellers. In the former case prices rise, and in the latter prices fall.

The first point that needs to be emphasised is that purchasing power, or money, includes deposits in the banks as well as notes in the pocket. Many people who do not have banking accounts, and many who do, are apt to pay too much attention to that part of the monetary circulation, which consists of legal tender money, that is, actual coins and notes. But, in fact, the greater part of the monetary circulation consists, not of coins and notes, but of deposits in the banks, which are transferred from one person to another by means of cheques. The relative importance of the two may be gauged from the table given on the next page. The volume of deposits is roughly four and a half times the volume of currency.

The quickest way to grasp the meaning of the Quantity Theory of Money is to examine a concrete illustration of its working. Before the war there were many people who either denied the validity of the theory or in practice ignored it. They assumed that changes in the price-level were always due to scarcity or abundance of goods without taking into account the scarcity or abundance of money. But the last eight years have taught us, in the bitter school of experience, that changes in the supply of money are at least as important as changes in the supply of goods. Everybody is aware that the cost of living rose during the war, not so much because things were scarce, but because money was plentiful. And most people are aware that money was plentiful because the Government and the banks increased the amount in circulation. The following figures show the changes in the general level of prices, and in the volume of bank deposits and legal tender money, between December, 1913, and December, 1919.

TABLE I

	Whole-sale Prices.	Cost of Living.	Legal Tender Currency.	Per cent.	Bank Deposits.	Per cent.
Dec. 1913	100	100	£214 m.[1]	100	£1,070 m.	100
Dec. 1919	303	235	£536 m.[1]	250	£2,398 m.	224

[1] Cmd. 734; figures for July, 1914 and March, 1920.

From this table it will be seen that the amount of money in circulation increased between 2¼ and 2½ times, while prices rose between 2⅓ and 3 times. The extent to which the rise in prices exceeded the increase in the volume of money may perhaps be attributed to a relative scarcity of certain goods; though an increase in the velocity at which money circulated is a more probable explanation. At any rate, the main factor in bringing about the higher level of prices was the creation of fresh purchasing power by the now familiar methods of inflation—the printing of paper money and Government loans from the banks.

Having illustrated the connection between price changes and changes in the volume of money, let us now examine the broad effects on production and consumption of changes in the level of prices.

Any rise in prices, owing to an expansion of purchasing power without a corresponding increase in the volume of goods, tends to check consumption. Only those whose incomes increase *pari passu* with the increase of purchasing power, can afford to buy the same amount of goods as before. The majority, whose money incomes either remain the same or increase more slowly, are compelled to take less. This is what happens when prices rise faster than wages, or, as we say, wages "lag behind" the rise in the cost of living. *Vice versa*, when prices fall, owing to an increase in the volume of commodities without a corresponding increase in purchasing power, production is checked; and of course this result is intensified when purchasing power is artificially decreased by a deliberate policy of deflation. We then have all the symptoms of a slump. Goods are sold at less than their cost of production. Manufacturers are unable to continue producing. Workers are discharged, and demands are made for a reduction of wages. Producers of raw materials find that they cannot sell their produce at remunerative prices, and consequently do what they can to restrict production by letting land go out of cultivation, closing down mines, and leaving crops unharvested. Any general change in the price level is thus bound to have undesirable consequences. A general fall in prices, though it confers an immediate benefit on consumers, especially those with fixed incomes, actually impoverishes the whole world.

In August, 1920, when the first Report on the Cost of Living was published, the main desideratum was to check the continual expansion of purchasing power and the steady rise in the cost of living.

The Committee saw, however, the danger of a too rapid fall of prices owing to a policy of monetary deflation.

Employers would argue (and in many cases with truth) that they could no longer afford to pay the existing rates of money wages, and, as trade would be depressed owing to the contraction of credit, the Trade Unions would be faced with the alternative of lower wages or unemployment.

The Report quotes the following warning by Mr. H. D. Henderson :

In these circumstances, deliberately to bring about a curtailment of production, a restriction of industrial activity (and this is what a policy of drastic deflation must mean) would involve a preposterous paradox. So preposterous, indeed, that it may almost seem incredible. Surely, it may be suggested, there can be no danger of a crippling of industry amid the present world-hunger for goods.

In spite of this recognition of the dangers of deflation, the Committee summed up as follows :

The broad policy which we regard as desirable is one which will deflate currency and credit sufficiently to overcome the present depreciation of sterling, relying upon the gradual expansion of world-production (which must be assisted in all possible ways) to bring about a steady reduction in world prices by normal means.

This end they proposed should be secured

by legislation fixing an absolute amount which the fiduciary issue must not exceed, this amount to be gradually and periodically reduced until the depreciation of British paper currency in terms of gold disappears.

They anticipated that such a policy " would mean perhaps a reduction of the general level of prices by about 20 per cent." But they also made it clear that they looked to the development of productive capacity all over the world to bring about ultimately a substantial fall in prices.

This policy of bringing about gradual deflation by fixing a legal maximum for the fiduciary issue of currency had, in fact, been officially adopted by Treasury Minute in November, 1919. The limit fixed for each year was to be the highest point reached in the preceding year, the figure for 1920 being £320 million. In spite of warnings by a few leading experts, such as Mr. McKenna in this country and Professor Cassel in Sweden, the policy of deflation was generally accepted by influential circles both here and in the United States. At the Brussels Financial Conference, held in October, 1920, there was not, indeed, the same unanimity on this point as is commonly supposed, and the cautious and non-committal terms of the resolution passed on the subject suggests that unanimity was only secured by an ambiguous compromise between contradictory points of view. These are the terms of the resolution :

> It is highly desirable that the countries which have lapsed from an effective gold standard should return thereto. It is impossible to say how or when all the older countries would be able to return to their former measure of effective gold standard, or how long it would take the newly formed countries to establish such a standard. But in the opinion of the Conference it is useless to attempt to fix the ratio of existing fiduciary currencies to their normal gold value. Unless the conditions of the country concerned were sufficiently favourable to make the fixing of such a ratio unnecessary, it could not be maintained.
>
> The reversion to, or establishment of, an effective gold

standard by any means other than devaluation, would in many cases demand enormous deflation, and it is certain that such deflation, if and when undertaken, must be carried out gradually, and with great caution. Otherwise the disturbance to trade and credit might prove disastrous.

In his memorandum on the World's Monetary Problems, submitted to the Brussels Financial Conference in September, 1920, Professor Cassel refers to the possibilities of deflation as follows:

> We have to take account of the possibility of enforcing deflation by a higher bank rate, or by other restrictions of the lending of the banks. . . . Such a policy would without a doubt press down prices, but it would at the same time have a very depressing influence on trade and industrial enterprise. The difficulties of a prolonged application of such methods are obvious.

The following mild rebuke to the advocates of wholesale wage reductions has a particular interest for organised Labour in this country:

> It seems hardly advisable to enter upon any deflation scheme which would involve a reduction of the general level of money wages; for every such endeavour would without doubt lead to social unrest, and in this way make harm out of all proportion to the advantage it could bring.

At a meeting of the International Chamber of Commerce nine months later, Professor Cassel's views were again expressed in a closely reasoned speech, which the Chairman, Dr. Walter Leaf, described as a "bombshell." As reported in *The Times*, Professor Cassel said that Governments must stop trying to deflate currencies, for it was impossible to stabilise currency while such attempts were in progress. Last year he had issued a special warning against deflation, particularly in the United States. That warning had been justified, for one of the main causes of the present serious depression of trade and the unparalleled degree of unemployment was the efforts which had been made to increase the value of money and force prices down. To this the British bankers, through the mouth of Sir Felix Schuster, replied :

> Countries which had departed from their pre-war gold standard must aim at deflating their currencies gradually so as to inflict the least injury, but with one object in view, a return as soon as possible to the pre-war gold standard. That would be the policy of the Bankers of the United Kingdom, and until that object was attained he thought they must adhere to a policy of gradual deflation—certainly in this country.

CHAPTER V

DEFLATION

In July, 1921, the Cost of Living Committee returned to the subject of deflation, and in their final Report they pointed to the disastrous results of the fall in prices that had occurred since their Interim Report was published. They explained that the fall which had taken place had not been the result of either the restoration of international trade or a reduction in the cost of production. "The cost of living has been reduced, but the workers are paying the price of this fall in unemployment and lower wages." They then showed the close connection between the fall in prices and the increase of unemployment. That the correlation was close, at any rate during the first twelve months of the slump, will be seen from Table II, opposite. (The best index of unemployment is that given in the third column.)

It will be seen that in the first year of the slump, while prices fell about 40 per cent., the percentage of unemployment increased from 2·7 to 17·8.

The chief reason which advocates of deflation in this country had advanced in favour of that policy was that only by that means could the pound sterling be restored to its pre-war parity with gold. In the middle of 1920, the Cost of Living Committee was advised by leading experts that the restoration of the pound to its pre-war parity with the dollar might involve a reduction of about 20 per cent. in the general level of prices. It is important to examine, therefore, the extent to which the fall in prices shown above was accompanied by an improvement in the dollar exchange. Table III,

TABLE II

		Board of Trade Wholesale Index No. Base, 1913.	Percentage of Unemployment in Trade Unions.	Percentage of Insured in Receipt of Unemployed Benefit.
1920.	Jan.	303·0	2·9	—
	Feb.	317·2	1·6	—
	March	326·0	1·1	—
	April	332·3	0·9	—
	May	332·6	1·1	—
	June	329·5	1·2	2·6
	July	323·8	1·4	2·7
	Aug.	320·0	1·6	2·9
	Sept.	318·1	2·2	3·8
	Oct.	308·5	5·3	4·1
	Nov.	292·9	3·7	3·7
	Dec.	269·4	6·1	5·8
1921.	Jan.	250·9	6·9	8·2
	Feb.	229·9	8·5	9·5
	March	215·1	10·0	11·3
	April	208·7	17·6	15·0
	May	205·0	22·2	17·3
	June	201·6	23·1	17·8
	July	198·2	16·7	14·8

on the following page, gives the average monthly quotation of the pound sterling in dollars, and its percentage discount on parity.

It will be seen that between June, 1920, and June, 1921, though there had been a fall in prices of 40 per cent., the pound had not only not improved, but had actually depreciated. Even to-day

(Nov. 1922), the pound is only worth about \$4.50 compared with its pre-war gold parity of \$4.86.

Another result which the deflationists hoped to achieve, as a means of restoring the gold value of the pound, was a substantial reduction of the

TABLE III

		Average Quotation.	Discount on Parity.
		\$	Per cent.
1920.	Jan.	3.67	24·59
	Feb.	3.38	30·51
	March	3.74	23·08
	April	3.93	19·25
	May	3.85	20·92
	June	3.95	18·80
	July	3.86	20·66
	Aug.	3.62	25·51
	Sept.	3.52	27·76
	Oct.	3.48	28·59
	Nov.	3.43	29·60
	Dec.	3.49	28·19
1921.	Jan.	3.74	23·21
	Feb.	3.87	20·44
	March	3.91	19·64
	April	3.93	19·22
	May	3.98	18·25
	June	3.78	22·23
	July	3.63	25·47
	Aug.	3.65	25·04
	Sept.	3.72	23·50
	Oct.	3.88	20·35
	Nov.	3.96	18·53
	Dec.	4.14	14·90

monetary circulation. But if we examine the figures for bank deposits and legal tender currency, we find that while there was a small reduction in the volume of notes in circulation, the total of bank deposits showed an actual net increase, between December, 1920, and December, 1921, of 1·2 per cent. The importance of this fact will be referred to later, when we come to consider the probable course of prices in the future.

For an explanation of the reasons why the fall in prices and depression of trade have been at least twice as severe as the deflationists anticipated, without producing any of the desirable results which it was hoped to achieve, we have to turn to the course of events in the United States. Advocates of a speedy return to the pre-war gold standard were apt to overlook the importance of the policy pursued by the Federal Reserve Board of the United States and its effect in rendering the restoration of gold prices easy or difficult in this country. When they estimated in the summer of 1920, that the restoration of sterling to its pre-war parity would mean a reduction of not more than 20 per cent. in the general level of prices, they assumed that the level of prices in the United States would remain fairly steady; but, in fact, the level of prices in the United States fell between May, 1920, and April, 1921, by no less than 43½ per cent. In other words, the value of gold, measured in terms of commodities, had been raised by about 80 per cent. This fact explains why prices fell far more than the deflationists thought likely or desirable, without any improvement in the value of the pound sterling measured in terms of the gold dollar. Indeed, it is now recognised that the slump in this country was due, not so much to any deliberate restriction of the monetary circulation as advocated by the deflationists, but by the policy of drastic deflation pursued in the United States.

In August, 1920, the note circulation of the United States was close on 5,000 million dollars, of which 3,200 millions were Federal Reserve

Notes. Against this the Federal Reserve Banks held about 2,000 million dollars in gold. The ratio between gold and total liabilities, that is notes and deposits combined, was about 40 per cent. At the end of 1921 Federal Reserve Notes had been reduced to 2,400 millions, the total gold reserve had increased to 2,870 millions, and the ratio of reserves to liabilities had increased to 70 per cent. Meanwhile the wholesale index of number of prices had fallen from 269 in the middle of 1920 to 148 a year later—representing a rise in the value of gold of about 80 per cent. This stupendous upheaval in monetary values, causing unparalleled unemployment and depression of trade, was primarily caused, according to Professor Irving Fisher and other authorities, by the Federal Reserve Board's policy of raising the rediscount rate too slowly in 1919, and then keeping it too high too long. What is the explanation of this fearful blunder? It is generally admitted that the policy pursued by the Federal Reserve Board was a deliberate policy, dictated by a desire to restore what they regarded as a normal ratio between liabilities and gold reserves. The argument is well set out in a book on *High Prices and Inflation*, by Professor Kemmerer, published in August, 1920. After setting forth clearly the evils attendant on a policy of deflation, he concludes as follows :

> The hardships and the resulting political difficulties of carrying through a programme of price level reduction through deflation are so serious that we should enter upon such a programme, if at all, only after careful deliberation and under the pressure of strong reasons. Are there strong reasons why we should deliberately suffer these hardships and adopt a programme of deflation ? I believe there are.

> . . . The strongest reason for deflation is that our present gold base is altogether inadequate safely to support the present paper money and deposit currency circulation. . . . The safety and security of our economic organisation demand that there be a reasonable relationship between the size of the metallic base and the size of the superstructure of circulating media it supports.

