THE WAR AND OUR FINANCIAL FABRIC

W. W. WALL

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BY
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PREFACE

In this work I attempt to gather up some of the lessons to be learnt from the experiences of the greatest of financial crises. Many predictions have been unrealized and many theories destroyed, and we are able, I think, to see with greater clearness and to grasp with more boldness the problems that perplexed us in the past. Banking, credit and currency problems have ever been subjects of contentious controversy, experts and academic critics alike being unable to agree upon their reading of phenomena and upon right interpretations. The problems are indisputably complex, the most complex, probably, in the vast domain of economics, and vision and logic have not guided us with sureness amidst their intricacies. Hence we have groped and gone our different ways, finding ourselves at no common goal. Royal Commissions have been asked for in order to tackle and, if possible, to find solutions that will be universally acceptable. For some time before last year's crisis a small committee of bankers had been sitting in order primarily to deal with the reserve problem and the provision of emergency currency. It is believed they were on the point of presenting a scheme to deal with future crises when the sudden outbreak of the war put an end to their labours. Whether or not their scheme will ever be made known to the public may depend upon future developments. Perhaps the public may never be enlightened, for it may now be thought that inspiration and genius discovered the most practical solutions at the right moments. Something had to be done swiftly. And that which was decided upon swiftly revealed deeper insight, maybe, than slower deliberation.

This is not uncommon, however, in the career of genius. Civilization has profited more, perhaps, from flashes of inspiration than from uninspired controversy.

In order to build up my arguments I start from the foundation, and in the earlier chapters deal with the monetary problem and the general working of the banking system. These lead us into the region of dialectics and controversy and to a survey of the happenings during the crisis.

I urge amongst other contentions that banks do not in the true connotation of the word create credit. If it be possible to convince ourselves that they do not create credit, that credit is a something existing prior to and independently of banking, it will, I think, make the gold reserve problem easier to solve.

What we gaze upon is not an unsubstantial structure called in Lombard Street "the superstructure of credit," but is something more solid. It is a superstructure of wealth. All that banks do is to transform this wealth into liquid capital, resolve it into its constituent, or original, elements. This enables wealth to perform its fructifying functions, to reproduce itself, just as the mature fruit reproduces itself when re-sown. Were the wealth to remain in its fixed, or, as the market would say, its frozen form, what sort of wealth-harvest could we hope to gather from it? Unless it be made liquid it cannot flow. And if it did not flow, but remained frozen, sterility would result. If this transforming machinery were not provided by banks, the Government, on the nation's behalf, would have to provide it, or the nation would become inert. As there is not, and never can be, enough legal tender coinage for this work, other legal tender currency should be provided.

In answer to those who have ever clamoured for high gold reserves I have endeavoured to show the impossibility, in the present system, of this realization. What critics have at the back of their consciousness is, not quantity *per se*, but proportion. They do not mean a mere counting of sovereigns, but the ratio of an individual bank's reserve to its liabilities. A small bank cannot have as much gold as a large bank, but it can have as high a proportion. Now, a high proportion can be attained only by keeping down the loan-deposits. It cannot be attained by getting a larger quantity of gold if the loan-deposits grow correspondingly. When banks see these deposits rising and the proportion falling, they cease lending, call in their loans, and allow the proportion to rise. We then see what we fallaciously call the loan-fund of Lombard Street diminish, showing that the loan-fund is not in the deposits, but in the gold reserves and in the totality of the wealth in the keeping of the banks at any given moment.

When banks cease to lend they drive borrowers to the Bank of England. Borrowing there causes a drop in the Bank's proportion. Therefore, we cannot have simultaneously high proportions of joint stock bank reserves and a high proportion of a Bank of England reserve unless both stop lending simultaneously. As the Bank's reserve is the reserve of the joint stock banks collectively and the national reserve, then, if its proportion falls, the reserve-proportion of the entire system falls. The only way to keep it high is for all to stop lending and for the whole money market to lapse into a state of stagnation. So far as my knowledge extends, this has not been pointed out.

We know that efforts are made, by raising the Bank rate, to replenish the reserve automatically from outside sources. But whether the gold flows in or not, it does not disprove the fact that a high proportion in the independent joint stock banks and in the independent Bank of England cannot be maintained at simultaneous moments except by a simultaneous refusal to lend. It needs no exceptional power of imagination to picture what would result from this action. It would have the same consequences as a great destruction of capital by war or any other calamity. If we had an elastic legal tender system, to provide for what I call a supplementary inflow of legal tender, we could avoid many inconveniences from which the money market and the nation suffers.

The supply of liquid capital in a perfect economic system should keep pace with the output of wealth. But our system is not perfect. Progress must necessarily be impeded by artificial and arbitrary restrictions.

I think, too, we could simplify the problem by segregating the composite deposits of a bank. These deposits are an aggregation of what I call, for lack of something more precise, pure deposits and loan-deposits. The loan-deposits are debts to the bank, which the bank has power to call in. If these loan-depositors have legal power to withdraw money on demand, the banks have power to withdraw from many of them on demand. On the approach of a crisis, or stringency, they do this, though in certain contingencies such withdrawals might precipitate a crisis. Nevertheless, the important fact remains that they have power to call them in.

If we set the gold reserves against the pure deposits we shall find that the reserve is invariably high.

But why do we want a high proportion? Why do we wish to hoard gold, when we know that the hoarding of gold is more harmful than beneficial? To avoid a panic, the critics and seers say. But a panic is not a mathematical problem; it is a psychological problem. If mathematics could save us from fear and madness we could then automatically ensure general sanity and common sense. What mathematical proportion will save us from a panic? Who is to lay down the proportion? Where are we to draw the magical line of safety? Is it to be an exact proportion or an approximate proportion? Is it to be an universally exact or universally approximate proportion? Or is it to be an individually exact or approximate proportion? There can be no exactitude, particularly if we include the Bank of England. In mathematics, however, we must have exactitude, for half per cent below the formula might be fatal. And if in order to keep up the proportion simultaneously in Lombard Street and Threadneedle Street lending ceases, then the crisis comes, despite the proportion.

A psychological disease is not to be diagnosed by the mathematician. We must find a psychological remedy for it, and that remedy is knowledge and common sense. The nation that met the crisis in August last so calmly and has faced since, resolutely and philosophically, the most terrible ordeal of its existence, is not likely to be seized with ungovernable madness because we cannot get an exact mathematical formula in dealing with bank reserves. The knowledge, and the only knowledge that will keep them sane and calm, is that banking is conducted soundly. The confidence of the community is based, and justly based, upon sound banking methods. So long as banks transform into currency the best wealth, then they are soundly managed, irrespective of mathematical gold reserves. The best wealth is to be tested by time—that is, by its durability. The highest wealth is durable; the lowest wealth transient.

If we are to have no solid, lasting confidence in sound banking, only in mathematical ratios, and if the highest wealth the banks possess are to stand them in no stead in a panic, then banks can reasonably refuse to liquefy the best wealth. We could not in that case blame them if they speculated. If they maintain the mathematical inexact ratio laid down by critics they will be mathematically safe, for sound wealth in a panic will, the theorists say, be as worthless as unsound wealth.

If banks are conducted soundly, if they perform vital services to the nation, if the nation would stagnate without those services, if the nation restricts their freedom of action by the provision of an inadequate supply of legal tender and by the law of legal tender, then it is the duty of the nation to help them in that trouble for which they are not responsible. It is also expedient for the nation to do this. It would be conforming to the law of self-preservation. To do otherwise would be national suicide.

Banks cannot do two contrary things at the selfsame moment. They cannot keep a high proportion and in the same moment lend freely. If they lend freely the proportion speedily falls, and might speedily fall far below the mathematical formula of safety. If they do not lend freely the mathematicians say they will aggravate the crisis. The only sensible course for the nation to take is to be its own physician. The Government on its behalf can do again what it did last year—provide a supplementary fund of legal tender currency. This was effective more than half a century ago, and it has been effective again. And experience is of greater value than theory.

These, then, are some of the questions I discuss in the following pages. I do not expect, of course, to find common agreement. This would be presumption. Nothing is more difficult than to destroy theories. Experience is often impotent. Prophets are not always silenced when their predictions are unrealized. They continue to prophecy. They predicted confidently that when the world-war came the financial crisis would be far worse than the military crisis, and that this country would be in the throes of a panic the dimensions of which no human imagination could conceive. Foreign countries with vast credits here would take away every sovereign and every bar of gold they could lay their hands on. Only those sovereigns would remain that we had been far-sighted enough to store in our back gardens, or, if we had no back gardens, in our discarded stockings. Nothing of this happened. There was no financial panic, no raid upon our gold reserves. If there was any apprehension it was mild and momentary, thanks to the soundness of our banking system, the strength of our financial structure, and the wisdom of our Government, to say nothing of the soul of the nation. It was discovered that, instead of other countries having it in their power to take gold from us, they were so greatly in our debt that they could not liquidate those debts, and the exchanges went violently against them. Since then gold has flowed into the country in unprecedented amount, and there is still no sign of interruption to the flow. This country is now overwhelmed with gold. The reserves of the Bank of England and of the joint stock banks continued to grow so rapidly that loans, or "credits" as they are called, glutted the market. Banks lent with difficulty even on nominal terms. So far from predictions being fulfilled, that has come to pass never dreamt of in the wildest of dreams—a land towards which, in the midst of war, the golden river was flowing, fed by tributary streams, and undiminished in volume by huge purchases of warlike stores and material from neutral countries.

The country was saved by wisdom—by the wisdom of the people and by the wisdom of the Government which promptly acted on the wisest advice. This begot confidence and strengthened faith. It was calm confidence and serene faith in intellectual ability that enabled the country to go through the crisis with success and that evoked the profound gratitude of all.

Confidence, the energizing, vitalizing spirit of economic progress is distinct from what is called Lombard Street credit. Yet both connote a confiding in or a believing in something. In what? Confidence is fundamentally a confiding in the greatness of the nation. There can be no confidence in the littleness of a nation.

The financial writer would probably be discharged who wrote in his money article: "Confidence in Lombard Street yesterday was in superabundant supply, and sellers could find no borrowers of it even on nominal terms. In fact, before the close of business balances of confidence were unplaceable. Overnight confidence fetched no more than 1 per cent. and weekly confidences 1½ per cent. In consequence, therefore, of this great mass and weight of confidence the discount market was very weak and rates fell further. It is thought probable that the Bank of

England may have to make confidence scarcer and dearer by taking it off the market, that is to say, by borrowing confidence."

Is, therefore, that superstructure of "credit" that superstructure of confidence beneath which the country economically prospers? Is there not often in Lombard Street an abundance of "credit" coincident with a scarcity of confidence? And is not all this "credit" impotent without confidence? Is prostrate confidence to obtain its re-creative power only from mountainous gold reserves? Or will it be regenerated by a new faith in the essential greatness and wealth of the country?

I have great hopes of the future. I give abundant reasons for this faith within me. Experience has taught me the incalculable harm pessimism does. Pessimism is like an infectious disease. It spreads quickly. It is difficult to fight against it. There are numerous sad-visaged prophets amongst us to-day—men without hope, men without a smile. They cannot cheer us. They see coming, with the inevitability and irresistibility of doom, the day of sorrow, the day when we shall reap the abundant aftermath of woe. But dark as the night may be, I see a new day of joy dawning, a day when the sowers will go forth with renewed hope and energy, with the confidence that they will gather in at the due season a harvest more abundant than they have reaped before. Let us not wring our hands and moan in dark corners.

Let us look forward with brave hearts and strong minds to the day of victory and peace: That day will bring us a new faith, a new confidence, perhaps a new happiness in which we shall forget the old griefs and despairs.

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CHAPTER I

INTRODUCTORY

Treatises innumerable have been written about money. Famous and non-famous political economists have attempted a definition of money. These definitions have been divergent, and often irreconcilable. Political economists have found it no easier to arrive at a simple, understandable, explicit formula than literary critics have found it to define poetry. All of us have a vague idea of what money is, but it is so vague that it is well-nigh impossible to present it in a concise and precise phrase.

This amazes the man in the street, who believes that nothing is so simple, nothing so easily conceivable as money. To him, of course, money consists of so many pounds, shillings, and pence, and when that is said, all is said. What more is there to explain and define? He is wealthy or poor, comfortable or miserable, according to the quantity of pounds, shillings, and pence he possesses.