Finally, he summarises his conclusions as follows :

> Deflation is a painful economic process. By raising the value of the monetary unit in which debts are expressed, it places unjust burdens upon many debtors to the advantages of creditors. It depresses business, and tends to reduce the demand for labour, thereby increasing unemployment, forcing down wages, and causing labour troubles. Despite these evils, world deflation is absolutely necessary.

And the sole reason given is that it is impossible in any other way to restore a free gold market at pre-war gold parities, even in the United States! The possibility of fixing new gold parities, of abolishing the free gold market, of stabilising the value of gold by international action, or even of doing without gold altogether, are not even discussed.

To-day these possible alternatives are freely canvassed, and even the Federal Reserve Board is beginning to feel uncomfortable at the results of its strenuously cautious handling of a situation that required, above all things, courage and imagination. The wave of deflation has passed, and the pendulum in the United States shows signs of swinging back somewhat violently in the opposite direction. The deflationists in this country are now hoping that as the combined result of the Geddes Economy Committee, the continuance of trade stagnation and unemployment, and a rise in the level of prices in the United States, the pound will at last emerge from the long ignominy of war, and recover its pre-eminence as the only monetary unit in the world worth exactly $4.86\frac{2}{3}$ dollars. When that conclusion is reached, our fate is apparently to be determined entirely by the United States Federal Reserve Board. We shall no longer have to think out a policy. Our thinking will be done for us across the water. "When an Englishman thinks," said an American recently, "he thinks he is sick." But the converse is also true: "When an Englishman is sick, he begins to think." And there are signs that he is now feeling very sick indeed.

As a result of the experience of the last two years, the policy of deflation has lost favour, both here and in the United States. But there is still very little agreement as to the right policy to pursue, and little recognition in public discussions that most of our budgetary difficulties, and the greater part of our unemployment and trade stagnation, are due to a mistaken monetary policy, first propounded in this country in the Report of the Cunliffe Committee on Currency.

The extent to which divergent views are still held in influential quarters may be illustrated by comparing a few representative opinions. It is not surprising that the strongest objection to the policy of deflation is found in manufacturing circles. A year ago, in a speech to the Scottish members of the Federation of British Industries, Sir Peter Rylands, the Chairman of the Federation, referred to the close connection between unemployment and monetary policy, and expressed himself in favour of permanent devaluation of the pound sterling.

According to the *Observer* of October 16, 1921, his statement was as follows:

The general recommendations of the Cuncliffe Committee were in the direction of the rehabilitation of the pound to its pre-war value on a gold basis. Since then I believe there has been a general modification in opinion, and in many quarters it is practically held that the stabilisation of our currency at its present value in relation to gold [$3.88 to £1] would be all that would be required to meet the necessities of trade.

About the same time the Federation of British Industries submitted a memorandum to the Chancellor of the Exchequer, in which they urged a revision of our monetary policy and the appointment of a new Committee on Currency. This proposal was rejected.

The most important survey of monetary conditions in this country is to be found in the Annual Statements of the Chairmen of the principal Joint Stock Banks. Early in 1922 important pronouncements were made by Sir W. H. Goschen, Mr. Goodenough and Mr. McKenna. Even among bankers, however, we find no substantial agreement. Sir W. H. Goschen, Chairman of the National Union and Provincial Bank, speaking early in 1922, lays stress on the importance of improving the value of the pound sterling. He criticises the policy of devaluation, and quotes a saying of a former London banker: "It is bad enough to be poor, but to look poor is the devil." He argues that Great Britain would be making a fatal confession of poverty if she permanently reduced the gold contents of the sovereign. He therefore welcomes the recent fall in prices. He points out that the average of wholesale prices fell during

1921 from 132 per cent. over the level ruling on July 1, 1914, to 75 per cent., and that the cost of living fell from 165 per cent. above July, 1914, at the end of 1920 to 92 per cent. at the close of 1921. He naturally welcomes the reductions that have taken place in rates of wages. At the same time he notices the somewhat extraordinary fact that the ratio of gold reserves to the total volume of notes outstanding only increased from 31·3 per cent. at the end of 1920 to 34·9 per cent. at the end of 1921. Needless to say, he does not refer to the immense increase in the burden of the National Debt, and the extreme difficulty of balancing the Budget, which the slump in prices and the consequent reduction of the national income has involved. Sir W. H. Goschen remains an unrepentant deflationist.

Mr. Goodenough, of Barclays Bank, occupies a position intermediate between Sir W. H. Goschen's and Mr. McKenna's. He points out that the policy of monetary deflation, such as was intended by the Cunliffe Committee's Report, has been found to be impracticable.

> It is only when there is a surplus of taxable capacity at the disposal of the Government that monetary deflation can be effected, and at the present time no such surplus is available or is immediately in sight.

He therefore urges the necessity for further expansion of credit by pursuing a policy of cheap money and liberal facilities to foreign customers.

> London held its position in the past as a financial centre through relatively cheap rates of discount. Unless we can maintain those conditions of relative cheapness, it is difficult to see how we are to regain, and retain, that position upon which the whole future of the country depends.

He points out that though this policy may be criticised as involving inflation, the alternative is unemployment, and that since the population cannot be allowed to starve, the Government will be forced to fall back upon relief work and doles, which would certainly call for inflation. He therefore concludes that it is better to follow a policy of productive expansion, resulting in the development of new markets and new sources of supply. For this purpose he urges the need for an elastic currency, which should be capable of expansion and contraction to meet the needs of productive enterprise. He seems here to be arguing in favour of the policy of stable money, but somewhat inconsistently, he still seems to desire that monetary deflation should merely be postponed until a more favourable season, and that meanwhile a policy of what he calls "commodity" deflation should be energetically pursued. In other words, he desires to see a general increase of production, followed by a steady fall in the general level of prices.

When we turn to Mr. McKenna's speech, we find that he has no doubt whatever as to the evils of deflation. He points out that two years ago he warned the country that any attempt to drive prices down by a policy of forced deflation would lead to grave trade depression and widespread unemployment. The evil consequences of deflation, he says, have now been learnt in the school of experience, and the policy has for the time being fallen into disrepute. Unfortunately, the lesson has had the effect of turning a considerable body of opinion back in favour of inflation, and "we seem now to have in prospect a regular alternation between two policies, each to be adopted in turn as a remedy for the other." He points out that inflation and cheap money appeal to manufacturers and the trading community, while deflation and falling prices appeal to consumers: but both are really equally bad. What is needed is stability; and only when we have stability of prices is there any basis with which trade can be carried on with confidence. Merchants, manufacturers and retailers are then able to enter into contracts with a reasonable assurance that the debts created will be paid when due in a currency of the same purchasing value. "The evil of inflation is that it raises prices. The evil of deflation is that it causes unemployment." While Central Europe is suffering from high prices and depreciated exchanges, the United Kingdom and the United States are suffering from a high percentage of unemployment, although these two countries have the greatest wealth and the largest volume of foreign trade. "The world offers at the present time the clearest examples of the evils of both inflation and deflation. In Russia we see the complete industrial and commercial collapse in which the inflationary process finally ends; while in this country part at least of the trade depression and unemployment, and much of the budgetary difficulty which we see ahead of us, are attributable to the policy of deflation."

The doctrine which Mr. McKenna has been preaching for over two years to deaf ears is now beginning to win general support everywhere except in the most conservative banking circles. Even the politicians have now taken the word "stability" as their watchword, and are beginning to find in it the one hope of reconstructing Europe and, incidentally, of keeping in power themselves.

CHAPTER VI

THE POLICY OF STABLE MONEY

IT will still be contended by many people that though stability would be preferable to the violent fluctuations that have occurred during the last few years, the most healthy and natural course in the long run would be for prices to fall steadily. The Joint Committee on the Cost of Living appear to adopt this point of view. In the concluding paragraph of their final Report they anticipate "a healthy and permanent fall in prices" as international trade increases, and the efficiency of industry is improved. Here we are faced with a fundamental issue on which it is necessary to make up our minds. There are three alternatives—inflation, deflation, stabilisation; a rise in prices, a fall in prices, and stability of prices. Each is a consequence of a certain relation between purchasing power and commodities; and each has certain consequences on production and consumption, which have a vital bearing on the standard of life of the workers.

In emphasising the importance of this question, let it not be supposed that I attach less importance to the other considerations mentioned in the Report of the Joint Committee on the Cost of Living. They rightly point out that the boom of 1920 and the resulting slump of 1921 were aggravated by the speculation and profiteering that took place when prices and distribution were no longer nationally controlled. The rise in prices after the Armistice was due to unrestricted inflation of the monetary circulation by the banks; this inflation was no more necessary or inevitable than inflation during the war. But in the absence of any collective scheme of economic reconstruction it was perhaps the quickest way to stimulate private trade and industry to its maximum activity. As the Report points out, inflated prices and inflated profits soon brought trade and industry to a standstill, because the purchasing power of the consumers was insufficient to enable them to satisfy their demands. Strictly speaking, even the slump was not inevitable. It could have been postponed more or less indefinitely by further inflation, as happened during the war, and is happening in Germany and Austria to-day. But, though further inflation would have stimulated production, it would have been accompanied by all those intolerable hardships and injustices which took place between 1914 and 1918. The only way to have avoided post-war inflation and the ensuing slump would have been to have continued Government control and international co-operation, until prices, wages, and the foreign exchanges had been stabilised, and a healthy equilibrium between production and consumption had been reached throughout the world. As Mr. Henderson points out, however, such an equilibrium has never been realised and never can be realised under the competitive system. As he says in an admirable passage quoted in the Report:

> One of the penalties we must pay for an economic system which is completely unorganised in the sense that there is

no attempt to correlate means to ends, that there is no one whose business it is to see that the right quantities of boots and shoes, or bread, or steel, are produced, is that we must be prepared to find the stability of this system is rooted in instability, and that its equilibrium rests on the fact that any departure from that equilibrium is corrected by the harsh checks of unemployment and distress.

Stabilisation of currency alone will not in itself ensure a healthy equilibrium between supply and demand, or ensure that the right quantity of work is done to produce the right amount of goods and services required to meet the real needs of civilised man. This is where a progressive policy will part company with that of enlightened monetary experts like Professor Cassel and Professor Irving Fisher, who believe that currency stabilisation would solve most of the anomalies and injustices of the competitive system. Those who believe in organised adaptation of means to ends and reject the optimistic assumption that the greatest happiness of the greatest number is best achieved by encouraging the greatest number to compete for the greatest happiness, will be prepared to endorse the Committee's view that "a steady improvement in productivity and the maintenance and raising of the standard of life of the people can only be achieved by co-operation between all countries in the trade of the world, by improvement in methods and machinery, and by a far-reaching re-organisation of industry." Ultimately we may find that even a stable currency can only be achieved by a world-wide extension of collective organisation in trade and production.

It will be noticed from this digression that I assume that the object of monetary policy is to maintain a stable level of prices. The Joint Committee, on the other hand, assume that the ideal to be aimed at is a progressive fall in prices. Let us return, then, to the consideration of this fundamental problem.

In the first place what, according to the Quantity Theory of Money, causes the general level of prices to fall? Either an increase of goods and services, while purchasing power remains constant, or a decrease of purchasing power, while goods and services remain constant ; or thirdly, a more rapid increase in goods and services than of purchasing power. In either case, it will be noted (and here comes in the important proviso which the Committee, as we have seen, omitted to mention), there is a temporary surplus of goods which cannot be sold at the former level of prices. We have what is called over-production. And the inevitable result of the temporary surplus and fall in prices is to check production. The marginal producer, who previously found a good market for his goods, now finds that he cannot sell at a profit, or even at a price which covers his cost of production. He therefore closes down his factory, or lets his land go uncultivated, and waits for the cost of production to come down. This happens sooner or later, partly because the price of the goods he has to buy is reduced, and partly because wages are reduced owing to the pressure of unemployment and destitution. Production then restarts, generally on a slightly larger scale because, prices being lower, the same amount of purchasing power will now absorb a larger volume of goods and services. But meanwhile two things have happened. Factories and workers have been standing idle for several weeks or even months producing nothing, with a consequent decrease in the amount of real wealth which the world wants but cannot afford to buy. And the purchasing power of the workers has been reduced roughly in proportion to the fall in prices. The worker is therefore no better off than before. Moreover, producers as a class, having to accept lower prices and lower profits than before, are also no better off. They may even be worse off partly from increased competition, but still more because their debts and mortgages, incurred during a period of higher prices, are now relatively more burdensome. Interest charges do not fall with prices, and therefore absorb a larger part of the debtor's income, when the value of money increases. Broadly speaking, the only persons who benefit from a general fall in prices are creditors, bond-holders and persons with fixed incomes. They gain at the expense of the general body of workers and producers, just as they are penalised by a general rise in prices. Popular resentment marks the distinction by fixing on the "profiteer" when inflation is in progress; and on the "bloated bond-holder"[1] while deflation is in progress.

Have we not here one of the main causes of the fundamental paradox of the economic system? Ever since the discovery of mechanical power and the use of machinery and large-scale production, the nightmare that has afflicted producers, manufacturers and workers alike has been the constant tendency for production to outrun consumption. The potential productivity of the world is vastly greater than the limited amount of purchasing power in existence at any time can absorb at the

[1] A phrase familiar to students of American monetary history.

existing level of prices. The world does not produce enough goods, because purchasing power does not increase fast enough. And, fundamentally, purchasing power does not increase fast enough, because monetary policy has hitherto always been wedded to the assumption that the amount of money in the world must be related to a fixed quantity of a single commodity. If the supply of gold, or of the monetary circulation based on gold, could be relied upon to increase at the same rate as the volume of other goods and services, and if the increased purchasing power could be evenly distributed (a very important proviso),[1] then we should have a stable correlation between money and goods, and the general price level would tend to remain steady.

The supply of gold, however, depends on quite accidental circumstances. A century ago, before the discovery of the Californian and Australian gold fields in 1848 and 1851, the world's gold production was fairly stationary at an average of £5,000,000 per annum. In 1853 it had increased to £30,700,000. From that time it fell away gradually to £19,000,000 in 1883. The discovery of the Rand gold fields in 1886, and improved mining extraction elsewhere, led to a rapid increase of output, which culminated in the record figure of £96,400,000 in 1915. Since that time the production has fallen to £70,000,000 in 1920. The future prospects of gold production are quite uncertain. The Rand gold fields are expected to yield less and less until they are completely ex-

[1] Increased production must be met by increased consumption. If prices are to remain steady, this means that wages must be increased *pari passu*. See Appendix on the Theory of Trade Fluctuations.

hausted somewhere about 1960. What will happen elsewhere no one can say. The world has been pretty exhaustively surveyed for gold except in Northern Canada, Siberia and the Antarctic, and hitherto no large fresh sources have been discovered. On the other hand, it is conceivable that physicists may discover a method of making gold out of lead by atomic disintegration. Clearly, therefore, if the world's monetary system is to be linked up as hitherto with the amount of gold in existence, the course of future prices is a gamble, the probability being that they would tend to fall progressively for the next fifty years. Is this prospect one that can be faced with equanimity? Assuredly not. And yet this is what is implied when we speak of restoring an automatic gold standard, the policy endorsed apparently without question until a few months ago by bankers, statesmen, business men, and most economists, and even, as we have seen, by the Joint Committee on the Cost of Living.

To-day largely owing to the influence of Professor Cassel of Sweden and Professor Irving Fisher of America, the automatic gold standard is discredited, and has been virtually abandoned by all except the most conservative bankers and economists. It is recognised that if gold is retained as the basis of currency, its value must be regulated by international agreement, and that the true standard of value must be the general level of world prices. This means that the monetary circulation of the world, instead of depending on a limited stock of any one commodity, like gold, will be made to expand and contract with the total volume of trade and production. When the general level of prices falls, purchasing power will be increased to counteract the fall; when the general level of prices rises, purchasing power will be restricted. Prices would then tend to be stabilised round about the cost of production, and economic progress would be measured not by falls in prices, but by increases in incomes.

Before we consider in greater detail the technical means of securing stability, it is worth while examining the question at what point we should aim in stabilising prices in this country. Is it proposed to stabilise the monetary unit somewhere about its present value? Or to return to the level of prices ruling at the peak of the boom in 1920? Or to fix some point midway between the two? In other words, is it possible to make any estimate of what should be regarded as the "normal" post-war level of prices. Just as in the ten years before the war there was a normal level of prices above and below which the actual price level varied with alternating periods of good and bad trade, so now it should be possible to determine roughly a position of more or less equilibrium. The normal level must clearly depend on the relation between the total volume of money on the one hand, and the total volume of goods and services on the other. This relation can be roughly gauged by considering on the one hand the statistics of bank deposits and paper currency, and on the other hand the production of certain staple products, such as raw materials, foodstuffs and pig-iron. It will be obvious, from the previous discussion, that there is no foundation for the popular view that the pre-war level of prices is any more "normal" or "reasonable" than any other. There is no reason in the nature of things why the level of prices ruling before the war should be regarded as any more normal than the level of prices ruling fifty or a hundred years ago.

Let us first, then, consider the problem from the side of money. Taking first bank deposits, we find that the total deposits of Joint Stock Banks in the United Kingdom increased from £1,033,000,000 in December, 1913, to £2,522,000,000 in December, 1921, an increase of nearly two and a half times. The important point to note is that in spite of the severe fall in prices, amounting to 30 per cent. in the course of 1921, there was no decrease in the volume of bank deposits. According to figures published in the *Economist*, there was an actual net increase of 1·2 per cent. During the same period the volume of legal tender currency, which increased about two and a half times between 1914 and the end of 1920, showed a decline of about 12½ per cent. As Mr. McKenna pointed out in his speech already referred to, what dear money and restriction of credit accomplished was a reduction of the rate at which purchasing power changed hands; in other words, the velocity of circulation of money was reduced. He estimated that there was a decline of at least 40 per cent. in the velocity of circulation in 1921 as compared with 1920. At the time of writing the figures for bank deposits at the end of 1922 are not yet available. They may show a considerable reduction; but, broadly speaking, it looks as though the reservoir of purchasing power is nearly as great now as it was at the time of the boom, and that, as soon as confidence revives and the wheels of business begin to revolve more rapidly, prices may be expected to start rising again. The large gold imports into the United States will certainly tend to raise prices there, and when the pound is restored to par this will contribute to raise prices here also.

If there were any signs that the volume of goods and services would be substantially increased, the tendency for prices to rise would be to that extent checked. But there are few signs of world production in the near future exceeding even the level reached before the war. There is still a large amount of leeway to be made good before the production of most of the staple products recovers its former level and, as we saw on an earlier page, the tendency at the moment is still for land to go out of cultivation and for herds and live-stock to be reduced.

If, therefore, the volume of money is still about twice the pre-war volume, and the volume of goods and services is likely to remain for some time no greater than the pre-war volume, and probably smaller, the normal equilibrium position for the post-war price level can hardly be much less than twice the pre-war level. If we aimed at stabilising the index number at about 185, there would appear to be a reasonable chance of maintaining equilibrium without any violent contraction or expansion of the monetary circulation.

This conclusion has an important bearing on the budgetary situation and current discussions about economy. It is usually assumed that the need for economy arises from the fact that while the burden of debt charges and pensions has remained the same, the national income has been seriously reduced. This statement of the case, though nominally correct, conveys almost the exact opposite of the truth. The fact is that the national income in goods and services has been only slightly reduced, while the amount of goods and services which have to be supplied to holders of War Loans and pensioners has enormously increased. The balance between national income and national debt has been completely upset by the general fall in prices which has taken place during the last two years. The *Economist* index number, which stood at 325 in March, 1920, was 166 two years later. That is to say, between the peak of the boom and the bottom of the slump, wholesale prices fell by nearly 50 per cent. and the value of money was practically doubled. Debt charges and pensions, as measured in terms of wholesale commodities, increased by nearly 100 per cent., while the national income, as measured in wholesale commodities, at best remained stationary.

What this means may be illustrated by comparing the budgetary position in March, 1920, and February, 1922, by reference to a common measure of value. If we take the value of the pound in July, 1914, as the base, and use the *Economist* index number of prices, the comparison comes out roughly as follows :

TABLE IV

IN PRE-WAR POUNDS (000,000's omitted).

	March 1920 (Index = 325).	February, 1922 (Index = 166).
Estimated National Income [1] ..	1,750	1,700
Total Revenue	400	650
Debt-charges and Pensions ..	154	300
National Debt	2,460	4,820

[1] According to calculations made for the Brussels Financial Conference, the National Income was £5,640 million in 1919-20. See Vol. IV of the *Proceedings*, p. 21.

In making the above comparison I have deliberately taken the highest and lowest levels of prices touched since the war rather than the average for the two financial years, in order to emphasise the significance of changes in the price level. The wholesale index number is not of course a true measure of the value of all goods and services, and it would be a mistake to claim any high degree of accuracy for the estimates of national income. The comparison, however, is valid enough to demonstrate the effect of changes in the price-level on the budgetary situation. If the present level of prices should be maintained, debt-charges and pensions alone will absorb about three-quarters of the total proportion of the national income raised by taxation in 1920; and if deflation proceeds much further, it will be necessary not merely to make paltry cuts of a hundred millions or so, as the Geddes Committee have vainly tried to do, but to wipe out practically the whole of public expenditure on education, health, unemployment and defence.

This intolerable situation is not likely to arise. Whether we like it or not, the burden of the Debt will have to be reduced. If there is to be no Capital Levy,[1] the tendency will be for prices to rise until the Debt bears a tolerable relation to

[1] I have not attempted to argue the case for a Capital Levy, first because it has been done exhaustively by Professor Pigou, Mr. Pethick Lawrence and others; and secondly because bankers and traders are so strongly opposed to it that it is unlikely to be adopted. If a Capital Levy were imposed in the near future, the price-level would not rise to the extent suggested, and the burden of the Debt would be reduced not by depreciation but by partial repayment. This would, no doubt, be the fairer course all round, and would tend to promote stabilisation at about the existing level of prices. But since the banks object to a Capital Levy, a further period of inflation seems inevitable.

the national income. Deflation has proved an impossible policy, and the attempt has only made stabilisation more difficult. Any further rise of prices will, of course, inflict hardship and injustice on recent investors in fixed-interest-bearing securities. But if the index number is stabilised at round about 185, most holders of War Loan can have no reasonable ground for complaint considering that in 1918 the index number averaged 225, and that their holdings in 1920 were measured in a unit worth on the average one-third of the pre-war pound.

CHAPTER VII

A PRACTICAL PROGRAMME

If we accept the view that the object of monetary policy should be to stabilise the general level of prices at a point about 85 per cent. above the pre-war level, we have next to consider the technical means by which this policy can be put into force. What prospects are there of achieving stability in the near future, and what are the practical steps which would most contribute to that result?

At this point it is necessary to emphasise again that the monetary problem is essentially a world problem. Just as it is impossible to argue profitably about the restoration of the gold standard without taking into account what other countries may decide to do, so it is hardly worth while advocating a policy of stabilisation for this country alone. So long as there are fluctuations of prices and unstable monetary conditions in other countries, the foreign exchanges must continue to fluctuate. The principal obstacle to the restoration of international trade would thus remain as before, and the resulting uncertainty would render it extremely difficult for any one country to stabilise its internal price level.

It is probably true, however, that so long as price fluctuations in other countries continue, it is preferable to aim at stabilising the internal price level rather than seek to maintain the foreign exchanges steady. As Professor Cassel says, " The first practical aim for the monetary policy of any country must be to give a stable internal value to its own monetary standard." A substantial advance towards the solution of the general problem would indeed be made if every country were to set about stabilising the internal value of its money without reference to the movements of the exchanges. But this process would be immensely simplified, and can only achieve ultimate success, through international understanding and co-operation. In considering the possibility of international co-operation, it will be convenient to examine first the problem as it affects European countries, and after that the relations between Europe and the United States.

Among the items included in the agenda of the Genoa Conference, held in April 1922, was the reform of European currencies. That European statesmen should have thought it expedient to confer on monetary questions, even if no speedy solution was to be expected, is an encouraging sign of the gradual growth of a saner outlook. At the Paris Peace Conference the monetary problems of Europe never received more than passing attention. When Germany warned the Big Four that the economic and financial clauses of the Treaty would compel her to inflate, they turned a deaf ear ; if they understood the point at all, they no doubt thought, " So much the worse for Germany." It never occurred to them to think, " So much the worse for the Allies." And yet our chief preoccupation at the moment is to stop the one means by which the German Government has found it possible to carry out even partially the terms of the reparations clauses. We now want Germany to stabilise her currency and stop inflation ; for without stabilisation we cannot trade with her.

The report of the Financial Commission of the Genoa Conference is a remarkable document. In submitting it for the approval of the thirty-one Governments represented at Genoa, Sir Laming Worthington-Evans claimed that the resolutions "constitute a financial code not less important to the world to-day than was the civil code of Justinian." This claim may prove to be less exaggerated than it seems. A hundred years hence the Genoa Report on Currency and the Exchanges may well be considered as epoch-making as the Bullion Report of a hundred years ago. In spite of its ostensible orthodoxy it in fact embodies doctrines which would have been looked upon as visionary and wildly unorthodox before the war. But in other respects it is a disappointing document. An unkind critic might say that in its remoteness and allusiveness, in the ambiguity and generality of its recommendations, and in its lack of any concrete and definite proposals beyond the summoning of a further international conference to consider how far its recommendations may be applicable, it is a typical product of that half-hearted and facile internationalism, which seeks to promote an atmosphere of general goodwill by devising conciliatory forms of words in place of effective common action. But this would be unfair. In the circumstances it was the best that could be hoped for. In order to produce agreement between all the States assembled at Genoa, including Russia and Germany, political considerations and inconvenient particularisations had to be rigorously excluded from the Report. The result is a tribute to the tact of that "cynical, humane and well-informed international officialdom" which drew up the Report rather than to the collective wisdom of the politicians who endorsed it without understanding it or seriously meaning to apply it.

The Report repeats many of the commonplaces of financial doctrine, about which there is general agreement. The greatest obstacle to the recovery of European trade is the instability of the exchanges. This evil cannot be dealt with as it was during the war by any system of "pegging the exchange" or even by imposing control on exchange operations. The evil must be tackled at its root; and the root of instability in the exchanges is the instability of internal purchasing power. The chief cause of this is the inability of European countries to balance their budgets and their constant recourse to the printing-press to cover budget deficits. It is impossible for any country to stabilise the purchasing power of its currency until it is able to meet its expenditure either by taxation or by loans which tap the real savings of its people. The first condition, therefore, of any plan of currency reform is reform of public finance. A programme must be laid down which will ensure a progressive decrease of expenditure and increase of taxation. Needless to say, the most important factor in rendering such a programme possible would be European disarmament. A necessary preliminary of currency stabilisation is, therefore, a political settlement, which is based upon a fair measure of consent and does not require the maintenance of large standing armies to enforce its execution. This means that the questions of reparations and inter-allied debts must be settled by general agreement before European countries can seriously tackle the task of financial reconstruction. On these questions the Report of the Financial Commission has to content itself with saying: "As with currency, so with exchange, complete restoration depends on the settlement of questions which are not now within our purview."

But supposing that some or all of these difficulties are disposed of, what will be the next steps in the direction of currency reform? As soon as there was a fair prospect of balancing the budget in any country, it would be essential to restore normal relations between the Government and the Central Bank. So long as any Government is free to borrow without limit from its Central Bank, in order to cover budget deficits, there is no hope of checking currency inflation; and before any Government can start along the path of currency reform, it must undertake to live within its income or borrow in the open market.

Having arrived so far, the time will have come for each country with a depreciated currency to have recourse to devaluation, that is to say, to fix a new legal parity for its monetary unit. We will assume that for the time being the gold standard will be restored in form, although as a result of further arrangements to be discussed later, it will be virtually abandoned in substance. The first step therefore will be for each country to fix a new gold parity—that is, a parity with the United States dollar.

The Report unfortunately advocates devaluation in general, but leaves each country to decide for itself whether to apply the principle or not. In this country the balance of opinion will probably be in favour of restoring the pre-war parity of $4.86⅔, although there are reasons for holding that stabilisation at a lower level would do more to promote the revival of trade and the restoration of equilibrium in public finance. The argument that any improvement in the value of sterling must necessarily cheapen our wheat and make it easier to pay our debts to the United States is, of course, fallacious. According to this reasoning we should aim at fixing the new parity, not at $4.86, but at $5.00—a ratio which would at least have greater convenience for purposes of calculation. The crucial point is, whether the pound is likely to improve in value without any further fall of prices in this country. The official view at the moment seems to be that a rise of prices in the United States will restore the pound to par, through depreciation of the dollar rather than appreciation of the pound.