He knows that he can satisfy his needs, his desires, his cravings if he has enough money with which to buy what he wants, but if he has insufficient his needs and longings will not be gratified.

He knows that when he goes into a shop he exchanges money for commodities. When he purchases a pair of boots he does not tender for them a watch, or loaves, or a couple of tender chickens that he has bred on his poultry farm. He hands over a few shillings, receives the boots neatly packed, thanks the shopman, says "Good-day," and is quite unconscious that he really has exchanged for the boots commodities that he or some other members of the community have produced.

It would be waste of time and labour, in a treatise of this character, to devote several chapters to the evolution of money, or, rather, to the evolution of those articles that have served the usages of exchange. Those who desire to acquaint themselves with these historical facts must consult the many works devoted thereto. The world's monetary systems, at the stage now reached by them—it does not follow that it is a final stage—are the outcome of experiments and improvements in national and international exchange. In primitive days direct barter was resorted to. Goods were exchanged directly for goods, commodities for commodities. The baker took his bread to the tailor when he was in need of a garment, and the maker of footwear took his handiwork to the baker or the butcher when he wanted food.

This worked well enough in small communities living in circumscribed areas, having no intercourse with communities living at inaccessible distances. But as the communities grew, as their boundaries expanded, as they came into closer touch with other communities, as distance became shortened by the discoveries of means of transport, as individual and collective mentality strengthened, these primitive communities had to face the increasing inconveniences of direct barter. Necessity stimulated ingenuity and invention until in the course of ages the inconveniences were lessened by the use of selected articles for exchange. These were selected partly because of their scarcity and partly because of their durability, for it was discovered that scarce things were prized more highly than things that were abundant.

That which was scarce, therefore, by being more highly prized became what we call more valuable. That is to say, more store was set by its possession. The possession of it excited admiration and envy and greed; admiration and envy are the bases of economic value to this day. They are not the bases of ethical value, but economic law and moral law are opposed in many directions.

Scarce things, therefore, were just as much prized by primitive people as they are prized by civilized people to-day. It was these scarce things, therefore, that could be exchanged for an abundance of things, because no one valued what could easily be got and what all could have. There was a time when iron was scarce. As iron, too, was most useful for a great variety of purposes and as its utility was constantly showing itself, its scarcity, added to its usefulness, made it increasingly prized and valued. A ring of iron for a crown was of greater worth once than are the diamond-studded crowns of present day monarchs, and iron was at one time scarcer than diamonds and rubies are now, and a man in possession of a little iron could exchange that possession for a great quantity of cattle with the man who had more cattle than he knew what to do with. Cattle, therefore, were what we call cheap and iron was dear, the primitive idea being, as it still is, that cheapness consists in much and dearness in little, irrespective of their values in preserving life.

Iron was dear because it was scarce, cattle were cheap because they were plentiful. But man cannot live by iron, though he can live on cattle. Judged, therefore, from the standpoint of life-preservation, cattle should be more precious than iron; but judged from the standpoint of envy and vanity, iron was, as gold now is, of greater value than cattle. The one preserves life, the other pride, and here we see some components of the foundation on which the economic fabric has been reared.

A savage with a little iron and no live stock was considered wealthier and more enviable than the man with no iron and a vast quantity of live stock. The man in possession of the iron knew that he could get as much live stock as he wanted by parting with all or only a portion of his iron, and when he exchanged a portion of his iron for cattle he actually parted with money. The iron and the cattle were money—the iron was the sovereign and the cattle the pence in those days.

Now, the iron being scarce and being highly valued by the community on whose land it was found, a greater value was conferred upon it in time by law. The king and his counsellors of those days enacted that a certain quantity of iron should discharge so much taxes or redeem so much debt, that the Government would accept it in payment of taxes and in liquidation of debt, thereby absolving the payer from all legal responsibilities and penalties. From being merely an instrument of custom iron was raised to the higher function of being a legal instrument. It was given a certain arbitrary value, the value being expressed in the amount of taxes it should represent and in the amount of debt it should legally discharge.

Great importance lies in the conception that the legal, apart from the custom value, was purely arbitrary.

Cattle would be accepted in payment of taxes and in discharge of debt also; but, being more plentiful, and therefore of less value, the Government decreed that so many cattle would be equivalent to so many pounds of iron. Those who had no iron, therefore, had to pay in cattle, just as in these times those who have no gold must pay in silver or bronze.

Although a diamond may be worth many sovereigns, it will not be accepted by the tax collector, nor by our creditors, because it has no legal value. That is to say, it is not a legal instrument.

We are beginning to have some glimmering now of what money is. Money performs two important functions. It is a medium of exchange and it is a standard of value.

Money was the instrument man invented, after mental travail, to lessen or remove the inconveniences of direct barter.

Money represents the possession of a claim on the products of the community. It is a present and a future claim upon a portion of the wealth of the general community. When the claim is exercised it performs its function of a medium of exchange.

The idea is this. We are all potential consumers and producers. We have read of the early Christian community, when all the members of that community brought their goods and possessions to the common store and divided equally. This is precisely how society lives to-day. We all bring our goods and possessions to the common store, or market, as it is called, and there they are divided. But they are not divided equally. This is the chief difference. They are divided unequally in accord with our notions of equitable distribution.

Our claims on the common wealth are supposed to be based justly upon our individual produce. The more we produce the more we claim, the less we produce the less we claim. This is the fundamental idea, or hypothesis; but, like many ideas or hypotheses, the practical working of it is far from just and perfect. But the fundamental idea will make clear the function money performs.

We are familiar with those schemes of relief in times of distress when tickets are given to the poor, representing a certain quantity of food. On presentation to the butcher the ticket is exchanged for a pound of meat, and on presentation to the baker it is exchanged for a quartern loaf. These tickets are money. They are a media of exchange and possess exchange value. They are claims on the butcher or baker. If the possessor chooses, he can exchange the ticket with another for a pint of ale, and the other can claim the meat or the bread. They can pass from hand to hand, become currency, as money is called, and the exchange can be effected immediately or deferred.

The meat and the bread are subsequently paid for out of another fund, and the butcher and baker hand over the tickets and are paid their respective portions out of this common fund.

Now, the Government of the land can proclaim, if it pleases, that these tickets can represent permanent claims on the community. Instead of being destroyed, they can be used over and over again for an indefinite period—be made what is called legal currency.

What the laws have done is to decree that gold, silver, copper, and paper shall represent our claims on a certain proportion of the nation's wealth. When we take our products to market we exchange them for these claims. These claims we afterwards present to the butcher, baker, and tailor, and when we have got rid of them we have exhausted our claims on them. If we can get no further claims we become poor or destitute. The only means of getting fresh claims is to bring more wealth to market and exchange it for more claims, and according to the quantity and quality of that wealth, so are the claims we get greater or smaller. The greater our claims the richer we are, the smaller our claims the poorer we are. If we bring to market products that no one wants and people will not exchange part of their claims for our merchandise, then we know our labour has been in vain.

In order to live, we must obtain these legal claims on the general wealth, and if we cannot obtain them we starve or become parasites.

A distinction exists, and a most important distinction, between money and legal tender currency. Anything may be money. If I have no legal tender currency and only a gold watch and I am in great need of a dress suit and I offer the watch for the suit and the watch is taken, that watch is money. It is no one else's concern if the tailor accepts the watch in exchange for his labour, his skill, and his cloth. He has liberty to exchange the dress suit, if he pleases, for some ancient ornament he desires to possess, instead of for legal coin or currency. But he knows that the ornament will satisfy only his desire, and will be no claim on any portion of the community's wealth. The butcher will not accept it for meat. But it has performed the function of money nevertheless.

The law has decreed, however, that there shall be a species of money, or currency, that shall have permanent value as a medium of exchange. It has decreed that all must accept this in exchange for wealth and in discharge of all legal obligations. With this object in view it has chosen gold to be the legal claim, and has set up gold to be what is called a standard of value. Treatises have been written on standards and on values. Both are highly controversial subjects, but these controversies must be ignored here.

This standard, or unit of value, is called in Great Britain a sovereign. It was decreed that this coin should consist of an arbitrary quantity of gold, mixed with alloy, and that it should be stamped with certain designs. These designs alone make it legal money, or legal tender. If I had a coin, containing exactly as much gold as a soverign, and worth exactly as much, but plain, with no design, it would not be a legal coin. It would not be accepted in discharge of debt, in payment of taxes, in exchange for wealth. I could, perhaps, sell it to the jeweller for something below its real value, because he could make use of the metal to advantage; but it would be useless to buy meat and bread with.

The law, therefore, has decreed that a coin composed of gold, of a certain weight, and with certain designs upon it shall be a legal unit of value, and that so much silver and so much bronze shall be equal in value to this unit. It has decreed that sovereigns shall be legal tender for liabilities to an illimitable amount, that silver shall be legal tender to the maxium equality of £2, and bronze to the maximum equality of one shilling. That is to say, a creditor, if he chooses, can demand gold in redemption of his debt beyond £2, but whether he will put the demand into execution or not depends upon his will or circumstances.

It is necessary, therefore, to lay emphasis upon this distinction between money and legal tender currency. Money is relative wealth, because it represents relative, temporary claims; but legal tender currency is absolute wealth because it represents absolute, permanent claims.

If Germany conquered this country and enacted that the sovereign should no longer be legal currency, and that the mark should be substituted for it, the sovereign would then become a commodity, worth only its value in gold. Sovereigns are commodities abroad, just as continental gold units are commodities here. Sovereigns have no legal value on the Continent. Francs, marks, and dollars have no legal value in this country. What, in each country, confers upon the commodity gold its legal function as money is legislative enactment. Legislative enactment can also make a comparatively worthless product like paper of much greater value than gold. The paper value of a note for £100 is trifling. But because the Government has decreed it shall be worth one hundred sovereigns, then the individual members of the community take it at its face value. What is its value in Germany, especially when we are at war with Germany?

This shows the great and arbitrary power the Government of a nation possesses.

It can make stones legal tender if it chooses. Or it can make diamonds legal tender. Many nations have made silver and not gold legal tender.

When individuals of a nation exchange commodities they exchange it as in national legal tender. There is, however, no international legal tender.

When nations exchange commodities the payment is made in different instruments, such as bills of exchange. Whenever gold is exchanged it is exchanged solely as a monetary commodity, and not in its national legal character as money. The gold in the sovereign is valued according to its quantity, and not by its value as a legal instrument, token or claim. But it is rarely that gold passes from one country to another in payment for goods received. This payment is managed in a much easier and less expensive fashion.

CHAPTER II

WHAT IS MARKET MONEY?

WHAT is the money that is bought and sold in the money market? Who are the merchants there? Who are the middlemen? Who are the sellers and buyers? What sort of a place is this money market? We can visualize a cattle market, where farmers bring their cattle to sell, and we can visualize Covent Garden, where fruit, vegetables, and flowers are sold: but can we visualize a money market? Is it in some vast building in the City? Is Lombard Street a mighty emporium where many merchants congregate at their stalls and offer, in the same fashion as vendors of apples and sweets do, pounds, shillings, and pence for sale?

It is not located in any spacious building, like the London Stock Exchange. Buyers do not go there and offer golden sovereigns for golden sovereigns and silver shillings for silver shillings. To the ordinary man, who is perplexed by the mysteries of the money market, it sounds strange, indeed, that money can be bought with money. This is because he associates money with pounds, shillings, and pence, and cannot understand a sovereign being bought with a sovereign. Yet he understands the business of a money-lender and he understands borrowing. He knows that when he borrows from a money-lender he borrows money and pays something for the loan, something that he calls interest. Well, the vendors of money in Lombard Street are purely and simply money-lenders on a great scale.

Banks are wholesale business houses where money is made, and where money is sold. The selling is not, however, on all fours with apple selling. When we sell apples we part with the apples for good. We do not lend them for a definite period to the buyer, and the buyer does not return them at the end of that period. In buying and selling apples an absolute exchange is made, money and fruit being definitely parted with.

In the money market the merchandise of the merchants is not exchanged in this absolute fashion, so that, in the literal connotation of the word, Lombard Street is not a market.

Lombard Street is an organism, essential to the vitality, health, and welfare of the body politic, as the heart and the lungs are necessary to the complete life-preservation of the human body. The nation could, of course, live without Lombard Street. But without it, it would be a corpse-like, moribund life in comparison with the vitality and energy imparted to it by this economic organism.