In other European countries, with the exception of some former neutrals, there will have to be more or less drastic devaluation. This necessity is not yet admitted by the Governments of France, Italy and Belgium, where bankers and politicians still hope to restore the pre-war value of the franc and lira by methods which experts in other countries regard as either impracticable or disastrous. The deflationary policy propounded by the Cunliffe Committee is unfortunately looked upon as the last word of wisdom even in countries where it is hopelessly inapplicable. But in Russia, Austria and Germany at least there is no such quixotic prejudice in favour of restoring the rouble, the krone, and the mark to their pre-war value. As soon as budgets can be made to balance and the flow of trade and investment resumes a stable equilibrium, there should be no insuperable difficulty in stabilising the value of the monetary unit round about a new gold parity; but foreign assistance will probably be necessary, at any rate in the early stages.

The new parities have been called gold parities, but this does not mean that every European currency will be freely convertible into gold in the country itself. No European belligerent, with the possible exception of Great Britain and France, will be able to afford to keep large reserves of gold as cover for their note issue, and few countries in Europe are likely to restore gold coins to circulation.[1] The dangers of such a course have been pointed out by Professor Cassel. If every country in Europe began to accumulate gold, the value of gold in the world-market would be forced up, deflation would begin over again in an aggravated form, and the difficulties of balancing budgets and carrying the burden of war debts would become intolerable for almost every country. Such a procedure would defeat the whole object of currency reform and aggravate the instability which it is sought to remove.

We thus come to the central point of the

[1] Switzerland has recently made the attempt, but the Swiss people seem to prefer notes, since they are worth more than gold in neighbouring countries.

programme discussed at Genoa, which is to stabilise the value of gold itself by international co-operation and control of the gold market. In presenting the Report of the Financial Commission to the Conference Sir Laming Worthington-Evans used the following words :

> In the resolutions which have been passed under the head of Currency, there is embodied the principle of preventing undue fluctuations in the purchasing power of gold, and therefore equally in the purchasing power of currencies based on gold. If this policy can be put successfully into operation, the price changes, which have caused so grave an unsettlement in trade both in America and in Western Europe, will become less frequent and less violent. The price changes to which I refer are changes in the general level of prices, changes which affect all commodities together. In recent years we have learnt to distinguish such changes from casual changes in individual commodities. Regulation of prices in this sense means regulation of credit. The experience both of the Bank of England and of the Federal Reserve Board in the United States since the war has demonstrated afresh the sensitiveness of prices to credit conditions.
>
> Thus the power to influence prices, and the responsibility for using that power, belong to the great Central Banks.

The doctrine here enunciated—that it is the business of the Central Banks to exercise control over the general level of prices—is a notable advance on the conclusions of the Brussels International Financial Conference in October, 1920, which dismissed the policy of regulating the purchasing power of gold in the following words :

> We cannot recommend any attempt to stabilise the value of gold, and we gravely doubt whether such attempt could succeed.

The Genoa Report contains a recommendation that the means of giving effect to this policy should be discussed at a Conference of Central Banks to be summoned by the Bank of England, at which the Federal Reserve Board would be specially invited to be represented. Unfortunately, political obstacles, of which reparations and inter-allied debts are the most chronic and insoluble, have hitherto prevented this conference taking place. So long as public opinion in the United States still insists on repayment of European debts not much progress can be made in monetary stabilisation. In the following plan, therefore, the immediate co-operation of the United States is left out of account. The quickest way to get America to adopt a reasonable frame of mind is for European countries to show that they are not entirely dependent on American good-will and are capable of taking effective common action in monetary matters.

The first step will be for as many European countries as possible to adopt a European Monetary Convention, following in certain respects the example of the Latin Monetary Union which existed before the war. The most important feature of the convention will be a provision whereby the Central Banks would agree to co-operate with one another, and even to form a sort of European Consortium.

The first thing the European Consortium would do would be to mobilise the gold reserves in the vaults of the various Banks of Issue. At the present time these are practically useless, or have only a psychological value at most. In only one European country, Switzerland, is there a free gold market. Every country is hoarding its gold for fear that if it parted with it, it would never get it back. Gold reserves, which are kept for an emergency, and then, when the emergency arises, are never used, are merely a useless luxury. Under the plan proposed, the Consortium of Central Banks would form a single pool of gold, which would be deposited in a few centres, where a free gold market would be established. Let us assume, for the sake of simplicity, that all the gold is deposited in London. Each Central Bank would then aim at stabilising its currency at its new gold parity by buying or selling exchange on London at fixed rates, and for this purpose they would always maintain a safe reserve of foreign bills and balances in London among their principal liquid assets. This system would represent what the economists call the " gold exchange standard."

Being thus linked together, with a single pool of gold, the Central Banks would need to pursue a common discount policy. In other words, the expansion and contraction of credit and the regulation of the volume of money and circulation would be effected by alterations in the Bank rate at a common centre. This would virtually restore the state of affairs which existed before the war, when the London Bank rate exercised a determining influence over monetary conditions in other European countries.

The final stage in stabilising the value of gold will of course depend on establishing a satisfactory understanding between this European Consortium and the Federal Reserve Board of the United States. But this, in its turn, will depend upon the settlement of the problem of European indebtedness to the United States.

The position with regard to Europe's debts to

America closely resembles that of German reparations. If the United States should insist on enforcing the payment of debts in full, the majority of the European Allies would be unable to balance their budgets or take effective measures towards stabilising their currencies. Sooner or later America will be forced, by much the same considerations as have led the European Allies to moderate their claims on Germany, to renounce any attempt to enforce payment of the whole of the debts owed by European Governments. It may take some time, however, before American public opinion is converted to this point of view. In the case of German reparations, Allied opinion was only converted by the practical demonstration that a flood of cheap German goods and the constant depreciation of the mark were against the interests of Allied countries. One of the quickest ways of bringing about the necessary change of view in the United States may well prove to be a similar practical demonstration. An understanding between the Central Banks of Europe in regard to gold reserves would provide a means of repaying a substantial portion of the debts without seriously inconveniencing European countries. If European countries had already adopted the Genoa programme, they might offer to ship to the United States as large a proportion of their gold reserves as the Federal Reserve Board could be induced to accept.

The total indebtedness of the European Allies to the United States Government is approximately \$11,000 million. The total of the gold reserves in European countries amounts to nearly \$3,000 million. In the middle of 1922 the gold reserves of the United States Federal Reserve Banks amounted to $3,021 million. It thus appears that Europe is in a position to double the gold reserves of the United States and repay nearly 30 per cent. of her total indebtedness simply by shipping the whole of her gold reserves. Supposing that such a course were politically possible—and the United States Government would be hard put to it to justify a refusal to take payment in gold—the effect on the level of prices in America would be disastrous. Under the existing Federal Reserve Acts the expansion of Bank deposits and paper currency is limited only by the amount of the gold held in reserve. Unless, therefore, the Federal Reserve Board were to pursue a deliberate policy of checking the rise of prices, the result of doubling the gold reserve might well be to raise the general level of prices by 100 per cent. This would mean that the gold dollar would lose half its value, and since Europe's debts to America are expressed in gold dollars, the remaining 70 per cent. of the debts still to be paid would be reduced by half.

This contingency is not likely to arise. But so long as the United States remains the creditor of Europe to such an overwhelming extent, a tendency in this direction will assert itself. Already during the last two years America has imported more than $1,000 million worth of gold. A large proportion has been drawn from India, South Africa and Russia, but a certain amount has also found its way from European countries. The result of this influx of gold has already been a rise of prices in the United States, and an improvement in the more stable European exchanges.

Sooner or later the growing demand for stabilisation of prices in the United States will lead to a reconsideration of American monetary policy. The United States Government will then probably be compelled to forgo the whole or the greater part of the debts owed to it by European Governments; and the Federal Reserve Board will be anxious to escape from the embarrassment of receiving shiploads of superfluous gold from Europe by entering into a reasonable working arrangement with the European Banks of Issue. When that time comes, gold will cease to play any useful part as a means of making international payments, and the gold standard will have been virtually abandoned throughout the world. All the Central Banks will be linked up in a common system and will maintain a safe proportion of their reserves in one or more common centres. In practice it will probably be found that London will gradually regain its old predominance as the principal banking centre of the world, and that the mutual indebtedness of the Central Banks in different countries will be settled through an international clearing-house in London.

I have attempted in this chapter to sketch in non-technical language what appears to be the most practicable means of achieving stabilisation with the least possible change in monetary policy. In main outline, this plan is implicit in the best thought of to-day; it is based on the proposals put forward by Professor Cassel and other experts and endorsed by the Financial Commission of the Genoa Conference. The essential feature of the scheme is that the Central Banks of the world, linked up with common centres in London and elsewhere, will endeavour to regulate the volume of circulating credit and currency, not with reference to any fixed amount of one commodity, such as gold, but by reference to the total volume of all commodities bought and sold, as indicated by the general level of prices, statistics of trade and production, and general economic conditions.

I now propose to consider how far this solution of the monetary problem is adequate from a wider standpoint.

CHAPTER VIII

A PROGRESSIVE MONETARY POLICY

THE essential feature of the technique of stabilisation examined in the previous chapter is the use of the discount rate as a means of regulating the volume of money in circulation. As before the war, changes in the London Bank rate will virtually determine monetary conditions in all the principal countries; but the Bank rate will be raised and lowered not, as before the war, to regulate the flow of gold, but to maintain the general level of prices as nearly stable as possible. The Bank rate will be lowered when prices show a tendency to fall, and raised when they tend to rise. These changes in the rate of interest for short-term loans will in the one case expand, and in the other case contract, the total volume of purchasing power, owing to the effects they produce on the policy of the banks in granting or renewing advances. A lowering of the rate encourages fresh borrowing, which means the creation of fresh purchasing power; a rise in the rate discourages fresh borrowing and forces a liquidation of previous advances as they fall due, which means a contraction or cancellation of purchasing power.

Three lines of criticism suggest themselves as to the adequacy of this policy. First, the lowering and raising of the Bank rate is an indirect, and many people would argue, a rather ineffective way of stabilising the level of prices. At one time a small change in the rate may have no appreciable effect at all ; at other times a small change may have a disproportionately large effect. There seems to be no quantitative relation between changes in the Bank rate and changes in the volume of purchasing power or changes in the general price level. The method is therefore empirical and rule of thumb.

Secondly, it is cumbrous and unwieldy. A rise in the Bank rate affects all kinds of activity without distinction. It does not discriminate between legitimate and speculative transactions. Still less can any such blind weapon distinguish between social and anti-social, or essential and less essential, activities. It has sometimes been suggested, therefore, as an alternative to a rise in the Bank rate, that the banks themselves should ration credit, and restrict advances by deliberate selection rather than by raising the rate of interest. This idea contains the germ of that social control of credit, which may one day prove possible. It should be noted, however, that when the Joint Stock Banks attempted to "ration credit" in 1920, they were naturally guided not by considerations of public utility, but of commercial profit ; a profitable cinema, for example, would be granted facilities before a municipal housing scheme or a project of agricultural development.

This brings us to the third respect, in which some modification will be necessary. Recent developments of banking have placed in the hands of the banks a vastly greater power of control over the economic system than they ever previously exercised. The banks supply the life-blood of the whole economic system. In his opening speech at the meeting of the Finance Committee of the International Chamber of Commerce on June 28, 1921, Dr. Walter Leaf, who is President of the Institute of Bankers and Chairman of the London County and Westminster and Parr's Bank, scarcely exaggerated when he said: "The banker is the universal arbiter of the world's economy." The abolition of the automatic gold standard and the linking together of all the principal banks in a single world system will place a still heavier responsibility upon them. In the past the banks have claimed, not without reason, that they are influenced by forces beyond their control; in the future it will be realised that commercial and financial panics, and periods of trade depression and unemployment, are primarily due to the policy or lack of policy of the Central Banks and the banking system they control. Is it right that this vitally important function of regulating the monetary circulation of the world should rest with private profit-making institutions?

In practice, it may be true that in this country neither the Bank of England nor the principal Joint Stock Banks are primarily conducted in the interests of their shareholders. Judging from the reports of the annual shareholders' meetings, the Bank directors seem to have a fairly free hand to pursue what policy they like, with little or no effective check or control by the nominal proprietors. Subject only to the condition that they must be able to pay a fairly generous rate of dividend, the directors are free to consider the general interests of trade and industry rather than the sole interests of the shareholders. But the anomaly is evident, and is only tolerated in view of the transitional and illogical structure of the whole economic system.

There is, moreover, the further anomaly that all the large banks are virtually guaranteed by the Government. None of them can be allowed to fail, because of the disastrous social consequences such a failure would entail. To all intents and purposes a shareholder of the Bank of England, or of one of the Joint Stock Banks, has a gilt-edged security, differing little from Government stock. The nationalisation of banking, therefore, so far as it implies a guaranteed dividend to the existing proprietors, and the recognition of banking as a vitally important public service, is already half accomplished. What has yet to be discovered is the means of making the banking bureaucracy more amenable to the general trend of democratic policy. No mere change in the ownership of bank shares is going to solve this problem. Ultimately an improvement in the functioning of the banking service depends on the growth of a more vivid imagination, a more creative intelligence, and a higher professional standard among bank officials themselves.

We must now return to the fundamental problem with which we started. The essence of competitive economy, as we saw, is that no man or group of men can control the free play of economic forces. The linking together of the principal banking systems of the world, and the supersession of the automatic gold standard by a deliberate policy of stabilisation, is the first step in the direction of scientific control. But this is not enough. It might remove the devastating fluctuations from which we suffer to-day, but it would not guarantee that the necessaries of life were produced with the minimum amount of labour and waste, still less would it ensure their proper distribution and provide a reasonably sure prospect of a civilised standard of life for all. The profound disharmony of the present system cannot be resolved merely by stabilising the value of money. We have seen that the fundamental reason why, in spite of the vast productive capacity of mechanical power and large-scale organisation, the masses of mankind are still compelled to struggle for a precarious livelihood under the constant menace of being forced below the level of a civilised standard of life through over-production of the things they need but cannot afford to buy, is that there is no central plan of adjusting production and consumption, even of the necessaries of life, in such a way as to promote the general well-being of the community.

It is in connection with this fundamental problem that the experiments of war-time administration open up new possibilities, which were almost unthinkable before the war. It was pointed out in a previous chapter that during the war the Government was able to secure a socially valid harmony between production and consumption owing to the fact that a very large proportion of the consumable goods required were taken for the Army, and a still further part was ordered direct for the purpose of supplying the civil population. The total demand for all socially necessary commodities was known or could be estimated by the Government. The problem of obtaining the supply was therefore comparatively simple. By centralised purchase, guaranteed prices, and long-term contracts, production could be so regulated as to ensure the supply required. But to-day conditions are totally different. I am not suggesting that the Governments of the world should feed, clothe and supply their populations like armies. In a well-organised State-Socialist world the supply of the necessaries of life could, theoretically, be adjusted to the demand, by arranging for so much work to be done to supply them and no more. Everyone would be required to do his share of such work, and when he had done it, would be released from further public service on full pay, until he was called up again. One might even hazard a guess that the provision of a civilised standard of life for all by such methods would take about one-tenth of the man-hours now fitfully devoted to the purpose. But such speculations are beside the mark. I do not propose to emulate Mr. Wells in sketching a new Modern Utopia. The problem before us is how to ensure a more adequate functioning of the economic system, given the psychology and institutions of a conservative and individualist world. The plan proposed is therefore designed to appeal to the farmer and the manufacturer as strongly as to the workers in industry.