In Lombard Street money is made. What kind of money? Some strongly insist that no money is made, but only what is called credit. This, too, is a highly controversial subject, on which divergent views are held and are likely to be held.

Instead of hoarding our money, placing our golden sovereigns in bags and old tea-pots, and burying them in our cellars, we have reached that stage in our economic development when we place them in the keeping of banks. We have several purposes in view in doing this. We place money in the keeping of the banks for absolute safety; we place it there for convenience; and we place it there to earn what we call interest on it. Hoarding, we are intelligent enough to know, would be unsafe, inconvenient, and unprofitable.

Yet we really obey the instinct of hoarding when we place our savings and surplus money in the keeping of banks. But we have a secondary motive in this action which we will call greed or avarice. We desire our hoards to be fruitful. It is like placing seed in the ground from which to gather future harvests.

But the banks do not hoard our money. If we think they do we labour under a delusion. They employ it in various ways. They lend it to a variety of borrowers at interest, they invest it in all kinds of securities and property, and earn interest on it by this varied employment. Out of this interest they maintain their vast and expensive establishments, pay the salaries to their servants, and pay the interest on the money we, as individuals, place in their keeping.

The position might be illustrated in a simple way. I have saved up two hundred pounds. These two hundred sovereigns I place on deposit at the bank, and am allowed, say, 2½ per cent. interest. I prefer the small interest because I believe the principal will be safe always, safer than if invested in any security or property. Moreover, I know that I can draw this money out whenever I please, but were it locked up in some security or mortgage, I should not feel sure of getting possession of it again in a moment of need. But the bank, lawfully, must return me intact the two hundred sovereigns when I ask for it.

Now the bank re-lends this £200 at, say, 4 per cent. interest, making a profit of 1½ per cent. interest. Out of this interest it must pay salaries, rent, and all working expenses. How can it do it?

It doesn't do it, and it couldn't do it. No such miracle could be done. This £200 is multiplied greatly. The bank can make that £200 into £1000 or £2000, and actually lend £2000. If I went one day to ask for the £200, the bank might tell me it could let me have only £10 or £20, and if I insisted on having the £200, it might have to close its doors and go into the bankruptcy court.

How is this £200 made into a fund of £2000? Do the sovereigns actually multiply in the bank's coffers? Is there a bank fairy that can make sovereigns out of nothing? No. There is no bank fairy, and no sovereigns are multiplied. Yet the bank says it has £2000 to lend, and lends £2000.

That which it lends over and above the original sum of £200 is said to be the bank's credit. The bank is said, in the terminology of the money market, to create credit to this extent. It keeps, say, ten or twenty sovereigns in its till to provide for the emergencies of a sudden demand, and lends the rest of the gold and something beyond it. This something else is called credit. Some people say it is to all intents and purposes actually money; others declare it is not. And in discussions on this subject a lot of anger has been wasted and more vanity wounded.

Anyway, whether we call it money or whether we call it credit, the fact is indisputable that this is the tangible or intangible something with which banks benefit the trade and commerce of the nation, and help us all to become wealthier. This is the so-called money of Lombard Street.

They risk, however, grave dangers, and the community risks grave dangers in setting up this machinery to facilitate and smooth national and international commercial dealings. These dangers will be unfolded gradually in subsequent chapters.

Already it has been hinted where one danger lies.

If of that £200 I place £100 on deposit and £100 on current account at the bank, the bank has still a total of 200 sovereigns, and can multiply this sum into £1000 or £2000. But it pays interest then only on half the sum—the sum on deposit. On the other half it pays no interest, but it can lend the whole. If I desire to withdraw the £200, I can by law draw half on demand. The bank, however, can insist on some days' notice before allowing me to withdraw the amount on deposit. But if I insisted on having £100 and the bank had only £20 and could not get the other £80 quickly, it might have to close its doors. This would be a run on the bank that might bring it to ruin.

The bank hopes, of course, that I shall not demand my money in a lump sum at a moment's notice; that there will be no run. It also hopes that if I do demand it, it will at once demand the return of its loan, or part of its loan, from those who have borrowed from it, and thereby get the two hundred sovereigns it owes to me. It will then be in a position of having still on loan money, or credit, based apparently on no gold.

If it is not based on gold, it is based, however, on some kind of wealth. Those who have borrowed from the bank leave securities, Consols, say, as collateral for the loan. If they do not repay the loan, the bank has the securities, which it can sell in the market for cash.

If it has no gold, it has something it can exchange for gold.

It now becomes a little clearer that what the bank has actually done is not to create £1800 out of nothing, but to liquefy £1800 of the nation's wealth. Is this process of liquefaction granting credit or creating currency? It looks more like a creation of currency than a creation of credit. If the bank lent without security, then it could with greater logic and reason be called a creation of credit. But it does not so lend.

If gold is wealth and Consols are wealth, then it lends wealth, whether it lends gold or Consols. Therefore, what the banks apparently do is to lend one man's wealth to another man, taking a commission from the borrower for the services rendered. If Consols were made legal tender, like sovereigns, we should not say that lending Consols was creating credit.

Selling Consols in the market is not creating credit. The selling of Consols to a banker for a consideration is not different essentially from selling them in the market. The borrower virtually sells them to the banker, and so long as the banker holds them he is not creating credit.

If a man hands over to me his mansion for a loan, that mansion is mine till he repays the loan.

He has sold it to me temporarily. By lending him the money I possess I do not lend him credit. I may part with all my money, but I have the mansion, which I can sell for money. If I cannot sell it, I may lose much. But that will depend upon my wisdom and foresight. I, at least, have something of some value in the shape of the mansion.

It is so with banks. Their security depends upon the nature of the wealth they liquefy. If it be the best wealth their security is sounder than if it be the worst wealth. It is not necessary, and it should certainly never be necessary, in the real interests of the community, to liquefy only one kind of wealth.

Banking security should rest, therefore, chiefly upon the highest wealth of the nation and not solely, as some contend, upon that limited species called legal tender. This aspect of the problem will be elaborated in later chapters.

Let us take another look at our modest current account. We draw cheques against this current account. We pay our income tax, our rent, our tradesmen, with these cheques. The cheques are accepted readily and unquestionably by all. Why? Because the cheques, the paper, have intrinsic value? No. But because they have trust in our *best* banks and trust in our possession of the money in these banks. A cheque on the *worst* banks would not be so readily accepted.

But we all know that the sovereigns are not actually there. Does the drawing of a cheque create credit? Or is the drawing of a cheque merely the evidence that we actually have what we profess to have? In drawing a cheque we do what the banks do when they grant a loan. When we pay for a suit with a cheque we receive the suit in exchange. When a banker draws a cheque and receives Consols or bills of discount, he really buys the Consols and buys the bills. But some contend that he buys the Consols with nothing. So it can be contended that we bought our suit with nothing in the event of the bank smashing.

The cheques we draw become currency, become, in the essential meaning of the word, money. They are not legal tender; but legal tender is only a small portion of the nation's currency, that portion arbitrarily selected by the legislature for a specific, but important purpose.

That that selection is wise is a view not unanimously held by economic thinkers.

But it is a selection that must control the policy of bank management to a paramount extent. This does not exclude, however, the scope and expediency of legislative reform.

We cannot draw cheques against our deposit accounts. But though we can withdraw these deposits the bank can insist, as I have said, on certain notice. This notice, however, is never insisted upon.

It would be injudicious to insist upon it. It would be injudicious because it would give rise to the suspicion that the bank was unsoundly managed and in a bad way. And suspicion is the surest way towards the destruction of a bank.

CHAPTER III

THE CURRENCY OF CUSTOM

A simple illustration has been given of how we entrust our money with a bank and how a bank employs it. Let us in our next step analyse a typical balance sheet of a big bank, for it will help us to get a clearer notion of the functions of a bank and of the character and complexity of the money market.

Dr.

	£	s.	d.	£	s.	d.
To Capital Authorised ...	30,000,000	0	0			
,, ,, Issued				3,000,000	0	0
,, Reserve Fund				1,125,000	0	0
,, Amount due by the bank on Current, Deposit, and other Accounts				37,583,237	8	11
,, Acceptances on account of customers				3,153,328	7	11
,, Rebate of Interest on Bills discounted, not yet due, carried to new account				53,807	1	3
,, Amount of Nett Profit ...				225,676	10	1
				£45,141,049	8	2

Cr.

	£ s. d.	£ s. d.
By Cash in Hand and at the Bank of England ...	5,996,667 14 8	
,, Money at Call and Short Notice	5,674,476 5 1	
		11,671,143 19 9
,, Investments—		
Consols and other Securities of, or guaranteed by, the British Government, of which £35,000 (Stock) is lodged with public bodies	2,488,966 12 6	
,, Indian, Colonial Government and other Securities	3,771,738 10 11	
		6,260,705 3 5
,, Bills Discounted		6,811,870 13 8
,, Loans, Advances, other Accounts and Securities ...		16,218,748 12 6
,, Liabilities of Customers for Acceptances as per contra		3,153,328 7 11
,, Freehold and Leasehold Premises		1,025,252 10 11
		£45,141,049 8 2

On the liability side the capital issued is the amount paid up by shareholders, capital which the bank has employed in the ordinary course of its business. It represents a contingent liability to these shareholders, who have invested their capital for the sake of the return in the shape of dividends. The large sum of thirty-seven and a half millions is the most important item. This is the real working capital of the bank. It is apparently the aggregate amount deposited by the public with the bank.

This is what the bank owes to its clientele.

But the deposits are not solely money actually placed with the bank. This huge sum includes the loans the bank has made to other customers, to its borrowers. Every loan makes an additional deposit. The man who borrows a sum of money from the bank is credited with that sum and the credit appears in the current accounts. The bank has security for this loan, and, as already pointed out, this security is liquefied into bank currency. Cheques can at once be drawn against it so long as the loan runs and cheques are the country's currency. Securities, therefore, have been converted into national currency and indirectly into legal tender.

The more, therefore, a bank lends the more do its deposit and current accounts grow.

The reserve fund speaks for itself. It is generally a fund accumulated annually out of profits and invested in the best securities. The larger the reserve in proportion to the capital and business the stronger is the bank's position. It is a provision against future contingencies and is not touched except for these contingencies. One purpose is to meet depreciation in investments or other losses. The money being invested in the highest securities these can be sold for cash whenever the need for it arises.

The acceptances on behalf of customers are also practically covered by securities deposited by customers, until they lodge the funds to meet the bank's liabilities in this direction. The net profit is the fund due to the shareholders of the bank, who receive their dividends therefrom.

On the asset side, the cash in hand and at the Bank of England consists of coin and notes. A portion of this is in the tills and safes of the bank in order to meet the ordinary daily needs, the incomings and outgoings, while the rest is money deposited with the Bank of England in precisely the same way as an individual deposits money with a joint stock bank. It serves two purposes. It composes an additional reserve there in legal tender, and facilitates the clearings between the various banks, debits and credits being daily adjusted in the books of the Bank of England.

It is contended by many that the banks do not keep reserves large enough in proportion to their liabilities—reserves, that is to say, in actual legal tender. It is contended that they trade on too slight a margin of gold, or legal tender; but this question must be threshed out when the way has been cleared for it.

The next item is the money at call and short notice. This is practically the money lent by the banks to money brokers, stock brokers, and discount houses. Money at call practically means that the bulk of it is lent from day to day and that banks can demand its repayment at a moment's notice.

The money is also borrowed on security, so that while the banks owe the money to the borrowers and the borrowers owe the money to the banks, the banks have the securities. These securities thereby become currency. They can also become currency if the public will accept them as currency, but the public prefers cheques to securities. The greater convenience of cheques need not, of course, be emphasized.

It will be seen that a bank's "investments" are a large sum. They include the reserve fund, and the bank's annual income is, of course, swollen by the interest it receives on these investments, in the same way as an individual's income is increased. These investments are of the very highest class and strengthen the assets the bank possesses against its liabilities on deposits. It is presumed, of course, that they can be readily sold for cash should the need for the conversion arise.

Bills discounted reveal the character of another source of income. They represent investments in another high-class security. A few bills may be discounted directly on behalf of customers, but the bulk are bills re-discounted from the discount houses. Bill brokers discount bills at a certain price and the banks re-discount them at a lower price, and both, therefore, make a good aggregate profit out of the business. Bill brokers are practically the middlemen between merchants and the banks.

These bills of discount being an investment and a sound security are thereby liquefied into ordinary currency and ordinary capital, capital which the merchant is able to use in the ordinary course of his business, while the nation at large benefits from the increased capital employed and the greater production and consumption that are the immediate fruits of it.

The largest item on the asset side is the composite one of "loans, advances, other accounts and securities." These include customers' overdrafts and advances to customers on all kinds of security and estate, and may, perhaps, be regarded as the least liquid or the least readily realizable assets a bank has. In this item are its chief risks, and, perhaps, the soundness of banking is best judged by the size of this account. The larger the size the greater, presumably, are the risks; the smaller the size the less are the risks.

But the aggregate forms a portion of the wealth of the community. A customer gives some kind of security when he overdraws his account. But all this composite wealth, of whatever class its component elements may be, is, by the machinery of the bank, converted into currency. These loans amount to nearly half the liabilities on deposit and current accounts, therefore additional currency to this amount can be placed in circulation. If no banks lent on such wealth there would be less potential capital in circulation; the capital would be as stationary and as unfruitful as hoarded coin. While, therefore, the bank owes this sum to the borrowers, giving them power to draw cheques against it or to take out the whole sum in cash, the borrowers owe the money to the bank; for the loans interest has, of course, to be paid according to the class of security lodged. This interest is one of the chief sources of a bank's income.

The liabilities of customers for acceptances has been explained. They offset the item on the liability side. They may be regarded as a moderate source of a bank's income, and this class of business has to be done with great care. As for the bank's premises, this is its own property in which it must do its business, and it is self-explanatory.

Having analysed a typical bank balance sheet, we are able to see the kind of business a bank conducts and the valuable functions it performs on behalf of the community. A bank is in reality a manufacturer of currency—not of legal tender currency, but the currency of custom. The Government does not provide this necessary machinery, so the banks provide it, and we can imagine what would happen to the country if the machinery broke down, or if it were compulsorily stopped.

This custom currency has become so much an integral part of the economic and financial structure of the country, that even our tax-gatherers will accept a cheque as readily as sovereigns. Our currency is to all intents and purposes a paper currency, the soundness of which is rarely questioned. It is not legal tender currency, but it is as vital to the well-being of the nation as legal tender currency.

The other paper currency is Bank of England notes and, since the war, Treasury £1 and 10*s*. notes. Even though the whole of these notes may not be convertible into cash, they are legal tender simply and solely because the legislature has enacted that they shall be legal tender. This is, of course, something outside custom. If the legislature were pleased to do so, it could enact that cheques on certain specified banks should be legal tender, just as it arbitrarily enacted that the new Treasury notes, issued without any gold backing at first, should be legal tender, equal to the amount of their face value in gold.

I wish to emphasize the distinction, therefore, between the currency of custom—something that has grown up out of the needs of the community, something essential to its welfare and progress, the product of an advanced stage of economics and of civilization—and the currency called legal tender. Though debts are paid and are payable in custom currency, the power of this currency to redeem debt could be destroyed in certain circumstances, the circumstances of a panic. They may be remote circumstances, but, remote as they are, they raise deep problems which to this day are discussed with energy and heat.

Ought the Government to provide machinery more adequate than that it does provide to meet the currency needs of the nation? This is one aspect of the problem. Some say it ought to provide it, some say this does not come within its province. It is left to the banks to provide that currency as best they may and quite apart from their methods of providing it, it is indisputable that they administer to a vital economic need. If, therefore, they administer to that need, should the Government come to their assistance in those circumstances which cause a collapse of their machinery?

This question has been answered in part by the Government since the outbreak of the war. It helped the machinery to work, and provided against a possible collapse by issuing "emergency" currency notes. The Government having acknowledged an emergency and established a precedent, the problem is now much simplified.

CHAPTER IV

CREDIT AND CONFIDENCE

Credit, which banks are said to create, has several connotations. It has a social, an ethical, and a financial connotation, and it is necessary to examine awhile these connotations. From the derivation, or original conception of the word, or idea, it is an expression of belief or trust, as distinct from disbelief and distrust.

In the social world, when we say a person stands in high credit, what is it we imply? That he is a rich man, a man of great wealth? By no means. He may be a poor man, that is to say poor relatively to the position he occupies. In the social sphere he can carry considerable weight even though he may be dishonest, dishonourable and immoral. We ignore his vices, yet hold him in high esteem. His credit is based less on his character than on our snobbery. We bow before title and caste, irrespective of the merits of the individual. A lord of bad character will be more sought after, receive more flattery and deference, than a no-titled man of noble character. If we were not snobbish we should despise him as he deserves.

From this springs the desire of men to gain title, no matter what means and methods they employ to this end. They know that a title in some potent way aggrandizes them, and they can enter an assembly with greater assurance and confidence and pomposity than they could if their names were still as plain as in their humble days.

The conferring of a title is not necessarily a recognition of high moral worth. But a title can be a national recognition of intellectual merits, or ability. The credit of those who receive this distinction is strengthened. We have greater confidence than before in their intellectual ability and power. We have deeper trust in their wisdom and sagacity and in their counsel. We have the less hesitation in following their guidance in those paths with which they are presumed to be intimately familiar. In this greater, but still restricted, knowledge of theirs we repose our trust.

We know that moral credit is distinct from this. It is based upon character solely, irrespective of social position or means. A poor man may be a man of high nobility. We may despise his poverty, but we honour his spirit. We are conscious that he is far beyond us, that we cannot reach the moral plane upon which he stands. He is a man in whose honesty, integrity, and conscientiousness we would place unquestioning trust. We know that in no circumstances would he disabuse that trust. We know that he would have the moral power to resist all temptation.

Such a man may have great strength of character, high moral worth, but he may be weak intellectually. He may be no scholar, no man of erudition, no man of imagination, and possess no exceptional ability. His intellectual limitations may be the cause of his poverty. But in whatever position he may be placed, according to his limited qualifications, we know that he will discharge his duties faithfully, conscientiously, to the best of his ability, and will not swerve a moment from the path of honesty and uprightness. Such a man could be no thief and could tell no lie.

He lessens our anxieties. We say we can trust him as readily and as confidently as we can trust ourselves. It is a matter for thankfulness that we have such a servant in whom we can place our trust.

Here, therefore, are illustrations of intellectual and moral credit which men are said to possess.

Financial credit is another kind of credit. With this, perhaps, mankind is more familiar. The economic standing and welfare, as distinct from the purely moral standing, of a nation is dependent upon what we call financial credit. If I lend money to a friend it is immaterial to me what his abilities or his morals may be, so long as I know he will be in a position to repay that loan. If his moral credit be bad, he will, perhaps, not repay it if he has the means; but even if his moral credit be bad he may pay it from motives of expediency. He may want a further loan later, and it would not be to his material interests for me to propagate the fact that he will not repay his debts. His credit is worth too much to him to be placed in jeopardy of this kind. He must redeem the debt if only from the business motive of expediency.

Tradesmen are said to live on credit. They declare that if they refused to grant credit to their customers they would speedily be in the bankruptcy court. By granting such credit they run grave risks. They have to trust to the honesty of their customers and to their future means. Therefore they have to face the risks of incurring losses by bad debts, phenomena inseparable from such business. On the other hand, they believe that by granting such credit and running such risks they extend their custom and compete with hopes of greater success against their rivals. What they may lose in the way of bad debts they may more than recoup in the larger profits they make on the growth of their business.

It may be, from an ethical standpoint, a degrading and deplorable way of living on each other in a highly civilized community, but the fact serves the purpose of illustrating our ideas of financial credit.

We have to live by trusting in each other, trusting in each other's financial means and financial honesty. A man may be highly moral and respectable in his life, a worthy husband, father and citizen, an able and faithful servant, thoroughly trustworthy, yet may be mean and financially dishonest. Or he may be the victim of misfortune and cannot redeem his debts to the tradesman and others even if he would.

Looking more closely into the credit on which a tradesman relies we find it altogether different from the credit which, it is declared, banks create and prosper on. We can, perhaps, contend that a tradesman lends cheese, butter, and eggs, in the hope that he will be paid for them eventually.

I am the customer. I ask him to let me have cheese, butter, and eggs for a month, and I will pay for them at the end of the month. Were I a stranger to him he might demur. But if he has known me for years and knows that I am a man of my word, a man to be trusted, he will gladly let me have the goods on the credit of the reputation I hold with him.

What is the tradesman's security? Simply my word and my reputation. Simply his trust in me. I do not leave with him my watch, my securities, or my works on political economy. If, however, I failed to pay for the goods I received of him and had left some of my valuable possessions with him, he could sell these possessions in the market, and indirectly be paid for his goods.

If he were indirectly paid for them, would he be granting me credit? He would certainly not be granting that kind of credit which the man in the street understands as credit. Political economists and financiers may be distinct from men in the street, but the simple-minded, the man unversed in the theories of political economy, would see no difference between this and barter. In fact, it looks exactly like the barter so beautifully and so fascinatingly described in primers on political economy. However, we do not pledge our watches with the grocer for eggs and bacon. We pledge our words and our character only, and at the end of the month we hand him over a cheque, the national currency, and once more demonstrate to him the value of *our* credit, not *his*.

Perhaps it is now less difficult for the simple-minded to comprehend why political economists, financiers, bank managers, and those highly gifted men, financial journalists, cannot come to a common agreement as to what it is banks create. There is more agreement amongst them that banks do really lend than there is as to the actual thing banks do lend, credit or money.

Perhaps they do not lend at all, neither credit nor money? Perhaps they no more lend than my employer lends when he pays me my weekly cheque for services rendered. We call them lenders, because it would seem absurd to call them converters. Yet it seems obvious that they do quite a large business in conversion, akin to what the Bank of England does when it converts gold into notes. The latter converts one species of wealth into one species of currency; the joint stock banks convert another species of wealth into another species of currency.

My employer pays me a cheque for services rendered. I am presumed to have produced some kind of wealth, which is converted into liquid and current capital when I receive the cheque and put it in circulation. When he gives me the cheque he does not give me credit. He pays me for the wealth I have produced and which the community has consumed, and that wealth goes to the common store.

If a banker lends me, as it is said, £200 on Consols—to put it in round, simple figures—does he sell me his credit, or do I sell him mine? Or is it, after all, barter? If it be bartering wealth, then it cannot be credit. If he lends me £200 and takes my Consols, he takes my wealth from me. It is no longer in my possession. He has it, and if I leave that £200 on deposit and do not withdraw a single sovereign, he is wealthier to the extent of £200 than he was before.

If he be so much wealthier, what has he exchanged with me? What has he sold to me? If he lends me £200 on my credit, plus the Consols, and I borrow

£200 from him on his credit, less the Consols, then we seem to exchange credit for credit. If credit be a species of wealth and credit be exchanged for credit, then wealth is exchanged for wealth.

But, I repeat, this is not the sort of credit the tradesman understands and lives on, nor is it the man in the street's conception of credit.

Yet it is declared by those who pretend to a deep knowledge of human psychology and temperament, that the stability of banks depends upon the credit they enjoy amongst the members of the community, and that that credit, in its turn, is dependent entirely on the proportion of gold the banks hold to their deposit and current accounts. It is quite possible that this is a delusion. Financiers may have misread the public and may not be completely acquainted with their arithmetical preoccupations. I do not believe that one man in 100,000 deliberately and seriously sits down each evening and works out the proportion of gold held by his particular bank in its last balance sheet.

The ordinary individual believes that he can use his leisure moments more profitably and more pleasantly than in this occupation. I do not believe that one man in 500,000 could say off-hand approximately what is the proportion of his own bank or the average proportion of all banks. He doesn't trouble to know, and he doesn't bother himself about it. He will tell you that he is burdened with quite enough anxieties to trouble himself with this unnecessary anxiety.

This is my experience of my fellow-men, and I shall not put greater faith in financiers than in my own experience until they have cross-examined every individual depositor in the country and given me each one's answer.

If, therefore, it be a delusion that confidence resides in individual knowledge of the exact proportion of gold banks hold to their liabilities on deposit and current account, then what is the basis of the national confidence? It is not an individual confidence, but a general confidence.

I believe that this confidence is based, and justly based, on the belief that our banks are soundly managed. This belief is a tradition, a habit, a custom. We inherit it as a nation, and the inheritance is handed on from generation to generation. We can, indeed, say that it is in our blood, in our system.