We have seen that a sound currency system involves stabilisation of prices, and the plan for international currency regulation sketched in the previous chapter was principally designed to secure this object. It is doubtful, however, whether this object can be effectively achieved, by manipulating the Bank rate and co-operation between the Central Banks, so long as the marketing of the staple commodities, which enter into the general index number of prices, are carried on under competitive conditions. It might even happen that serious disharmony in the adjustment of supply and demand in the case of particular commodities might show no influence on the general level of prices ; for a sharp rise in one commodity might be offset by a general fall in the remainder. The essence of the wider plan of stabilisation therefore is that the price of a fairly wide range of staple commodities should be regulated by a similar method of international co-operation and control. Just as under the plan of currency reorganisation adopted at the Genoa Conference it was proposed to stabilise the value of gold, so under this plan stabilisation would be applied to certain basic raw materials and foodstuffs, such as coal, petroleum, wheat, sugar, wool, cotton, rubber, nitrates and other similar commodities in universal and fairly constant demand.

This idea should not be dismissed offhand as impracticable. It is put forward not indeed as an immediately practical programme, but as an intelligent policy in keeping with modern tendencies. Before the war it would have been rightly regarded as chimerical. But it is not so wildly unpractical to-day. During the war practical business men and administrative experts created machinery for just this purpose. Foodstuffs and raw materials were bought and sold in bulk at guaranteed prices by the Governments of half the world. To-day, though the Governments have gone out of business, international combines, trusts and co-operative societies are moving in the same direction. Spasmodically and ineffectually enough, their efforts are directed to the same end —the elimination of unnecessary price fluctuations by centralisation and large-scale operation.

CHAPTER IX

STABILISATION OF COMMODITY PRICES: OIL, RUBBER, COAL

IN the case of petroleum and its products price changes are recognised to be an extraordinarily wasteful and unsatisfactory regulator of supply and demand. Partly for this reason there is a natural tendency in the oil industry towards monopoly and large-scale organisation, and this tendency is steadily growing owing to the disastrous results of violent price fluctuations.

When consumption falls off and prices show a tendency to decline, oil production cannot be quickly reduced. Under competitive conditions this aggravates the slump. Tanks and pipe-lines become congested, and oil may be actually wasted owing to the impossibility of finding a market. On the other hand, when consumption increases and prices start going up, oil production cannot be quickly speeded up. Several months are required before new wells can be bored and new pipe-lines laid down. It therefore happens that prices rise to extravagant heights before the world's production can overtake the increased demand. But meanwhile, the actual consumptive demand has been artificially exaggerated by speculation, with the result that production is again disorganised by a fresh period of depression and over-production.

Mr. Walter Teagle, President of the Standard Oil Company, referred to this evil in an address to the American Petroleum Institute in December, 1921. The ideal to be aimed at, he pointed out, was to maintain production at a given level irrespective of current requirements. This would entail, first, the building of vastly greater tank storage for the purpose of holding reserves, and secondly, stabilisation of prices by a world monopoly operated in the world's interest.[1]

This statement by the head of the largest international oil combine is significant. It is possible that voluntary co-operation between the Standard Oil, the Royal Dutch and the Anglo-Persian Oil Company may prepare the way for such a world monopoly in the near future, but it is more likely that mutual jealousies and political considerations will stand in the way. The alternative will be for the Governments to intervene and bring about a statutory monopoly with proper safeguards for the interests of consuming countries. It is worth recalling that during the boom of 1920, when speculation had forced prices to an extravagant height, the Commercial Motor Users Association of the United Kingdom and the Petrol Sub-Committee set up by the Board of Trade under the Profiteering Act recommended that the Governments of the world should take action, through the League of Nations, to regulate the price of petrol. Now that the boom has been followed by an unprecedented slump it is the

[1] *Manchester Guardian Commercial*, Reconstruction Supplement, p. 253.

producers who are beginning to talk of the stabilisation of prices and the creation of a world-wide organisation to regulate the production and distribution of oil.

The administrative machinery would be similar to the plan discussed at Genoa for the stabilisation of the value of gold. In oil, as in gold, adjustment of supply and demand at fixed prices would be effected by the pooling and centralisation of reserves and the adoption of a common reserve policy throughout the world.

An interesting development of a similar kind is to be noticed in the case of rubber. British and Dutch rubber producers have been demanding inter-governmental action to control the price and regulate the production and marketing of plantation rubber. The volume of rubber production is even less sensitive to price changes than oil production. It takes five or six years before a new rubber plantation begins to bear. Consequently, changes in price owing to an increase or decrease in demand have very little immediate effect upon the supply. The result has been that rubber production, having been excessively stimulated ten years ago, is now in excess of the world's demand at a price that will cover the cost of production of a large number of plantations. Under competitive conditions there is no means of securing the necessary restriction of output, since most companies will continue for a long time producing at a loss, in the hope of better times coming, rather than be driven out by their competitors. Amalgamation and voluntary agreement having proved impracticable, the producers now demand Government intervention to save the majority from ruin by enforcing restriction and stabilising the price of raw rubber.

The precise machinery by which it is proposed to attain this object is still under discussion at the time of writing, and the refusal of the Dutch Government to co-operate in the Dutch East Indies has created serious difficulties. Experience of war-time control suggests that attempts to control prices must be thorough and that half-measures are likely to fail. On the analogy of war-time schemes the simplest course would be for the British Government to make a long-term contract with the rubber producing companies to take the whole or the greater part of their output at a fixed price. But in peace-time there would be certain disadvantages in entrusting commercial operations of such magnitude to an administrative department of the Government. An alternative plan, which has much to commend it, would be to form a mixed company in which the Government would hold the majority of shares and would appoint the majority of directors, the rest of the capital being subscribed by existing rubber companies in the form of actual stocks of rubber. Any funds required over and above the subscribed capital would be obtained by long-term bonds from the investing public. Such a company would obtain possession of the existing surplus of rubber on favourable terms, and would thus hold sufficient reserves to dominate the market and check any tendency to speculation, when demand showed signs of recovering.

If, taking a long view, it appeared that the world's rate of production was likely to be permanently in excess of the world's demand, steps would be taken to restrict output, either by a proportional reduction enforced on all producers, or by buying up and closing down the least economical firms. There is nothing visionary or Utopian about such a proposal. It is a perfectly sound business proposition based upon up-to-date principles of commercial organisation; and from the monetary point of view, with which we are here mainly concerned, it would make a useful contribution to the general stabilisation of prices.

It is easy to see how similar schemes, differing according to the circumstances of each trade, could be applied to most of the other raw materials and foodstuffs mentioned above. Without going into unnecessary details, a word or two may be said about some of the most important of these commodities.

The case of coal is of fundamental importance to the whole economic system and of vital concern to the workers. A tremendous amount of the social unrest and unemployment of the last four years has been due to fluctuations in the market price of coal. The severe slump which followed the boom of 1920 has taught both the miners and the owners that there is something much more fundamental even than the private ownership of the mines; and that is the chaotic conditions prevailing in the marketing of coal and the impossibility of organising production on a regular and scientific basis without attending to the commercial and financial causes of instability.

Price changes, as a means of adjusting supply and demand, are as wasteful and unsatisfactory in the coal industry as in oil production. The supply cannot adjust itself quickly enough to changes in demand to prevent prices going up unduly during a boom and falling excessively during the succeeding slump. Moreover, exaggerated fluctuations in the value of coal have a disastrous influence upon the rest of trade and industry, since coal plays such an important part in the cost of production of iron and steel and other basic materials. Greater stability in coal prices would contribute enormously to the regularisation of production in other industries and the mitigation of profiteering and unemployment. If it is important to stabilise the value of gold owing to its influence on the general level of prices, it is scarcely less important to try to stabilise the value of coal for the same reason. Is such a proposal really so impossible as it appears at first sight? The history of the last few years suggests that it is not.

During 1919 and the early part of 1920 a relatively small shortage in the supply of coal in relation to the demand, combined with the general expansion of credit, caused prices to rise to fabulous heights, except where they were deliberately kept down for internal consumption by the action of various European Governments. Countries like Italy, depending on imports, were compelled to pay extortionate prices for British coal. Moreover, the widely divergent levels of prices in different countries upset distribution and caused serious economic and political complications.

In these circumstances a proposal was made for the appointment of a European Coal Commission to regulate the price and distribution of coal throughout Europe. This common-sense arrangement, which was particularly pressed by the French and Italian Governments in the interests of their countries, was also backed, strangely enough, by the American delegates in Paris, who were strongly opposed to any international control of American foodstuffs and raw materials, but were able to look upon the problem of Europe's coal supplies with a realistic and unbiassed mind.

A European Coal Commission was in fact appointed; but owing to the refusal of Great Britain to allow any interference with the export of British coal, its powers were too limited to enable it to do anything useful, and its existence was soon brought to an end. It is interesting to note, however, that even so orthodox an economist as Mr. J. M. Keynes, writing towards the end of 1919, urged, among other remedies for the economic crisis of Europe, that

> the Coal Commission already established by the Allies should become an appanage of the League of Nations, and should be enlarged to include representatives of Germany and the other States of Central and Eastern Europe, of the Northern Neutrals, and of Switzerland. Its authority should be advisory only, but should extend over the distribution of the coal supplies of Germany, Poland, and the constituent parts of the former Austro-Hungarian Empire, and of the exportable surplus of the United Kingdom.

The word "advisory" may suggest that the Commission was not intended by the writer to have any effective control; but it should be remembered that in order to preserve inviolable the nominal sovereignty of the participating States, all the inter-allied bodies set up to control the purchase and distribution of food and raw materials, including even the Wheat Executive, were in fact merely advisory bodies, and that the actual control was carried out by the various Governments, after consultation of the "advisory" body concerned, according to a common plan.

As with other commodities, this plan for controlling coal prices during the boom by common action on an international scale was rendered abortive by the opposition of the producing countries. In the succeeding slump it is the producing countries which have suffered most; and though the British mine-owners, in their quixotic determination to carry on their business in their own way, even if it involve misery for their employees and ruinous losses for themselves, have not yet invited the British Government to help them out of their difficulties as the rubber producers have done, the British miners have shown a wider grasp of economic realities and have endeavoured repeatedly and in vain to get an effective Coal Commission established under the auspices of the League of Nations. It is only natural, however, that importing countries like Italy and Scandinavia should have lost their interest in a measure, which would now primarily benefit exporting countries like Great Britain and relieve us of some of the consequences of our short-sighted greed during the boom.

Sooner or later the pendulum will begin to swing back, coal prices will begin to rise unduly, and Great Britain will again have to choose whether she is going to co-operate in European reconstruction or to profiteer at Europe's expense. Then, if the miners are true to their principles and a progressive Government should happen to be in power, a policy of price stabilisation in the interests of importing and exporting countries alike will become a serious proposal worthy of careful study.

It would take us too far from the monetary aspect of the problem to consider whether such a policy would necessarily involve a change of ownership and management in the mining industry. In practice it may prove impossible to establish international co-operation without nationalisation in the principal producing countries, especially if the proposal was made at a time of rising prices and large prospective profits. But if the mining industry was better organised and the owners had learnt to combine (as in Germany) instead of competing, there should be no more insuperable difficulty in arranging co-operation between the mining groups in each country than between the banking systems of the world as proposed at Genoa.

Moreover, in the case of coal the need for co-operation is more limited geographically. An agreement between Great Britain, France and Germany would be sufficient to stabilise prices throughout Europe. As the American delegates saw at the Peace Conference, the United States are not greatly affected by Europe's coal policy. A European Coal Consortium could be organised without waiting for American participation, while a European Consortium of Central Banks would be likely to arouse grave suspicion, if not actual hostility, in the unsophisticated minds of United States Senators.

A practical difficulty in the way of stabilising coal prices arises in connection with reserve stocks. In the case of oil and rubber the Central "Pool" would normally carry large reserve stocks sufficient to dominate the market and meet periodical fluctuations in demand without upsetting the regular programme of production. In the case of coal, storage on a large scale, sufficient to meet all variations in demand, would be much more difficult ; for accumulation of stocks beyond a certain point in the open air is uneconomical, owing to deterioration in the quality of the coal. This means that production would necessarily be less regular, and that variations in supply and demand would have to be met to a larger extent by increasing and decreasing the number of workers employed or the hours of labour. The cost of maintaining a reserve of labour power sufficient to supply the maximum demand would have to be recognised as an essential element in the normal selling price of coal. Whether unemployment pay comes out of the funds of the industry or is partly borne by the State and met by taxation of the industry, the principle would have to be laid down that the maintenance of an adequate reserve of labour at full rates of pay is just as much an element in the cost of coal as the upkeep of plant or the storing of coal reserves. The present system under which the needs of the human factor in production are treated as of less account than the care of machines or the upkeep of warehouses is a monstrous travesty of sound economy.

Whatever be the future organisation of the coal industry, whether it be nationalisation as the Labour Party demands or unification by districts as the more enlightened employers propose, one of the main objects to be achieved will be stabilisation of wages at a reasonable level and the provision of full maintenance for the unemployed. Without stabilisation of prices wages can never be satisfactorily adjusted. They will always lag behind when prices are rising, and will all too easily be forced down below a reasonable level during a slump.

The level of prices is thus fundamental. The commercial and financial conditions which dominate the coal market are of more importance to the miners even than the ownership and management of the mines. And these financial and commercial conditions are international rather than national in character. It is necessary to emphasise this commonplace, since even the Sankey Commission paid very little attention to this all-important side of the problem. The Commission seemed anxious to avoid a thorough examination of the foreign coal market, and even the advocates of nationalisation assumed that the export trade could be carried on as before without analysing its effects on employment, wages and prices and the conditions of production at home. But that was before the slump came. If the Sankey Commission was still sitting, it would be taking evidence about the causes of the ruinous slump in coal prices, about the effects of the policy of deflation upon the livelihood of miners in South Wales, and about the possibility of adjusting production and consumption by some less ruinous method than that of starving the workers and bankrupting the employers.

CHAPTER X

THE PROBLEM OF AGRICULTURE: WHEAT, COTTON, ETC.

AN essentially similar problem exists in regard to raw materials and foodstuffs which are the products of agriculture.

During the last two years of the war some check was placed on the exorbitant prices which the mischievous policy of inflation enabled farmers in favourably situated countries to extort. At the same time, farmers in remote countries like Australia, who would otherwise have been ruined by the impossibility of shipping their crops to Europe, were guaranteed a fair price and induced to maintain their normal production by the machinery of inter-allied control. After the war, while France, Italy, and to a less extent Great Britain, desired to continue collective purchase in their own interests, strong opposition came from the producing countries, especially the United States and Canada. Immediately after the Armistice America withdrew from the inter-allied purchasing organisations, and destroyed all hopes of utilising the inter-allied machinery of control as the economic foundation of an effective League of Nations.

In November 1920, when the proposal to re-establish international control of raw materials and foodstuffs was made by the Italian Government at the first Assembly of the League, Mr. Rowell, one of the Canadian delegates, made a vehement protest on behalf of Canadian farmers against any interference with the free play of market forces. But even while he spoke, the prices of agricultural products in North America were starting to fall at a headlong rate to the utter dismay of the farmers, whose interests he thought he was defending. Ever since that time the boot has been on the other leg. It is the farmers in the British Dominions and North America who have been demanding a return to war-time measures of control, in order to save them from the ruin brought upon them by the free play of economic forces. The economic providence which ordains that men should always be guided by self-interest in business matters must have a sense of humour. Or is it merely the economists who have misinterpreted the laws of Providence? If only the hungry peoples of Europe, and the bankrupt farmers of the outside world, saw where their mutual interest lay, the situation would be less comic; but it would also be less tragic.

It is worth while glancing briefly at this movement among farmers in favour of stabilisation of prices.

In the United States there is now a powerful Agricultural *bloc* which is rapidly becoming a thorn in the side of the orthodox Republican Party. The farmers' representatives in Congress are naturally vehement critics of the Federal Reserve Board's disastrous policy of deflation. They complain, rather unfairly it appears, that the banks have discriminated against agricultural interests in the matter of credit facilities. President Harding recently had to surrender to this criticism to the extent of appointing a special agricultural representative on the Federal Reserve Board ; and shortly afterwards the Board announced that it was considering a special rediscount rate for agricultural paper, viz. : $3\frac{1}{2}$ per cent. compared with the official minimum of 4 per cent. If farmers in this country should have the good sense to demand a similar privilege, a Conservative or even a Labour Government might well include in any scheme for the reform of the Bank of England a stipulation that one of its Directors should be nominated by the agricultural interests.

A still more important victory for the Agricultural *bloc* has been the resuscitation of the War Finance Corporation, a State credit institution with a capital of $500,000,000 created and guaranteed by the United States Government for the purpose of financing war industry. This is now being used chiefly to assist agriculture. On August 10, 1922, the War Finance Corporation announced that it had advanced $104 million to farmers' co-operative associations "for the purpose of assisting in financing the orderly marketing of agricultural products," in other words, for stabilising the price of agricultural products by enabling farmers' organisations to carry over stocks and avoid flooding the market owing to temporary over-production.

The discontent of American farmers is easy to understand. They are disgusted with the ordinary machinery of marketing, and they attribute their woes to the sinister manipulations of speculators, middle-men and banks. But this is to over-simplify. It is all too easy to personify the causes of economic disaster and to attribute conscious wrong-doing to mere cogs in the machine, who are no more responsible than the sufferers themselves. There are as yet few signs that American farmers realise that their troubles are international in origin, and that no mere provincial tampering with the problem in an area, which is after all only a fraction of the world's surface, can achieve any lasting results.

The discontent among the growers of cotton, in which the United States plays a far larger part in the world's economy than in other agricultural products, is as pronounced as among the grain growers. Cotton growers' associations have sprung up all over the South for the purpose of co-operative marketing and price stabilisation. These associations are linked together in the American Cotton Growers Exchange, which aims at dominating the American cotton market. The movement is growing rapidly and already 150,000 planters are members of the various associations. The War Finance Corporation on August 19, 1922, had advanced over $50 million to assist "the orderly marketing" of cotton. Californian fruit growers and Southern tobacco planters are now following the example of the cotton growers, and are forming co-operative selling associations with similar policies and principles.

In Canada, during the war, the exportable surplus of Canadian wheat was purchased at fixed prices for re-sale to the Inter-Allied Wheat Executive by a Government institution called the Canada Wheat Board. By this means the farmers, while still getting an extremely handsome price for their wheat, were unable to exploit the economic situation to the fullest possible extent. Under competitive conditions prices would undoubtedly have been far higher. In 1919 the system of centralised purchase and sale was abandoned, in Canada as in the United States, and for a time Canadian farmers reaped the full benefit of the speculative rise which accompanied the post-war boom. At that time Government intervention and international control were naturally unpopular. Two years later, when the price of wheat had fallen over 60 per cent., the farmers began to look upon Government purchase at fixed prices with a more sympathetic eye. Loud complaints were made against the parasitic speculators and middle-men, who were blamed for ruining them during the slump without receiving any credit for their share in bringing about the preceding boom. Finally the farmers themselves demanded the reconstitution of the Canada Wheat Board, whose operations during the war were now recalled with more favour than they had met at the time.

The sequel is significant. Yielding reluctantly to the pressure of the agricultural interests the Government invited the business men, who had managed the Wheat Board during the war, to accept the same position of responsibility in the present emergency. But these distinguished business men flatly refused the invitation. Though the views of the farmers with regard to Government intervention had undergone a not unreasonable modification, the attitude of commercial and financial circles remained the same. There the matter rests at the present time. The project of a reconstituted Wheat Board has had to be dropped, and the farmers of Canada are turning to political organisation as the only means of realising their new economic programme.

In Australia and New Zealand the slump has been exceptionally severe, and it is not surprising that farmers there also are increasingly favourable to the principle of collective sale. In New Zealand the Government has taken powers under the Meat Export Control Act to regulate the marketing of New Zealand meat, and the cattle-raising industry of Australia has had to appeal to the Commonwealth Government for assistance. During the war the effect of Imperial purchase of meat, wool, grain and dairy produce was to guarantee Australian and New Zealand producers a fair price at a time when the dearth of shipping would have rendered it impossible for them to market their produce in any other way. So far from restricting their profits the British Government saved them from heavy losses. This partly explains why the idea of State purchase and control is more popular with Australasian than with British farmers.

In the case of wool the existence of large surplus stocks in the hands of the British Government after the war has led to an interesting experiment in centralised marketing which may have a lasting influence on the sale of Australian produce. From 1917 to 1920 the Colonial wool clips were bought at fixed prices by the British Government with a proviso that half the profits realised on sales for civilian purposes should be returned to the growers. The total turnover for the four years amounted to £363,000,000, and on March 31, 1921, accumulated profits stood at £51,000,000 and stocks in hand at £37,000,000. At the beginning of 1921 the assets and liabilities were handed over to a specially constituted body, the British Australian Wool Realisation Association, commonly known as BAWRA. The capital was fixed at £22,000,000, representing the estimated value of the producers' share in the profits, and shares up to this amount were issued in proportion to their individual claims to about seventy thousand wool growers. £16,000,000 has already been repaid to the shareholders, leaving BAWRA with a capital of £6,000,000 in November 1922. BAWRA's operations during the last two years have prevented the price of wool falling to the full extent which the existence of large surplus stocks would otherwise have rendered inevitable. The reserve stocks have been kept off the market and liquidated slowly and cautiously. Australian producers have been quick to realise the significance of this fact.

A proposal has recently been made in Australia that BAWRA should be retained permanently as a huge co-operative marketing organisation. The plan as outlined by Senator Fairbairn in the Melbourne *Argus* of October 16, 1922, is to utilise BAWRA's existing capital of £6,000,000 for regulating the marketing of pastoral and agricultural products. It would act if necessary as a selling agency, but its main object would be to hold reserve stocks with a view to the stabilisation of agricultural prices. It would also give financial assistance to producers in time of drought or of acute commercial depression. The intention apparently is to extend its operations to wheat, meat, skins and other products as well as to wool.

Whether or not this far-reaching scheme is likely to be realised in the near future it is impossible to say at the time of writing. Considerable opposition is to be expected from vested interests in the commercial and financial world which are likely to be adversely affected by the scheme. Nor does the existing capital of £6,000,000 appear sufficient to enable the proposed organisation to play an important part in more than one, or at most two, of the commodities mentioned. But if the general idea meets with support, there seems no reason why BAWRA or its successor should not be developed in course of time into a virtual selling monopoly of Australian agricultural produce; especially if the Commonwealth Government follows the example of the United States Government in extending special financial facilities to co-operative marketing organisations of this kind.

Though the tendency of farmers to realise the principle of collective sale, either through co-operative associations or through State intervention, is a world-wide phenomenon, to be found in varying degrees not only in the United States, Canada, Australia, and New Zealand, but also in the Argentine, Russia, and indeed most European countries, including Great Britain, it must not be supposed that these tendencies by themselves are likely to be sufficient to bring about stabilisation of prices and a more satisfactory adjustment of supply and demand. The existing movement represents an instinctive reaction against the worst effects of the present slump rather than a conscious effort to eliminate all price fluctuations. We may be pretty sure that when the next boom comes and the prices of agricultural products rise again to a profiteering level, the farming community throughout the world will grow more tolerant of the system of speculative markets, and will quickly drop their proposals for guaranteed prices, "orderly marketing," and Government "pools." It will then be the turn of consumers in all countries to resume the outcry against profiteering on the part of farmers and middle-men, and to demand the re-imposition of State control.

Moreover, the starting of isolated schemes of State intervention and guaranteed prices in Canada, Australia or elsewhere might even accentuate the tendency for world prices to fluctuate. Effective stabilisation of price is only possible, as we have seen in other cases, either by world monopoly or at least by international co-operation on an extensive scale. More especially in the case of wheat, isolated action in one or two countries would be attended with serious financial risks. A Government wheat "pool" in Canada or Australia would be quite unable to dominate the world market and might easily be rendered insolvent by a slump in world prices. It would be impossible for any one Government to guarantee the price of wheat for even a year ahead, unless it was prepared in the event of a general fall in world prices to grant a subsidy to wheat growers at the expense of the rest of the community.

This is why the Coalition Government's scheme for encouraging wheat growing in Great Britain was immediately dropped when world prices began to fall. When a Labour Government comes into power and turns its attention to agricultural policy, it will have to look further afield than the wheat-growing area of Great Britain. It cannot be too strongly insisted that the problem of British agriculture, like the problem of British coal, is an international and not a national problem. If we desire to give stability and security to British wheat growers, we can only do so by co-operating with Canada, Australia and other wheat-exporting countries, whose Governments find it desirable to try to achieve the same objects.

Stabilisation of wheat prices would then become a practicable commercial proposition. It would involve the creation of an international wheat "pool," in which Governments, farmers' co-operative societies, and perhaps even milling combines would participate. The object of the pool would be to reduce price fluctuations to the minimum by holding large reserve stocks and meeting seasonal and even cyclical variations in demand by increasing or decreasing its reserves.

Since deliberate restriction of output, in the event of the reserves becoming unduly large, would be far more difficult to enforce in the case of millions of farmers than in the case of coal mines, oil wells, or rubber plantations, price changes could never altogether be eliminated as a means of influencing supply. But such changes would be far less frequent than under any system of marketing hitherto tried. Seasonal fluctuations could be eliminated without difficulty, with the result that wheat growers would know for a certainty, when they sowed their seed, what price they were going to realise for their harvest. Variations in yield owing to weather conditions could also be averaged out and provided against without serious difficulty by the scientific use of statistics and an elastic reserve policy. After determining the amount of wheat likely to be required by consuming countries for, say, two years ahead, the Wheat Pool would be able to fix a guaranteed price to farmers, which could be counted upon to produce the required amount with a negligible margin of error. During the first two years, while reserves were being built up, the price would have to be sufficiently attractive to ensure a substantial surplus.

Once seasonal and fortuitous variations had been successfully dealt with, there is no reason why an attempt should not then be made to tackle the so-called cyclical fluctuations. Whatever the exact causes of these cyclical fluctuations may be,[1] it is well known to statisticians and economists that they occur with a fairly regular periodicity. Booms are followed by slumps, high prices by low prices, under-production by over-production. Once a natural tendency which runs counter to human well-being has been discovered, and its "law" or mode of operation has been established, it is the business of science to devise means of controlling it or of counteracting it to our advantage. This, as we have seen, is the purpose of the plan of currency stabilisation formulated at Genoa. It will be the business of the International Wheat Pool to reinforce the efforts of the Consortium of Central Banks in this direction.

By taking a long view it should be possible for the Wheat Pool to forecast the demands of consuming countries with reasonable accuracy, not merely for two years, but for five years ahead. If a study of the trade cycle revealed the probability of a boom period in the course of the next five years, the Wheat Pool would start deliberately accumulating reserves slightly in excess of the normal consumptive demand. When the boom came, or rather, before the worst features

[1] It will be clear from preceding chapters that the writer attributes more importance to the action of the banks than to "sunspots" or other mythical agencies. See Appendix.

of a boom had developed and as soon as wheat prices showed a tendency to rise, the Wheat Pool would begin to sell freely from its reserves at the same time that the Central Banks were increasing the monetary reserves by withdrawing credit and currency from circulation. Similarly when demand showed signs of falling off owing to the development of a cyclical depression, the Wheat Pool would start building up stocks, and thus check any tendency to a temporary glut, at the same time that the Central Banks were encouraging the further expansion of credit and currency by lowering the rate of interest and decreasing their ratio of reserves.

It will be evident from this reference to the parallel functions of the Wheat Pool and the Central Banks why I have treated what appears to be merely a problem of commercial organisation as a branch of the monetary problem. Many of the objections which at once arise in the mind as to the possibility of controlling the value of any staple commodity implicitly rest on the assumption that it is impossible to stabilise the general level of prices or, in other words, to control the commodity value of gold. But the foremost financial experts have now agreed that it is perfectly feasible to fix the value of gold, and to maintain it at a practically constant level, by an understanding between the Central Banks. The new doctrine embodied in the currency code of Genoa, and endorsed by the thirty-one Governments represented at the Conference, is that it rests with the Central Banks "to prevent fluctuations in the commodity value of gold."