Years have rolled on and this confidence has not been abused. There have been times, of course, when the country has found itself face to face with a financial crisis, but it has been saved from disaster by the wisdom of men in high financial stations and by the common-sense of the nation. And this confidence has been further strengthened by the manner in which we have faced the greatest war in which the nation has been involved.

I shall analyse the phenomenon further in later chapters, but I will say here that the manner in which the general public received, as a mere matter of course, the creation of the emergency currency notes revealed a psychological trait, or characteristic, of tremendous importance.

It is my belief, then—in fact, it is my conviction—that, so far as the general public is concerned, its confidence in banks rests more in the belief of their honest and sound management than in the knowledge of the exact amount of gold they have in their reserves, or where they actually hold their reserves. And I believe, too, that if all were interrogated, forty-four millions and more out of forty-five millions, including some of our shrewd bank managers, would say they believed that that confidence would be strengthened if the public were assured that all the reserves were held at the Bank of England than in the safes of the joint stock banks.

When the man in the street says that a something is "as safe as the Bank of England," it is no empty phrase. The safety of the Bank of England is ultimate, absolute safety. He associates the safety of the Bank of England with the safety of the nation itself. The Bank of England could fall only when the Empire itself fell. And that fall, in his conception, seems as remote as the fall of the skies.

He would tell you, and tell you with all solemnity and earnestness, that he would rather have his money at the Bank of England than elsewhere. And if he were told that that is the very place where the joint stock banks keep their gold reserves, he would say, with equal seriousness: "That's right." His mind would then be at rest that all was absolutely right in the best of all banking worlds.

CHAPTER V

SOUND BANKING

If it is indisputable, therefore, that the confidence of the individual, and therefore the confidence of the nation, is based in the soundness of banking, we must see if that confidence be justified or not. I have, indeed, already said that it is justified. I must give reasons why I think so.

What is banking? What is soundness of banking? These terms must be defined.

I do not know if a definition of banking has been given that is universally acceptable. I know what the vague conception of banking is, but if a precise, explicit definition has ever been given, agreed upon unanimously by economic theorists, and accepted as the right and only formula, I am ignorant of that fact.

I consult Nuttall, and he describes a bank as an establishment which trades in money, by receiving, lending, exchanging, etc. He does not say it is an establishment which trades in credit, by receiving, lending, and exchanging credit, etc. This definition may be false and misleading, and Mr. Nuttall may have been deplorably ignorant of the functions of a bank, but as, in my opinion, it is as good a definition as I have met with in economic and financial works, I will accept it. At any rate, I consider it in no wise false or misleading.

A bank trades in money. This is indisputable. A bank receives money. This is indisputable. A bank lends money. This is indisputable. A bank exchanges money. This also is indisputable.

What money does it trade in? We know there are various kinds of money. Legal tender currency is but one kind of money. Cheques, bills of exchange, securities, and even commodities are other kinds of money. Even if the legislature declared that only legal tender shall be money, the legislature could not by this declaration alter the laws of nature and of economics. It can make one kind of money legal tender, but it cannot destroy the law that anything used for exchange purposes is money. If a beggar steals a watch and afterwards exchanges the watch for a decent shirt, the watch and the shirt become money. They perform the functions of money and the functions prove that they are money.

A bank trades in money subscribed by its own shareholders and money deposited with it by the public. A bank in the course of time finds itself in the possession of what it describes as its deposit and current accounts. These accounts, it is popularly supposed—included in the populace are political economists and City financiers—are the aggregate of the money placed with a bank by the public and the money with which it mainly trades.

These are called a bank's liabilities, its immediate liabilities the redemption of which can legally be demanded at a moment's notice. It is because they can be so demanded that banks are ever faced with a grave potential peril.

It is necessary to clear the way by destroying a delusion. This money on deposit is not entirely money placed in the keeping of a bank in the same fashion as one would keep money in a safe. This fact, in my view, is of great importance. Only a portion of these deposits is what we may call in an indefinite way pure deposits. By pure deposits I mean money placed with a bank that is not a direct loan. If I place £100 of my savings in a bank, instead of investing it, I call that a pure deposit, and this money I can withdraw without the subtraction of a farthing at a moment's notice.

But we have already seen, from our analysis of a bank's balance sheet in Chapter III, that these deposits are not all pure deposits. A considerable portion of them consists of loans to all kinds of people, loans made on the security of various kinds of wealth. That is to say, the bank owes money to these so-called depositors and the depositors owe that money to the bank. The depositors have the power, of course, to withdraw the entire sum of money lent to them temporarily by the bank; but the bank, in due course, has the power to claim the redemption of the loans. Not only has it this power to call in these loans, but it actually possesses the equivalent of the loans in a portion of the country's wealth.

It is possible—but the wisdom or unwisdom of it need not be discussed here—for the legislature to enact that only pure deposits should be withdrawable at a moment's notice, and that borrowers should be compelled in times of panic or vital urgency to give long notice. I merely say that this is within the power of the legislature to enact, but I do not say here that it is practicable, necessary, or wise.

I merely throw out the hint here in order to emphasize the importance of the distinction between pure deposits and loan deposits. The latter, I have already urged, may be regarded as the product of the machinery for converting wealth into currency, or liquid capital. From a sound banking standpoint the vital question to be considered and answered is as to the kind of wealth that is so converted.

Sound banking is to be tested by the nature of the wealth so converted, or, in the language of the financial community, the wealth on which loans are made.

Others argue that this is a matter of quite secondary and even third-rate importance. They contend that the matter of supreme and vital importance is the amount of gold a bank holds in proportion to its liabilities in deposits. Should there be some differentiation here? Should it be the amount of gold held in proportion to its pure deposits, and not in proportion to its aggregation of pure deposits and loan deposits? For the loans, as we have seen, are automatically redeemable.

If, say, a bank habitually holds gold to the proportion of 15 per cent. of its aggregate deposits, and if half these deposits are loans, then the gold will be equal to 30 per cent. of its pure deposits, a proportion much higher than the figure advocated by those who agitate seriously and zealously for higher gold reserves.

We have seen many small banks go under in recent years. This was in some cases because they lent their money on what I will call bad wealth. In other words, because they gambled and speculated with the money of their depositors. Here we have some evidence that the general public are unable to discriminate between sound and unsound banking. This may be deplorable ignorance, but it is not culpable ignorance. It is to a great degree inevitable ignorance.

The matter is dismissed by the quidnuncs saying that fools deserve their misfortune, they should have placed their money in sound banks. We should not so readily denounce them as fools. The Government is not without its most serious responsibility in the matter. It should not allow such money-lending establishments to describe themselves as banks. The

Government has a moral duty to protect the public, and it would not be at all difficult to take steps to this end. It should allow only those establishments to call themselves banks that are conducted upon sound banking principles.

Joint stock banks have a legal safeguard. Though they are under compulsion to repay deposits, they are under no legal compulsion to repay them in gold. They must repay them in legal tender, and they can fulfil their legal obligations by paying out in legal tender notes. These, of course, are Bank of England notes and now the new Treasury emergency notes.

This being so it is immaterial, or it should be immaterial, whether the reserve of a bank consists of gold or legal tender notes. If it can redeem its liabilities in notes and has sufficient notes for its purpose, it can consider itself safe and can securely stand in a crisis. The notes can, of course, be taken to the Bank of England and be exchanged there for gold; but this is immaterial to a bank which has successfully met the peril of a run.

Soundness of banking consists in the soundness of the wealth that constitutes a bank's assets. We know there are infinite degrees and categories of wealth. But it is easily possible to discriminate and know exactly which is the highest class of wealth in the country.

Banks do and must speculate to some extent. It is unavoidable. If they did not speculate they would not incur bad and doubtful debts. But they must keep their speculations within the most prudent limits. This most of them undoubtedly do. Traders complain that they are, indeed, too cautious in this respect, that they do not lend freely enough. There have been, indeed, most bitter complaints on this head since the outbreak of the war.

But we cannot reasonably insist upon banks being ultra-cautious, and in the same breath complain of their cautiousness. We cannot reasonably insist upon them keeping large gold reserves, thereby diminishing their loan capacity, and with equal reason insist that they shall lend with increased liberality.

This is as impossible as trying to reach two goals simultaneously, when each lies in a direction opposite to the other. The man in the street would say you cannot eat your cake and have it.

When a bank lends to a man or firm on good security, it cannot be sure, of course, that that man or firm will be able to pay off the loan when it falls due.

We may, if we wish, call this a speculative chance, but the bank is considerably safeguarded by the security it possesses.

Public confidence is based, therefore, upon the soundness of banking methods. It is an article of belief with us that banks become gravely imperilled when confidence breaks down. It is when confidence is destroyed that runs on banks commence. Fear seizes the public, it develops into panic, depositors clamour for their deposit money, and banks either successfully meet these runs, or close their doors. But so long as confidence is strong and unimpaired, sound banks keep safe.

The safety of banks depends, therefore, upon this feeling of confidence in them, and this feeling of confidence, in its turn, is based upon the intelligence and common sense of the public. Up to now this intelligence and common sense have been triumphant. They have triumphed in a crisis unparalleled in the history of the British Empire, in that very crisis, in fact, which the prophets always feared would show their superficiality and vulnerability.

The predictions of the prophets have not been realized. This is because human genius and human wisdom have been mightier than human fear and apprehension, because the nation had supreme faith in the Government, in the economic strength of the Empire, and in the might of its navy and army.

And if the prophets have prophesied falsely in this supreme situation, they are just as likely to prophesy falsely in other potential emergencies.

CHAPTER VI

THE SUPERSTRUCTURE OF WEALTH

In our loose and indefinite way—as a result, maybe, of our defective vision—we talk of a vast superstructure of credit erected on a tiny gold basis. We gaze upon this mighty fabric and shake our heads ominously. As we gaze we see the structure grow, extending upwards and outwards, enlarging itself by some invisible and mysterious agency, and when we cast our gaze to the foundations we see that it looks like a towering edifice perched insecurely on a small, uneven piece of rock. No wonder we have feared that when storms break the whole crazy thing will come crashing down, scattering ruin and devastation in a vast area around it. It seems to us like a structure built by a madman, in defiance of the laws of architecture, and that there can be but one end, sooner or later, to so fantastic a fabric.

So have we been told time and again that our superstructure of credit has been built only for fair weather and not for foul.

Well, it has withstood much foul weather since the building of it commenced generations ago.

Storms have beaten against it, and to the naked eye it has hardly swerved. The storms have made no rents in its walls, and it still stands, growing visibly, pointing its rising apex to the skies, and millions of people to this day—stolid, unimaginative Britishers, maybe—enter within its portals fearlessly and without suspicion of their peril. They heed not those who warn them that the whole thing may fall about their heads at any moment, that it needs but an earthquake, and all will be over in the twinkling of an eye.

"Foolish people!" these architectural guardians of safety cry. "We have warned you, and you have heeded us not. Let your fate be upon your own heads. Let him who is guided by the feeble, confusing light of his own folly, suffer the doom of his folly. We, at least, have done our duty, bravely, like voices crying unto the lost multitude, drunk with its ignorance and conceit."

Well! well! Perhaps, after all, this superstructure may have no counterpart in reality. It may be but a fantastic dream, or nightmare, after all, yet seemingly so vivid to our fearsomeness that we find it almost impossible to believe that it can be but a creation of the imagination.

Would it not be more accurate to say that we have erected in our midst a vast superstructure of wealth? And cannot we say that this superstructure is based, not upon a slight foundation of gold, but upon the solid wealth of the nation, the empire, the world? If it can be proved to our nervous eyes that this is the real superstructure, after all, and not the one we have seen in disturbing visions, perhaps we shall feel more secure against and less apprehensive of the force of storms.

Let us look more closely at that balance sheet, for then we shall come into actual physical contact with the composition of this awe-striking structure. We will analyse the various ingredients which we shall describe as the assets of a bank.

First of all, we see that the cash in hand and at the Bank of England is nearly £6,000,000. This is legal tender, that which the law of the land has enacted shall be absolute, permanent wealth, not subject to the vagaries of fashion or sentiment.

Money at call and short notice is nearly as much —over five and a half millions. This forms a portion of the loan deposits, and being callable by the banks practically on demand, they show that a portion of the deposits payable on demand can also be recalled on demand. The equivalent of these loans, or deposits, the bank possesses in the shape of wealth not in the absolute category of legal tender. They are securities of the highest class, securities representing the credit or wealth of the nation. While these securities are lying in the safes of the banks they have been converted into temporary currency, and have been fulfilling all the purposes of money in circulation. They have been resurrected from dead into live capital. A similar process could be gone through by selling the securities in the market. The owner could convert them for his purposes into liquid capital. But he sells them temporarily to the bank instead of permanently in the market, and when he has employed his liquid capital temporarily, he repays it to the bank. He rechanges it, as it were, into dead or illiquid capital, until the moment comes when he desires to reconvert it into live capital, or currency. The bank possesses the wealth in bonds; he possesses the wealth in currency, and the bank's gain consists of the interest on the accommodation, and his gain in the profit accruing from the active employment of his capital.

There is no more trust than a butcher has when he sells a leg of mutton for 4*s.* 6*d.* on the nail. His dead leg of mutton he converts into live legal tender currency. If he never sold his mutton he would starve. If the housewife's husband earned no more salary wherewith to exchange it for future legs of mutton they would starve.

If the banker lent the borrower money without security, it would be more truly credit, for he would have no wealth that was the equivalent of the loan.

If he, at certain seasons, is compelled to call in these loans to bill-brokers and others and cannot renew them—quite a frequent, familiar operation—

those who want to convert their dead wealth into currency go to the Bank of England. Machinery similar to that employed in the joint stock banks is put into operation there. The Bank takes in the securities, debits itself with the amount it empowers the borrower to withdraw in currency, and credits itself, not with words, but with valuable bonds. It insists that these bonds shall be of the highest value, and this insistence is inconsistent with the idea of what the ordinary man regards as giving credit. Otherwise, there would be greater trust in promises than in securities.

The objection borrowers have in going to the Bank of England is, they have to pay more for the services rendered. In the phraseology of Lombard Street, they have to pay higher interest for their loans, and being ordinary mortals, not too full of the milk of self-sacrifice, they prefer to go where they can deal more cheaply. This is precisely the motive that sends the housewife to the cheap butcher. She might get her leg of mutton a farthing a pound cheaper than if she went to the dear, extortionate butcher.

And there are some people in the City who have whispered that the Bank of England *is* extortionate. And those who have listened to them have made grimaces not altogether unlike expressions of sympathy and agreement.

Still keeping our attention on the balance sheet, and turning it for a moment from the stern, unbending business men at the Bank of England, we find that the legal tender and the call loans total over eleven millions and a half, and the deposits are thirty-seven millions and a half.

Next, investments exceed £6,000,000. The balance sheet says these investments consist of Consols and other securities of, or guaranteed by, the British Government, Indian, Colonial, and other securities.

I do not think any critics, not even financial journalists—for do not the public ask their advice what to invest in?—will deny that here we have the cream of investments. We could not, not the brainiest critic of us all, imagine anything creamier. Why, these are the creamiest things that make a hungry City editor's mouth water. I dare say the most humble of them would confess that if a kind-hearted employer would only give him a few thousand pounds' worth, he would not waste his intellectual resources in writing another line of financial criticism. He would be so content with this wealth that he could till his death-moment repose in absolute idleness and enjoy contemplation of the continued labours of less fortunate City journalists.

Here, then, is an aggregation of approximately £18,000,000 of first-class wealth, or nearly 50 per cent. of the total pure and loan deposits.

Bills discounted approach £7,000,000. I need not spend much labour in analysing and describing what bills of discount are. Those who wish a detailed description must consult other works dealing more fully with elementals. It is sufficient to say here that these bills represent also the best class of wealth, distinct, of course, from gilt-edged securities, but wealth, nevertheless, of the highest character. They represent produce, raw materials, manufactures of a vast and varied character, and when the bank has in its possession these bills which it has discounted, it practically has the varied wealth they represent.

Cheques are to be regarded as our national currency, bills of exchange are to be regarded as international currency. Cheques are wealth converted into national currency. When a bank discounts bills it enables them to perform also all the functions of our national currency. Until they are so discounted their functions are limited to their international purposes.

This is one of the purposes served in re-discounting them with the joint stock banks.

The great bill-broking firms and discount houses discount them on behalf of customers and re-discount them with banks. It is in the re-discounting that they make their profits and continue their existence. They cannot tie up their capital in these investments. They must re-discount them in order to liquefy them and restore their capital. And all the vast wealth behind the bills thereby becomes liquid capital that can continue fructifying instead of becoming stagnant.

Now this wealth, I say, the banks indirectly possess. It is theirs. They buy it. And if they buy it and it comes into their possession and they exchange money for it, as merchants and tradesmen do, how do they grant credit? When the wealth is eventually sold the proceeds go into the coffers of the banks, and the banks hand over the promises to pay. But the promises to pay are more tangible than the promises of the schemer who flits from suburb to suburb and town to town living on what is called credit.

Then there is the other composite wealth amounting to over £16,000,000. These are advances to tradesmen, merchants, and other persons well known to bank managers, who deposit some kind of wealth as security.

They are loans to all sorts of people who have pledged all sorts of wealth with banks. This wealth, in other words, they have liquefied and the banks have been paid consideration for liquefying it. People have parted with the wealth, sold it, if you like, and it has been passed over into the possession of the banks.

Adding these to the other loans we make a total of nearly £22,000,000, which compose that portion of the deposits which we call loan deposits. If we add the bills discounted as another form of loan the total is raised to £28,700,000 out of a total of £37,600,000 of deposits. This leaves a residue of £9,000,000 of pure deposits against which the bank holds £6,000,000 of legal tender, or over 60 per cent. If we add the £6,000,000 of investments, the total considerably exceeds the aggregate of the pure deposits.

Ought the position to be made clearer to the public, to the unsophisticated man in the street, by segregating the deposits and showing their component elements? What is the objection? Will some great bank start reform in this direction if it be earnestly and sincerely desired to show the public exactly what the position of affairs is; if it be sincerely desired to surround the groping man in the street with a bright light? Why not extend reform here after commencing with the segregation of a bank's legal tender reserve?

I can imagine, however, that the refusal would be strenuous.

Are the pure deposits credit? If they are not credit, entirely distinct from the loan deposits, but consist of money in some form or other lodged with the banks, they cannot form a part of what is described as the credit superstructure of the banks. The so-called credit superstructure must be composed, then, of the loan deposits which are at one and the same time loans by the bank, and loans to the bank. If they are other people's liabilities and at the same time the bank's liabilities, whose credit are they? The borrower trusts the bank and the bank trusts the borrower; whose credit comes first? Who is the first creator of the credit? It is as difficult to answer as the question which came into the world first, the egg or the chicken?

No matter how we answer the conundrum, it seems to me indisputable that what we gaze upon is a superstructure of wealth. And it is indisputable that the banks furnish machinery vital to the progress of humanity. And it seems to me vital to the interests of national well-being that every resource should be ready to prevent the collapse of any sound banking establishment.

CHAPTER VII

WHAT IS THE LOANABLE FUND?

The loanable fund in Lombard Street is said to be the totality of the deposits in the possession of the joint stock and other banks, plus the deposits in the Bank of England. We will, however, for the moment leave out the Bank of England as being immaterial in the present stage of our argument. Let us confine ourselves to the deposits in the joint stock banks, and let us assume that these total £800,000,000. What is called the loanable fund, therefore, is a mass of money aggregating £800,000,000. If a merchant or any other person desires to get a loan he gets a portion of this huge sum, and the commerce and industries of the country are financed thereout.

It has been likened by the imaginative to a vast reservoir of money, into which money is constantly flowing from many channels, and out of which it flows into a great number of channels. In fact, these channels form a mighty network, like the veins of the human body, and as the steady flow of blood to all parts of the body is essential to health and life, so the steady flow of money throughout the economic organism is essential to its health and life.

It is indisputable that money or capital, however we designate the element, is vital to the well-being of the economic organism of the State. Without this provision the organism would in time decay and perish. Therefore some perennial source of this life-giving and life-preserving element should be provided by the Government or some other organization if the nation is to thrive and progress. As the Government has not hitherto provided that source, and as the banks alone provide it, let us examine the peculiar character and essence of that element.

We have seen that this so-called loanable fund, or reservoir of capital, consists of money hoarded with the banks by the public and loans by the banks to other members of the public. These deposits are, in fact, representative for the most part of fixed capital. It is the habit to call them mere book entries, intangible and invisible, and that the only sign of their existence are the figures written in the books of a bank.

I have endeavoured to show, however, that so far from being intangible, they are tangible, because they are the composite wealth of the community in possession, not of the community, but of the banks. It follows, therefore, that the loanable fund of the country does not consist of an intangible something called credit, book liabilities, but of a certain portion of the wealth of the country.

Now this must necessarily be so. Wealth is the source of wealth and the fruit of wealth. If you use wealth you produce wealth. We call the product wealth, or capital, the terms being interchangeable. Capital is wealth, therefore wealth must be capital, and if the banks possess wealth they possess capital. Wealth or capital is valued in the terms of money. We know of no other terms than money for valuation purposes. If we say a pound of cheese is worth a pound of tobacco, we mean nothing unless we make simultaneously a calculation by the common standard of value.

The cheese is worth sixpence, we say, or one-fortieth of a sovereign, and the tobacco is worth sixpence. If I borrow sixpence from the cheese-monger and give him my tobacco I create a loanable fund, for I can lend the sixpence to some one else for half a pound of tea as security, and the third person can lend it to some one else, and so on *ad infinitum* till the sixpence drops down a deep well and is lost. Though the sixpence be destroyed the wealth it has created in the course of its existence is not destroyed, for we assume that it has been used profitably and fructifyingly in the hands of successive borrowers.

If the wealth of the country constitutes the loanable fund, it is possible to make this wealth fruitful only by converting it into currency and making it flowable, or liquid. We know that a stagnant pool will not irrigate land. We know that it must be made to flow along innumerable channels. The pool of water is as unfructifying as fixed or stagnant capital. In order to make fixed capital flow and enrich the area through which it passes it must be re-converted into its original substance, currency. Fixed capital is rigid currency, as ice is rigid water. It is frozen. Well, the banks merely unfreeze it, or thaw it. It is a misuse of language and terms to describe this thawing process as a creation of credit.

Now the Government does the same thing when it issues its war loan. It unfreezes fixed capital; it starts into fruitful circulation hoarded capital. A similar effect follows other loans and other promotions. The Bank of England does precisely the same thing when it unfreezes gold direct from the mines by giving notes for it. The gold is fixed, or rigid, frozen capital. It is useless for fructifying purposes of a certain character, and in order to make it fructiferous, or fruitful, it has to be submitted to the reconversion process. When it has gone through this process it is able to perform exactly the same functions, or the same services, as the conversion of other wealth into currency by the banks.

How is it that in one case the Bank of England is said not to create credit, and in the other case the banks create credit, when the two processes are identical? Because, we say, the Bank of England gives legal tender currency for the gold, and the banks give only custom currency for the wealth. The one is not exactly a loan, it is argued, but the other is.

If gold were a commodity, just ordinary wealth, would it be a loan then? The answer is that gold is not a commodity. But we know that gold is a commodity until it has been minted into sovereigns. As an ordinary export and import it is a commodity.

But, the answer comes, the notes are legal tender and legal tender is not credit. Here comes in the schism, the casuistry. Fundamentally, the argument is this. The conversion of wealth into ordinary money or currency is credit, the conversion of wealth into legal tender is not credit.

As the banks lend, therefore, something over and beyond the exact amount of legal tender they possess, they create credit. If they lend only the sum equal to their legal tender they do not create credit. Therefore, credit is a something not inherent in legal tender.

Now pure deposits are loaned to banks. Therefore the pure deposits, if they are credit, are the credit of the depositors. If I exchange gold for notes at the Bank of England and deposit those notes with a bank, the bank has not created these notes and, therefore, has not created credit. And the legal tender notes are, as I have already said, no part of the structure of credit. The legal tender notes are loaned to borrowers, or exchanged for other people's wealth, and in ordinary business transactions there is no credit when there is equal exchange. Credit comes in when there is no direct exchange, or when there is unequal exchange.

No wonder the views on this complicated problem are irreconcilable. I may recall what Mr. A. C. Cole, a director of the Bank of England, said years ago, in an argument between him and Mr. Tritton, the President of the Institute of Bankers.