A similar doctrine was of course one of the chief features of international bimetallism. The bimetallists were perfectly right in arguing that if all the principal countries had adopted gold and silver as their standard, a fixed ratio between them could have been maintained without difficulty, owing to the monopolistic power of the Governments and banks to determine the value of the precious metals. Even to-day the United States Government still guarantees a fixed price for American silver, as though it was a far more important matter to keep the silver mines working than to ensure a steady production of wheat and cotton and fuel.

From the monetary point of view the programme sketched above has affinities with a currency scheme which has never been thoroughly worked out, known as "multimaterialism." Under this scheme the monetary circulation would be based not on gold alone, nor on gold and silver, as in bimetallism, but on a number of staple commodities whose price-ratio would be fixed. Clearly such a scheme would have to be international in scope; and even then the administrative difficulties of regulating supply and demand, so as to keep the price-ratios constant, would have seemed insuperable before the war.

These administrative difficulties are no longer insuperable. The greatest and most fundamental obstacle is that, in spite of the overwhelming lessons of the Great War, the world has not yet acquired the international mind. But this objection applies equally to the Genoa programme. If when bankers and statesmen have endorsed the principle of regulating the value of gold by international co-operation, a logical extension of the same principle to a wider field can scarcely be dismissed as altogether visionary. If such a plan is not immediately realisable, it is at least not utopian.

CHAPTER XI

OBJECTIONS, PRACTICAL AND THEORETICAL

To consider all the possible objections to the above proposals would lead too far into the realm of economic theory. Though the idea of eliminating price changes as the normal means of adjusting supply and demand may appear to run counter to most economic teaching, and though it has received little attention from economists even as a scientific hypothesis, it is in fact entirely consistent with the results of modern speculation, particularly the study of the regulation of prices under a monopoly and the stabilisation of the monetary unit. It is admitted that prices may be fixed under a complete, or even partial, monopoly at any point within fairly wide limits, and that under certain conditions the same level of price may be maintained indefinitely. The most important of these conditions is that the value of the monetary unit itself should be reasonably stable. But it is now admitted not merely in theory but, as we have seen, by practical experts and statesmen, that it is perfectly feasible to stabilise the value of the monetary unit by appropriate international action.

There are, however, certain practical objections and difficulties which must be briefly considered.

There is first the question of storing. You have assumed as an essential feature of your scheme, it will be said, the possibility of maintaining much larger reserve stocks than are normally carried under competitive conditions. Is this physically possible or desirable in view of the increased burden of overhead charges and the risk or certainty of deterioration in quality?

Reference has already been made to this difficulty in connection with coal, where the accumulation and handling of very large reserves would undoubtedly be a costly and wasteful form of insurance against irregularity of production. In the coal industry irregular production cannot be altogether avoided; but it would be substantially mitigated by eliminating price fluctuations, which have a tendency to stimulate and depress the rate of production unduly in successive periods. Variations in demand would therefore be met not by maintaining very large reserve stocks, but by keeping a sufficient reserve of labour and productive capacity to satisfy requirements when demand was at its peak; and the cost of maintaining this reserve in full efficiency must be regarded as just as essential an element in the cost of coal as the overhead charges involved in maintaining a reserve of coal. This policy is all the more feasible in the case of coal, since production is elastic within reasonable limits, and can be quickly increased or decreased at will.

In the case of oil the building of adequate tank storage, to provide against the possibility of a temporary glut or an unforeseen shortage, would undoubtedly involve heavy overhead charges, but the expense to the community would be negligible compared with the waste and maladjustment of a speculative market. Indeed, we are assured by no less an authority than the President of Standard Oil that this proposition is already within the bounds of commercial development. Presumably in the case of petroleum and its products storage involves no serious loss by deterioration.

In the case of wheat and grain the limits of possible storage require further investigation. It was widely prophesied by business men connected with the corn trade during the war that the Government would suffer heavy losses through the deterioration of wheat unavoidably accumulated in Australia. It was freely stated at one time that these vast stores of wheat, which could not be shipped to Europe, were being consumed by rats. This anticipation appears to have proved erroneous, or at least greatly exaggerated. The loss from rats and deterioration was far less than had been expected. Special measures to deal with the rat pest and the dry climate of Australia no doubt explain the result. As an alternative, in climates where wheat cannot be conveniently stored, it might prove economical to keep reserves of flour.

But would such very large reserves in fact be necessary? In the case of breadstuffs the demand is far less subject to fluctuation than in oil and coal. The inevitable fluctuations are rather on the side of supply and are due to the vagaries of the weather; and it rarely happens that bountiful harvests or crop failures occur at the same time in all parts of the world. This being the case, the safe figure at which it might prove desirable to maintain the normal "carry-over" of wheat, even when cyclical fluctuations are taken into account, might well prove no greater than the existing storage capacity of the world could well accommodate. A vast amount of wheat is, of course, normally held in reserve at certain times of the year by farmers. There would be no need for the whole of the reserves to be physically pooled in a few large stores, as in the case of gold and petroleum.

The extension of the same principle to perishable commodities such as meat and dairy produce is by no means to be altogether ruled out. Here the reserves can be maintained in cold storage; and so long as there is a continual flow through the cold stores, so that the first consignments to go in are not the last to come out, the loss by deterioration is not serious. Other perishable commodities, such as fruit, vegetables and milk may be bottled, dried or canned. Dried and condensed milk already make an important contribution to the stabilisation of milk prices, just as the working of the laws of supply and demand in the English meat market has been revolutionised by the introduction of frozen meat.

The importance of the "keeping" qualities of different commodities, as a factor in the economic adjustment of supply and demand, has been strangely overlooked by theoretical economists.

Another line of investigation, which might be profitably explored, is the extent to which staple commodities are or can be standardised in uniform grades. This has an obvious bearing on proposals for price regulation. To talk of stabilisation, or even of compiling an index number, is meaningless, unless the commodities in question can be classified according to standard qualities and weights, which are substantially uniform in time and place.

The extent to which different trades vary in this respect is one of the most remarkable and significant facts in the economic system, and one to which economists have given too little attention. The laws of supply and demand work in quite different ways in horse-fairs, where no two horses are ever identical, and in the market, say, for Manila hemp, where though every individual plant and leaf is scientifically unique, the selling product is officially graded by the United States Government into a series of standard grades, which are recognised and accepted as sufficiently uniform for practical purposes by rope manufacturers throughout the world.

Writers on currency have taught us that the precious metals, which are used for monetary purposes, must have "cognisability," that is, a recognised degree of fineness and weight. Before any commodity can be included in the list to which the principle of price stabilisation is to be applied, it must similarly possess cognisability. The experience of the war showed that even where raw materials and foodstuffs are not already standardised, it is perfectly practicable to devise satisfactory methods of official grading. Price stabilisation does not mean that the same price need be fixed for every quality of wheat, flour, wool, cotton, coal, etc. It is even possible that when more scientific methods are applied to trade and industry, it will be found desirable to recognise a far wider range of standard qualities. It is worth mentioning that when the British and Commonwealth Governments abolished wool speculation during the war and introduced fixed prices by centralised purchase and control, it was found desirable to grade Australian wool into over a thousand different standard qualities.

A more fundamental difficulty has now to be faced. The critic will argue that though the scheme proposed might conceivably work over a short period when supply and demand can be pretty accurately determined, there would still be factors both on the side of supply and demand, which would necessitate changes in price, and which it would be mischievous to try and prevent by artificial means. For example, on the side of supply the real cost of production might vary substantially either upwards or downwards. The exhaustion of easily tapped oil strata or of economical coal seams, the operation of the law of diminishing returns in agriculture, and the extension of the margin of cultivation to less fertile regions would inevitably increase the cost of production; while new inventions, or the discovery of new and hitherto untapped resources would decrease the average cost of production and produce a permanent surplus, if the stable price remained unchanged.

Similarly on the side of demand, though periodical changes owing to the normal fluctuations of trade might be discounted and averaged out, no artificial measures could permanently counteract a really substantial change in demand either up or down. The discovery of a new form of power might enormously decrease the consumption of coal, new methods of flax production might reduce the demand for cotton, and wool might go out of fashion, if everybody took to wearing cheap artificial silk. Or again, a new use for rubber to replace some more expensive commodity, or the substitution of wheat for rice as the staple article of diet in the Far East might enormously increase the demand for rubber and wheat, and necessitate the raising of prices as the only means of checking consumption.

I do not deny for a moment that these difficulties are of fundamental importance and preclude any dogmatic over-simplification of the idea of price stabilisation. I am not arguing that price changes can be altogether ruled out, still less that price stabilisation should be directed to stereotyping for all time the existing production and consumption of commodities and preventing all natural and healthy growth and development. The fact that you cannot expect to stabilise for all time the value of the monetary unit itself is no argument against trying to reduce its fluctuations to the minimum. Most people would agree that changes in the value of gold and silver, though perhaps inevitable in the long run, are not in themselves desirable, and that any means of keeping fluctuations within bounds, even though they are necessarily artificial, are worth studying sympathetically. To the extent to which gold and silver fluctuate, the world's monetary system is recognised to be imperfect. The same attitude should hold good in regard to other basic commodities. Fluctuations in the value of fuel, foodstuffs, and textile materials are no more desirable than fluctuations in the value of gold and silver. The probability that changes in supply and demand of a permanent character may compel revaluation is not a reason for abandoning all attempts at stabilisation; any more than the possibility that the world may one day decide to dispense with gold and silver for currency purposes, or discover means of producing them as cheaply as lead, is a sufficient reason for doing nothing to keep their value as stable as possible at any rate during the next twenty years. Just as in politics the aim of reasonable men is to achieve stable progress without violent revolution and reaction, so in economics our aim should be to achieve ordered progress without violent booms and slumps and alternating periods of profiteering and bankruptcy. This should be the more possible in view of the fact that the fundamental changes in supply and demand, which we are here considering, are necessarily of gradual growth and can therefore be met by a correspondingly gradual adjustment.

The objection commonly made that any control of prices must necessarily exercise a depressing influence on production needs no serious refutation, and cannot be brought against the policy of stabilisation except as the result of a misunderstanding. It is not proposed that prices should merely be controlled in order to prevent profiteering during a boom, while they are left to fall to any extent during a slump. From the experience of the war this is naturally the way that most people regard price control. But when stabilisation is recognised as meaning a guaranteed price during a slump as well as a maximum price during a boom, the proposal at once takes on a different complexion; and when the slump comes, it is the farmers and producers, as we have seen, who are likely to demand State intervention. Even during the war the British Government, at any rate, did not control prices merely in the interests of consumers. Since it was concerned to stimulate the maximum production, it naturally took care to guarantee a minimum price sufficiently high to ensure the necessary supply. Farmers did not do badly during the war in spite of State control; and in Australia and New Zealand they were rescued, during the last two years before the armistice, from certain ruin. So much was this recognised in the Dominions that farmers' organisations more than once passed resolutions in favour of the continuance of Imperial purchase of farm produce after the war.

In an otherwise acute analysis of price control during the war, Professor Pigou in *The Political Economy of War* has missed this point. He assumes that price control must have a depressing influence on production in the long run, and he puts the argument thus :—

> If the State adopted a general policy of forbidding farmers to charge abnormally high prices when there are bad world harvests, this would check investment in agriculture ; because people expect bad world harvests from time to time and look to high prices then to set against low prices in bumper years. With price regulation limited to a single exceptional occasion, the position is, of course, quite different.

Surely the argument might be reversed and stated thus :—

> If the State adopted a general policy of guaranteeing farmers against abnormally low prices in bumper years, this would encourage investment in agriculture ; because people would expect bumper years from time to time and would look to minimum prices then to compensate them for maximum prices during bad world harvests.

During the war the best incentive to the farmer to extend his arable land, to increase his dairy herd, or to grow more potatoes, was not the chance of making very large profits with the equal chance, if the war came to an end or a glut occurred, of making a big loss; but the certainty that he would make a reasonable profit whatever the state of the market. The same considerations apply with greater force in normal times, when the chance of large profits is more remote. Price stabilisation is in the nature of a scheme of compulsory insurance against bad times. The producer surrenders his chance of making excessive profits, as a premium against the risk of making big losses.

There is no ground therefore for holding that price stabilisation would necessarily check investment in the forms of production to which the policy was applied; indeed it would rather encourage investment among people who look for a gilt-edged security and a safe and stable return on their money.

The effect on investment, however, is worth pursuing further, since many people hold that the level of prices and the volume of production and consumption are primarily determined by that incalculable factor, the growth of savings. The argument apparently is that since the amount which the world will save in any one year and the channels into which new savings will flow are quite beyond the power of human agency to predict, any attempt to maintain the general level of prices steady, and still more to stabilise the price and regulate the production of any one particular commodity, is bound to fail. If this is so, it would appear to be a good reason for trying to establish social control of investment somewhat on the lines of the Government scheme for the control of capital issues and the stimulation of savings by the sale of Savings Certificates during and after the war. But this is not the conclusion generally drawn. It is usually regarded as merely another reason for doing nothing and trusting to luck.

The objection does not appear to be valid, first because, as we have seen, price stabilisation would widen the field for gilt-edged securities, and secondly because organised control of the production of basic commodities would facilitate a wise allocation of the world's savings and eliminate a great deal of the waste and misdirection of capital which characterises the present system. Present-day investors are exposed to quite undue risks owing to the instability of prices. In most countries of the world the *bona fide* investor has been compelled, whether he likes it or not, to become a speculator and gambler, generally with the dice loaded heavily against him. This has the worst possible effect upon the saving habit. There are more amusing ways of gambling than speculating on the purchasing power of Government bonds, or the value of rubber shares, ten years hence. If rubber and coal and wheat remain subject to violent price fluctuations, people will prefer to throw their money away on horse-racing and luxurious consumption rather than invest it in productive enterprises. To attract the real savings of the people you must provide security. At the present time the staple productive activities of the world have no real security to offer.

Misdirection of fresh savings is almost as serious an evil as their drying up. Indeed, the one leads to the other. The over-capitalisation of rubber production and the more recent stimulation of superfluous shipbuilding and excessive oil production have involved the dissipation of real savings, which the world could ill afford to spare, and which should have been devoted to more valuable social purposes. I am not suggesting that such misdirection could have been avoided, or that shipowners and rubber companies are to be blamed for over-estimating future demand and wasting the resources of the community. I am merely pointing out that such mistakes are not calculated to encourage *bona fide* investment, and inflict untold injury owing to the losses and unemployment which they contribute to bring about.

If investment is to be rightly directed into the production of raw materials and foodstuffs, there could be no better way of achieving that aim, short of a comprehensive plan of capital expenditure for production as a whole by a Central Credit Institution, than the scheme of price stabilisation and organised adjustment of supply and demand outlined above.

As regards the administrative machinery required, the plan proposed is not necessarily to be identified with an extension of State trading. Though I believe that with a reasonably enlightened Government, and certain modifications in the established routine of public administration, direct purchase and re-sale by Governments would in most countries with a decent civil service and a fair number of public-spirited business men be the simplest and most convenient mode of operation, yet this procedure is not the only or most probable way of achieving the main objects in view. A number of compromises and combinations between State control and private enterprise are possible, which it would be out of place to examine in great detail. Mixed companies, for example, might be formed with one or more Governments holding the greater part of the shares. An existing Trust or combination of Trusts, as in the oil industry, might be transformed into an International Public Utility Company, with a guaranteed rate of dividend to the shareholders, special provisions with regard to reserves, and allocation of surplus profits either to the League of Nations or by mutual agreement between the various Governments. In some commodities a selling monopoly might take the form of a Union of Producers' Co-operative Societies, which would work in close understanding with Consumers' Co-operatives or capitalist kartels in importing countries, subject, of course, to the overriding authority of the Governments and the Central Banks in matters of statutory obligations and finance. In other trades, again, even the creation of a buying and selling monopoly might prove unnecessary, and normal competitive trade might be carried on on a professional basis, for customary fees and brokerages, provided that there was a single financial pool strong enough to dominate the market and check any pronounced tendencies to speculation and price fluctuation.

CHAPTER XII

CONCLUDING ARGUMENTS

ONCE more it must be emphasised that the above proposals are designed as a contribution to the fundamental problems of commerce and finance. Many readers, who are naturally and rightly preoccupied with the problems of industry, will be inclined to argue that I am beating the air in all this talk about currency and prices and world markets. I have missed the real point. I have said nothing about workers' control, or nationalisation, or guild socialism, or even about that obvious cure for all our troubles, the abolition of the capitalist system. It may even be held, with some degree of plausibility be it observed, that all these far-reaching schemes of international co-operation and control are merely preparing another instrument of tyranny for the workers, and that the masses of the people can have no guarantee that the vast power, which such schemes would place in the hands of a few bankers and administrators, would not be abused. Think of the dangers of corruption, of incompetence, of political pressure, or of misguided paternalism, which such power would place in their hands!

I admit these dangers. But they are inherent in the very nature of society itself; and ultimately I know of no safeguard against the dangers we run every day at the hands of doctors and engine-drivers and other public servants than their own sense of propriety and trained intelligence. The development of other safeguards, such as publicity, inspection, and audit, and the right methods of appointment and dismissal, are problems of wider range which lie outside the scope of the present enquiry.

To critics who are primarily concerned with industry I must appeal for patience. I am working at one end of the tunnel, they at the other. Some day, perhaps, we shall meet in the middle. The relations of employers and employed and the anachronism of private property in land and railways and the instruments of large-scale production are questions of burning interest about which a solution may or may not be in sight. Certainly a deep hole has been made in the tunnel in that direction. At the other end of the tunnel, where the bankers and company promoters and merchants and speculators are quietly performing the operations which determine the fate of employers and employed alike, and place even landowners, farmers and middle-class investors at the mercy of blind economic forces, the ground has hardly been explored. Here lies a jungle of tangled undergrowth with tall trees spreading out in every direction. We have first to find our way through before we can make much impression in this wilderness of exotic growths.

The technical difficulties of altering this system, once you begin to study them, are really considerable. We might get along without landowners, and even brewers and mine-owners might be dispensed with without inconvenience; but if the whole country is not to starve we cannot do without bankers and merchants and financial magnates. We must therefore learn to understand them, and if possible enlist them on the side of progress and reconstruction. Nor should this prove so impossible as it may appear. Even bankers and merchants are not satisfied with the existing state of the world, and the majority are willing to work for economic reconstruction provided they are satisfied in what direction it lies. It should be our ambition to show them; or at least to show them the direction in which a large number of their fellow-countrymen are looking to them to lead the way.

The last and most fundamental objection will be that such a high degree of collective organisation and intelligent purpose is contrary to human nature. Two hundred years ago the existing banking system and the whole apparatus of international trade would have been dismissed in the same terms. We cannot tell what human nature can do until we have tried. But in this generation, at least, we cannot safely set limits to the possibilities of human co-operation, whether for good or for evil. The whole course of the war runs counter to pre-war views of human nature and the potentialities of modern society. Side by side with devastating destruction and bloodshed, feats of collective endeavour, unimaginable and unbelievable before the war, were accomplished by the new technique of large-scale organisation and a new spirit of corporate enthusiasm.

Each one will be inclined to attach weight to objections about human nature according to the general view he takes of the future of human society and the value of constructive thought. The arguments in this book are not designed to convert the pessimist or to convince the purely destructive critic. They are addressed primarily to constructive thinkers, who are predisposed in favour of some form of collective planning in dealing with the crisis of the world's affairs. The time is ripe for a synthesis of different ways of thinking in the interests of common action. It is no time for splitting hairs over the dogmas of Ricardo or the mythical doctrines of Marx. The authors of that wisdom or unwisdom of the past, which acts like a pernicious drug upon the mental life of reactionary and revolutionary alike, were for the most part constructive thinkers themselves, who rejected the teaching of their predecessors and turned their attention to the concrete situation before them. But the concrete situation which they observed was not the situation that faces us to-day. Marx and Adam Smith would be the first to recognise the inadequacy of their teaching in the light of modern problems, and to tilt at the dogmatic complacency of those who swear by their words. When we apply the pragmatic test of what all these abstract doctrines, which mean so little and yet divide quite reasonable people into bitterly hostile camps, amount to in actual practice, as shown by men's actions and concrete aims, we find that there is really far more agreement on the way things should be done than the controversies of theorists would lead us to suppose. There is much more in common, for example, in the practical outlook and working philosophy of such men as Mr. Lionel Hichens, M. Albert Thomas, Mr. Hoover, Dr. Cassel, M. Krassin, and the late Dr. Rathenau than their political labels or social sympathies would lead one to expect. Practical Communists, moderate Socialists, theoretical monetary experts and large-scale Capitalists are all working towards an economically organised world. Each in his own way believes in conscious control of the free play of economic forces and the substitution of deliberate planning and organisation for the fatalistic doctrine of competitive anarchy.

In considering the practical possibilities of progress on the lines indicated we have paid particular attention to the point of view of farmers and producers of raw material. We have seen that opinion in producing countries overseas, especially in the United States and the British Dominions, is increasingly favourable to the idea of "orderly marketing" and guaranteed prices. If in this country the progressive parties advocated such a policy for agriculture, they would be assured of a large degree of support not only from farmers and agricultural labourers, but even from provincial traders and others whose interests are bound up with agricultural prosperity. The immediate response of rubber shareholders, tea planters, and investors in other raw materials and foodstuffs could be counted upon whenever there was a prospect of a serious slump.

When we consider the view likely to be taken by the consumers of raw material, that is by manufacturers in industrial countries, and especially in Great Britain, we must be careful not to attach too much importance to their first reaction, which would almost certainly be hostile. Manufacturers have had experience of State control of raw materials during the war, and for the most part they disliked it intensely, though they did fairly well out of it, and have probably modified their views somewhat in the light of two years' bad trade. Moreover, many manufacturers have something of a gambler's instinct, and prefer the risks and excitement of constantly fluctuating prices to the exacting routine of attending to the actual business of manufacture. But though nearly all small employers set great store by their own personal freedom and individual enterprise, they are finding it increasingly difficult to survive. The very risks which they enjoy, in the end prove too much for them; and after priding themselves on a fine show of profit, which any child could make during the period of a boom, they are apt to come down with a bump in the succeeding slump, and either close down or be swallowed up by a larger concern.

The modern tendency towards amalgamation and combination is largely due to the disastrous results of price fluctuations, in raw materials no less than in the finished goods, and to the natural desire of all except the pure gamblers to reduce commercial risks to a minimum. Under competitive conditions the risks of price fluctuation are so great that it is no exaggeration to say that most manufacturers in the less organised trades, such as the woollen and worsted industries, have to pay more attention to the business of buying and selling than to the processes of manufacture. Large profits are more easily made by skilful or lucky purchase of raw material than by technical efficiency or improved methods of production. Stabilisation of the price of raw material would diminish the speculative risks to which the manufacturer is now exposed, and would leave him free to concentrate on the real business of manufacture and to compete in a useful and fruitful way in the reduction of costs and the increase of efficiency. We may therefore expect that with the growth of existing tendencies towards amalgamation and price-fixing associations, the proposal for international regulation of raw materials will be looked upon with increasing favour by manufacturing interests as a logical extension of the principle of price regulation, which is gradually becoming the rule rather than the exception in highly organised industries.

If manufacturers were able to count on receiving a steady supply of raw material at a stable price for six months or a year ahead, it would be far easier for them to maintain regular production and to plan for the future. If to this were added the usual procedure of kartels, whereby orders are pooled and allocated, and prices and output are regulated by a common programme, industry would tend to become a branch of applied science instead of a private lottery. By a further extension of the same principle on an international scale, combined with some form of public supervision and guarantee, price regulation of certain manufactured goods might develop into virtual stabilisation. If coal and iron-ore can be stabilised, there should be no insuperable difficulty in stabilising the price and production of pig-iron and standard lines of iron and steel goods. Similarly, with cotton and wool regulated in the manner suggested, it should be perfectly feasible to regulate the production and distribution of certain standard kinds of cloth at stable prices, in such a way that supply and demand would be scientifically adjusted and the workers engaged in those industries would be guaranteed steady employment at reasonable remuneration.

Developments of this kind would have seemed utopian before the war, but the success of the Wool Control Board and other war-time experiments have demonstrated that their realisation is only a matter of time. The technical details of administration, novel and complicated though they may be, are not insuperable and are not even the chief obstacle. The plans of economic reconstruction which were worked out on moderately ambitious lines four years ago have been cast aside, not because they were impossible, but because the Government in power and their supporters in the House of Commons did not want to try them, or if they were tried, to make them a success. Fatalism, inertia, lack of imagination and fear of the unknown are the real obstacles to sane projects of reconstruction, greater even than unenlightened self-interest and a jealous insistence on anti-social power and privilege. For it is the masses of the people who are guilty of the former, and only a minority of the community who have any reason to feel the latter. All suffer alike, in some degree or other, from alternating periods of profiteering and bankruptcy, of unemployment and strikes, of recurring wage disputes, and all the misery and unrest and waste of wealth and human capacity, which economic instability involves.

The fact that the causes of this pitiable and seemingly inevitable maladjustment are world-wide and international in scope is no reason for resigning ourselves to our fate, or contenting ourselves with jejune commonplaces about peace and free trade. The fact that our troubles are international in origin means that by far the most important field of economic reconstruction and scientific reform lies outside our national boundaries in the great world of international trade and finance. International regulation of currency, international control of foodstuffs and raw materials, and international understandings as to prices, markets, and output are the foundations on which the future world order will be based, and the economic skeleton of the coming World State. With the growth of a saner outlook on international affairs and a democratic revival in this and other countries, progress along these lines will become practicable, and indeed essential. For in this direction lies the best hope of preventing commercial and financial crises, of remedying unemployment, and of increasing production of the things most needed to ensure a civilised standard of life for all. When the banking and monetary system of the world and the prices and production of many of the world's staple commodities are regulated in the general interest by the modern technique of large-scale organisation and intelligent planning, many of the most glaring anomalies of the economic system will be brought to an end; and the foundations at least will be laid for a more sane and tolerable social system, a fairer and more fruitful distribution of income, more real wealth and less futile drudgery, and a wider and more generous provision for education and freedom, and all that makes life worth living.

APPENDIX

THE THEORY OF TRADE FLUCTUATIONS

THE argument on page 52 rests on two theories of trade fluctuations, which are generally regarded as mutually exclusive. The first emphasises monetary, and the second non-monetary, causes.

1. According to the first school, there is a natural tendency of the banks to expand credit by making advances to traders and manufacturers, the ultimate limiting factor being the banks' cash reserves. This expansion of purchasing power causes prices to rise and profits to increase. Wages tend to lag behind the rise in prices, and therefore cash reserves (the demand for which arises chiefly from payment of wages) are not depleted as quickly as credit expands. But when at last credit has become unduly expanded in relation to reserves and at the same time, owing to the general rise in wages, cash reserves begin to fall, the banks become alarmed and are compelled to contract credit. This causes purchasing power to be reduced and prices to fall. Wages do not fall *pari passu*, and therefore for some time cost of production remains too high. Production is therefore reduced, workers are discharged, and wages are gradually forced down by unemployment, lock-outs, etc. By this means cash reserves are again accumulated by the banks, and when a safe ratio between cash and credit is restored prices stop falling and trade begins to revive. The cycle then repeats itself.

The remedy, according to this theory, rests primarily with the Central Banks. They should restrict credit earlier in the cycle, and not wait until their cash resources are depleted. The symptoms by which they should be guided are the general state of trade and the index number of prices; they should consciously aim at so regulating credit as to keep the level of prices steady. Their task would at the same time be simplified if wages increased automatically with every rise in the price level; for in that case their cash reserves would be depleted sooner, and they would have earlier warning that credit was being expanded too fast. See R. G. Hawtrey's *Good and Bad Trade* and *Currency and Credit*.

2. According to the second theory, the monetary aspect is secondary. The chief trouble is the improper distribution of purchasing power between the few and the many, which has the effect of increasing production faster than consumption. Too much of the national income is saved in good times and devoted to increasing the amount of consumable goods; overproduction then ensues. The remedy is to effect a better distribution of incomes by means of higher wages and increased taxation, so that consumption may be increased *pari passu* with every increase in production. The argument is well set out in the *Economics of Unemployment*, by J. A. Hobson.

This theory is not incompatible with the first; indeed, each emphasises the tendency of wages to lag behind prices in good times as one of the chief causes of trade fluctuations. When purchasing power is expanded, too much is placed at the disposal of traders and producers, and too little goes into the pockets of wage-earners and the State, with the result that consumption does not keep pace with production. The monetary theorists are apt to overlook the importance of securing that the increased purchasing power available each year through normal economic development is more evenly distributed.

The popular view that increases of consumption should normally take place only through a general fall in prices (incomes remaining the same) is radically unsound, owing to the depressing effect of falling prices on production; the true remedy is to try to keep prices stable and to secure that increases in consumption take place through increases in the money incomes devoted to consumption—i.e. wages, salaries and public revenues.