"Now, I was very much surprised, on reading Mr. Tritton's paper, to find him stating that the commonly accepted opinion that a bank can create credit is a pure fallacy. In my opinion, if a bank does not create credit, it cannot make a profit; in fact, it is by the creation of credit that banks earn their dividends. While I was surprised at the above-mentioned statement, I was equally surprised to find that a number of the bankers who took part in the discussion which followed his paper seemed to accept the statement as correct."

Banks seem to me to make their profits by taking a share of the profits earned by the merchants and tradesmen of this country. The profits of the country are divided, as we all know, amongst the capitalists, the retailers, and the working people. If there were no such division of profits industry would come to a standstill, and the community would starve. The producers share their profits with the consumers, and the consumers with the producers. It is impossible for one branch of the community to amass all the profits and the other branches to have none.

The banks form one branch of the community that takes a due share of the aggregate profits of the community.

The banker says *de facto* to the merchant who borrows from him: "I will help you to make your capital liquid so that you can continually earn profits by the use of it, if you will remunerate me by giving me a portion of your profits." The merchant readily agrees to the bargain, knowing that it would be a bad bargain for him if he did not earn with his mobile capital larger profits than he would hand over to the bank. If he makes ten per cent., say, he gives the bank two or three per cent. If the bank made no charge for its services, the merchant would then have the greater part of the ten per cent. The merchant is the middleman between the capitalist—that is, the banker—and the consumer, and the middleman gets the profits of the middleman. Unless the bank provided him with the capital he would be helpless.

It will be seen, therefore, that a bank's profits are not something over and above, out of the sphere of the total profits of the community, but are a share of them, just as my employer shares with me the profits he makes. If he paid me no salary, his personal profits would be larger. But they are diminished to the extent of the salary he gives me.

When banks raise their interest for loans it is tantamount to raising the price of their services. That is to say, they demand a larger share in the profits of the community. Merchants then try, in their turn, to obtain a larger portion of the profits of the community.

Less wealth is then liquefied, the wheels of trade begin to revolve more slowly, and depression sometimes begins. Profits diminish, less capital and wealth are produced, and the effect is subsequently seen in the so-called loanable fund.

The character of the loanable fund alters, however, in times of depression. The pure deposits then increase and the loan deposits diminish. As it becomes less profitable to liquefy fixed capital, then less wealth is taken to the banks to be liquefied, and therefore the banks have to take their lessened share of the aggregate profits of the community. But a considerable portion of capital already in liquid form in the shape of profits, instead of being reconverted into fixed capital, remains liquid, and in its liquid form is hoarded with the banks. But this hoarded, liquid capital is not credit now, although in its origin it was called credit. Even those who hold that banks originally created the credit will hardly deny that these deposits are now money, even though the money may be the product of former bank loans, or former liquefaction of wealth. If in their original liquefaction they were credit, why are they not credit now? At what precise moment did they become no-credit? If they originated as credit why are they not permanent credit?

However, we see the character of the loanable fund change. The pure deposits grow, the loan-deposits diminish, and banks are said to have more money or capital than they can employ. This is so, even if the aggregate of the deposits is precisely the same before the depression as after it, the increase in the pure deposits being, say, merely equal to the decrease in the loan deposits.

Why, if the deposits are equal in amount, is the loanable fund much greater in times of depression than in times of activity, and why do rates for loans fall?

CHAPTER VIII

THE METAMORPHOSIS OF THE FUND

THIS is because of the character of legal tender currency, and a legal tender currency, however desirable and however great its merits, must necessarily have its shortcomings in a progressive state.

The loanable fund is restricted, or controlled, not by the growth of the country's wealth, but by the production of gold. To control it by so artificial and arbitrary a circumstance as the output of gold may seem absurd, and from a strictly logical and economic standpoint it is absurd. The loanable fund ought to be governed entirely by the production of wealth, and not by something entirely independent of wealth and having no natural or economic connection with it.

I am now speaking of the loanable fund which collects in the joint stock banks. Of the other loanable fund, which collects in the Bank of England, I will speak later.

What the banks lend is liquid wealth, but the amount they can lend at any given moment is governed less by the amount of wealth that is brought to them than by the amount of gold they possess.

This is the gold which, we say, constitutes their reserves.

Let us assume that it is the custom of the banks to keep a gold, or, rather, a legal tender reserve—it is chiefly composed of Bank of England notes—equal to fifteen per cent. of their combined pure and loan deposits. It follows that the growth of these deposits must be controlled by this fifteen per cent. reserve. This is so in practice. When the reserve begins to fall below this fifteen per cent., then the banks cease liquefying wealth and increasing the loan fund. When the reserve increases beyond the fifteen per cent., then the banks continue to liquefy the wealth.

It is then said that money—some say credit—is abundant, and the banks cannot find full employment for it. When the reserve falls it is said that money—or credit—is becoming scarce. We find, therefore, that the loan-fund actually contracts when trade is active, and expands when trade is depressed. In the economic interests of the nation the fund should grow simultaneously with and commensurately with the growth of trade and commerce.

In times of activity more wealth is created. It is like an abundant harvest resulting from a favourable season. In times of inactivity less wealth is created, to be likened to bad seasons and poor harvests. In times of activity there is necessarily and inevitably a greater demand for capital, that is to say, for more liquefied wealth. Bills of discount multiply, and they are taken to the banks as security for loans, in other words, to be converted into liquid form. Another phrase is, into floating capital. If they could not be so converted, the needs of the community in such times could not be met, for the bills of discount could not be used as currency, or capital, like cheques. They are discounted at the banks in order that they may be transformed into cheques, the representatives of floating or circulating capital. In this form they are able to reproduce wealth more rapidly than if they had to remain in their original form.

So it is with other forms of wealth, all are taken to the banks to be converted into quickly reproductive shape.

But the banks have to keep an eye on that gold reserve, watch it closely. Managers have to calculate when the limit of their conversion powers will be reached, and when it is reached their wealth-liquefying machinery has for the time being to cease working. It does not follow that when the machinery of one bank has to stop, the machinery of all the banks simultaneously stops. The limit may not yet have been reached in other banks. Borrowers, as they are called, then rush to them, and as the numbers grow and the pressure increases, so is the limit of the other banks more speedily reached, until at last the entire machinery comes to a stop. It often comes to a stop when in the interests of the economic welfare of the nation it should be working most actively.

But the machinery is controlled by another independent agency, and the economic interests of the nation must suffer the effects of this obtrusive force.

If this independent force be at times harmful and not beneficial to the economic welfare and progress of the nation, what is to be said of the cry that this force, in the most urgent times, should be made more interfering and harmful? What is to be said of the cry that at the moment when the need is greatest then the succour should be restricted?

What should we say of the doctor who by ligatures prevented the free flow of blood in the body of an active, energetic man, in order to paralyse his energies and enforce rest? We should say that he was not only an unscientific doctor, ignorant of the functions of the bodily organism, but that he was actually killing his patient. These gold reserves, therefore, act like ligatures, for they stop the free and health-giving flow of economic blood at the very moment when the flow should be stimulated.

In inactive times we see the metamorphosis of the fund take place. The loan deposits decrease, because the liquefied wealth becomes frozen again and the production of wealth decreases, while the pure deposits grow. The fact that the loan deposits decrease simultaneously with the contraction of wealth production is an additional proof that the loanable fund is wealth in liquid form. As the wealth in fixed form is withdrawn from the bank so the loan deposits drop.

Now the increased pure deposits may be regarded as a portion of the harvests gathered from the fructifying use of the liquid capital in times of activity. They are called the profits, or the savings of capital. They accumulate in times of depression. For lack of other employment they are placed on deposit with the banks. They are, in a way, loaned to the banks, and the banks are supposed to lend this money to the classes of borrowers already described. But the banks at these times benefit, or are presumed to benefit, not because the aggregate of the deposits grow enormously compared with other periods, but because these pure deposits bring them more gold. The loan deposits take gold, the pure deposits bring gold.

This is why, the aggregate being the same, or even less, the potential loanable fund is greater in inactive than in active times of trade. The gold reserves increase and the proportion of the reserves to the aggregate deposits rises. When this proportion rises, the banks say they can afford to let it fall, and therefore they can liquefy more wealth if there were more wealth to liquefy. But there is less wealth to liquefy, and therefore money is now said to be abundant and cheap. The banks are willing to take less interest, that is to say, a smaller share of the profits earned by liquefied capital.

But depositors also have to take a smaller share of these profits. The banks divide their smaller share of the profits with the pure depositors, and, therefore, can give only a smaller rate of interest on the deposits. Dissatisfied with this small rate of interest, depositors seek for other channels of use, other forms of investment, and when they find these other channels, they withdraw their deposits and reconvert them into fixed or frozen capital. They may speculate with them in mining or rubber shares, or invest them in Consols or War Loans. When this is done, gold is automatically withdrawn from the banks and the proportion may drop. Should the proportion drop, banks can lend less, and the potential resources for liquefying capital becoming less, they can begin to charge more for these services.

When the pure deposits increase the reserve of gold automatically increases. Therefore, though the risks of the banks increase, because the liabilities on demand increase, so the power to meet those risks automatically increases. This being so, the necessity for increasing gold reserves is less apparent; for they increase automatically. When the pure deposits decrease and the loan deposits increase the proportion falls, but it falls at a time when the risks are lessened if set against the pure deposits as distinct from the loans owing to the bank.

It will be seen, therefore, owing to the constantly fluctuating character of a bank's liabilities, or risks, it is impossible to maintain a fixed, undeviating reserve, whether it be a high reserve or a low reserve. And we know that this impossibility is demonstrated every day in Lombard Street.

It is demonstrated at the end of each month, when the banks cease lending, and when they compel their loan depositors to pay in their loans. This is proof that a proportion of the deposits are loans to the bank. As these loan deposits thereby contract, banks cannot compel the pure depositors to withdraw their deposits, therefore the proportion of the gold reserve to the *whole* rises, and the wish of those who clamour for high reserves is fulfilled.

This policy is resorted to because an idea exists amongst bankers that, instead of going to theatres and other places of amusement, the public, as a body, spends its leisure time during the closing days of each month working out the proportion of the reserves to the total deposits. This is a fantastic dream. The public does nothing of the kind. It is fallacious to imagine the public working out the proportions minutely and then deciding in strictly mathematical fashion whether a bank is safe or not, and whether there is likely to be an immediate run upon it or not. If bankers and theoretical financiers were only gifted with the power to understand human psychology there would be less contention amongst them on questions of pure theory. They would not magnify the unimportant at the expense of the important functions of banking, and magnify the superficial at the expense of the deep traits of British character.

We see the same policy adopted at the end of each half-year, or year, when the banks make up their half-yearly or yearly balance sheets. Such a great deal has been made of this high reserve need—as though it were possible for any mortal being to draw up an absolute line of safety—that at these periods trade is penalized because bankers imagine that the millions of this nation are auditing their accounts. They see them poring over these accounts in the great castles of the realm, and in the cottages of the poor. It is a pure delusion, and if the millions engaged themselves voluntarily in these uncongenial tasks, the result would only be national confusion, and not national agreement. There can be national agreement on one thing connected with the banking system, and one thing only, alike in the mansion and in the cottage, and that is agreement upon the honesty and soundness of that system. And honesty and soundness are not to be tested solely by the bulk of the legal tender reserves.

The only members of the community who, perhaps, might be more concerned than others about these reserves are the very members who share the responsibility equally with the banks. They are those who borrow from the banks, who get their liquid capital there. All they have to do is to cease borrowing, cease converting their wealth into currency, and the thing is done. The remedy is in their hands.

Do they do this? No. Do they show this feverish concern? No. What do they do? These men, who have more at stake than the other millions, actually growl when the banks refuse to liquefy their wealth. They make it a grievance, and a sore grievance. To imagine, therefore, that these growlers are watching minutely the movements in the reserve is a delusion verging near to absurdity.

When some bank managers tell borrowers they must repay their loans, then they rush round to other bank managers, caring not a fig about reserves so long as they can get the accommodation they want, for their needs are above all other considerations. And when they find that no bank manager will serve them, and when all bank managers tell them they are sold out, then they have to go to the Bank of England. They do not like to go to the Bank of England, because they have to pay more for the services that Bank renders. That is to say, they have to share with the Bank of England a larger portion of the profits they make than the portion they would divide with the joint stock banks.

By this analysis we see that the deposits of a bank, the so-called loanable fund, consists of pure deposits, which we may call cash deposits, and loan-deposits, which those who believe in credit creation call credit deposits. These latter deposits represent the wealth placed with the bank, and so long as this wealth is in liquid form in these deposits it cannot be employed in its fixed form. These deposits are loans owing by the bank and owing to the bank. Others call them credit deposits created by the banks themselves.

These loans are made in relation to the proportion each bank is in the habit of maintaining between its cash, or legal tender reserves, and the deposits as a whole. The loan deposits increase or decrease according as this proportion rises or falls.

It is left to the discretion of each bank to decide what the proportion shall be. There is no legal compulsion. Therefore it is their practice to retain the minimum ratio which they consider sufficient for their safety. When this safety limit is passed, then they stop lending and proceed to call in their loans. The totality of the deposits automatically diminishes, and though not a sovereign has been added to the reserve, the proportion rises.

This, then, is the important point. Not so much the amount of the reserve, as the proportion. One bank may have fifty millions in its reserve, and another bank only fifteen. But the smaller bank may have a higher proportion to its liabilities and the larger bank a smaller proportion. The test, therefore, if there must be a test, is the proportion of the reserve to the total liabilities, and with this I shall deal more fully later on.

CHAPTER IX

THE CENTRAL FUND

What I call the Central loanable fund is the fund in what financial journalists call the Central Institution. This is not to be regarded as an institution standing in the centre of a great circle of banks, with directing chords, as it were, radiating from this governing centre. Why it is called the Central Institution I do not know, except it be a birth of the mother of invention, or a need arising out of the limitations of the English language.

But the origins are unimportant. The Bank of England, let us say, stands in an unique position, and it is a banking institution that possesses great, but not absolute, autocratic powers. The public attribute to it greater powers, and surround it with a greater glory and majesty than it probably possesses. This is a psychological fact of significance. It is the Bank *of England*. That is *the* Bank; the Bank that props up the nation, and which the nation in its turn props up. It is a mutual propping up. The one cannot fall headlong and leave the other standing erect. Both must stand or fall together. As, however, in the consciousness of the community the nation is unshakable—then it follows that the Bank of England is in the nation's view unshakable.

Let me say, before I proceed further, that there is no delusion in this. It is a fact of tremendous import.

Where a delusion does exist is in the belief or consciousness that the Bank of England is a State bank and not a private bank like other banks. It is, however, a private bank, like other banks, performs similar functions, earns its profits in the same way and distributes its dividends to its shareholders in the same fashion. It is a proprietary establishment, run by the directors for the benefit primarily of its shareholders.

It is only a State Bank in that the Government deposits its funds with it alone, borrows from it now and then, and employs the Bank as its medium for issuing loans, paying interest on the funds and performing many other functions on its behalf. These functions, it need scarcely be said, are not performed gratuitously. They provide a source of income for the Bank.

The Bank of England is also a banker for the private individual in the same way as an ordinary joint stock bank is.

It is also the banker's bank. It may seem strange to some people to learn that the banks themselves have a common bank. This common bank is the

Bank of England. But they bank with it in a strictly limited way. They do not borrow from it, nor discount or, rather, re-discount bills of exchange there. The Bank of England is to the joint stock banks a limited convenience.

They deposit what is called their reserve funds there. In the balance sheet we have examined we see that that particular joint stock bank possessed in coin in hand and at the Bank of England a sum aggregating £5,996,668. How much it had in its own safes and how much at the Bank of England, no outsider can divine. At any rate, we learn that a portion of it was in the keeping of the Bank of England.

This reserve performs two functions. It acts as a part reserve against deposits, or liabilities, and it helps in adjusting the balances between the various banks, the adjustment being made in the books of the Bank of England.

I need not describe here the methods of the bankers' clearing house, how each day the cheques are cleared, and how each bank at the close of each day finds out how it stands in relation to the other banks. Debits are settled, not by a direct transfer of cash, but by drawing a cheque upon the Bank of England, just as an ordinary individual redeems his liability by handing to his creditor a draft on his bank. If they both bank at the same bank the necessary adjustments are made in the books of that bank. The aggregate deposits of the bank are unaffected, and the reserve is unaffected.

All the joint stock banks, then, have accounts with the Bank of England, and the deposits of the Bank of England include reserves of the joint stock banks. The Bank of England pays no interest on its deposits.

Let us now analyse a Bank of England return, which we may call a Bank of England balance sheet. The following return is a post-war return, issued some months after the outbreak of the war:—

BANK OF ENGLAND.

ISSUE DEPARTMENT.

	£		£
Notes issued ...	86,802,605	Government debt ...	11,015,100
		Other securities ...	7,434,900
		Gold coin and bullion	68,352,605
		Silver bullion ...	—
	86,802,605		86,802,605

BANKING DEPARTMENT.

	£		£
Proprietors' capital	14,553,000	Government securities	21,324,358
Rest	3,499,722	Other securities ...	108,836,570
Public deposits ...	47,393,479	Notes	52,098,065
Other deposits ...	117,593,833	Gold and silver coin	813,512
Seven day and other bills	32,471		
	183,072,505		183,072,505

We must leave out of consideration for the present the Issue Department. This is quite distinct from the Banking Department, and so far as the Banking Department is concerned, its working is as independent as though it were merely a Treasury Office in Whitehall.

The Proprietors' Capital explains itself. It represents the amount of capital subscribed by the shareholders. The Rest may be regarded as the Bank's accumulated profits, and ordinary reserve fund. It is the fund into which the profits flow and the funds out of which the dividends are paid. It is not allowed, however, to run below £3,000,000.

The Public Deposits are the Treasury deposits, and it will be observed that these are kept distinct from the Other Deposits. As every return explains, these deposits include Exchequer, Saving Banks, Commissioners of National Debt, and Dividend accounts. When we pay our income tax to the Government it is paid into the Bank of England and swells the Public Deposits, and the Government uses them in the same way as the private individual uses his deposits in his own bank.

The Other Deposits are the aggregate deposits of all the Bank of England's depositors except the Government. They include the Reserves of the banks of the Kingdom and the loans the Bank has made to its various customers. As they include loans they are a composite account. The Seven Day and Other Bills is an item of no importance.

On the other side are the assets the Bank holds against these varied liabilities. Government Securities are securities lodged by the Government as a security for loans, and they also include the Bank's own investments. The Other Securities include bills of discount, and securities of the highest class lodged with the Bank as security for the loan-deposits.

The notes are the ordinary Bank of England legal tender notes, and constitute, with the small amount of gold and silver coin, the Reserve of the Bank against its liabilities. In this particular week the ratio of the Reserve to the liabilities was $32\frac{1}{8}$ per cent.

It will be noted that the Reserve does not consist of coin, but almost entirely of notes. But the notes can be exchanged at the Issue Department for gold, so that they are equivalent to a holding of gold.

On the asset side of the return, then, we see the character of the wealth the Bank possesses. This wealth represents the loanable fund of the Bank and totals a huge sum. The deposits are, of course, merely book entries, or book liabilities, or credits, as most call them, and what I call the liquefied form of the wealth held against them.

Those who borrow the most extensively from the Bank are bill brokers, and they only borrow in those seasons when the joint stock banks have reached the limit imposed by their reserves and cease lending. Having need of liquid capital and not being in a position to wait until the joint stock banks can lend again, it is with great reluctance the bill brokers borrow from the Bank of England. The reluctance is most natural, because the Bank of England charges higher rates for discounting bills and for lending money on security than the joint stock banks charge. And it also discounts and lends for much shorter periods. This explains the Bank rate, which is of such great importance in the economic life of the nation. It is the minimum rate at which it will discount bills for customers and the brokers, while it will lend only at half per cent. above its minimum rate for discounting.

The rates charged by the joint stock banks are always well below Bank rates, except on the rarest of occasions, and therefore bill brokers and borrowers of money generally naturally go to the cheapest market, and when they are forced to go into the dearest market in Threadneedle Street they go there from necessity and not from choice.

We are able now to grasp in some measure what the Central Fund is. The Bank of England, when other sources are dried up, is always able and willing to lend *at a price*. This price is regulated by the calls upon it, by the state of its reserve, by the condition of the foreign exchanges, and by a general survey of financial conditions.

The rate is an instrument for limiting borrowing, for correcting the foreign exchange, for drawing gold to England, and for replenishing its reserve, if the proportion has fallen to what is considered below the average ratio of prudence, or safety.

The loanable fund of the Bank of England, therefore, is identical with the loanable fund of what is called the outside market. It is the highest class of wealth liquefied, but to the Bank is given the sole power of attracting gold from abroad as a basis to this fund when that gold is needed.

CHAPTER X

THE CENTRAL RESERVE

The Central Reserve is the reserve held by the Bank of England. Not only is it the Central Reserve, but it must be regarded as the National Reserve, the sole reserve. This is regarded by many as the chief weakness of the banking system.

Let us first of all distinguish between reserve and reserve. This Central Reserve is the national legal tender reserve. The joint stock banks have other reserves, as we have seen, composed of the highest wealth in the kingdom, and though there may be some reason, there does not appear to me to be the soundest, deepest reason why the foundation of the system should be considered unsound because of our moderate legal tender reserve, dependent as it is upon independent forces, and because we place minor importance upon the country's store of wealth.

To me it would seem the soundest reason to plant our banking system chiefly upon the solid basis of wealth, and not let that system be in the capricious control of a force that has no direct connection with the country's real wealth, especially when we have now found it to be easily possible to meet that most remote contingency, a national panic. The nation lives like a parent whose obsession is that in some far-off day his son may meet with a serious accident that will affect his brain and make him an imbecile. What will he do, then, when his son becomes mad? He broods over the possibility; it darkens his life; it keeps away joy and happiness; his health suffers; his energies, mental and physical, become paralysed, and death gathers him while his son is still in the prime of healthy manhood.

After all, what panics have we had in this country? Not one but what has been quickly assuaged since the banking system developed into its present stage of soundness.

As it is insisted in many quarters that the system is far away from being sound enough simply because we have not large enough gold reserves, we must examine the national reserve from this point of view.

This reserve is not only the Bank of England's reserve against its own liabilities, but is the reserve against the aggregate liabilities of all the banks of the kingdom. The joint stock banks, as has been explained, keep their reserves at the Bank of England, the gold they keep in their tills and in their strong rooms being too small to take into serious consideration.

If we take the average fluctuation of the Bank of England's reserve to its own liabilities as from

40 to 50 per cent. throughout the year—this is quite a fair average variation of the proportion,—we should probably find that the proportion of this reserve to the total liabilities of all the banks would be as low as from 1 to 3 or 4 per cent. This is, of course, a very low proportion, but low as it is, it has served us well enough in the past, and as we cannot ignore experience, it should continue to serve us well in the future.

When the proportion, say, falls below 40 per cent., and is approaching 30 per cent., the Bank of England takes steps to restore it to what is considered the normal or prudent level.

The proportion, as is inevitable, begins to fall as borrowers are driven to the Bank of England when the joint stock banks have ceased giving accommodation. Though not a single note may be withdrawn from the reserve the proportion must necessarily fall as the liabilities rise. But it by no means always follows that when the proportion falls from this cause alone the Bank will raise its rate. This will depend upon general circumstances. There will be no need for the step if general circumstances are favourable, for the loan-deposits will in time be paid off and the normal conditions of the market will be restored.

As a fact, nothing is more familiar and certain in Lombard Street than these recurring phenomena. At the end of quarters, especially the March quarter, when the taxes are flowing into the Exchequer, there is a considerable amount of borrowing from the Bank of England. When the money flows back into the market through Treasury disbursements, the borrowers are able to repay their loans to the Bank.

In these times we see the Bank's liabilities grow in twofold fashion. The Public Deposits grow owing to the tax-ingathering, and the Other Deposits grow because of the borrowing on the part of what is called the outside market. At the same time, a counter-active influence is at work. As the taxes are paid in to the Government they come indirectly out of the Other Deposits, because they come out of the deposits of the joint stock banks and out of their reserves, so this puts a check upon the growth of the Other Deposits.

The Bank of England generally raises its rate when a large export of gold abroad takes place. There are two main channels through which gold flows from the reserve of the Bank of England. The one channel is that which takes gold into national circulation, to the provincial banks and to Scotland and Ireland at certain seasons of the year; and the other is the channel by which gold is taken to foreign countries.

The internal drain, as it is called, rarely has any influence upon the movements of the Bank rate. This is because gold is known to be in the country, and if it is not in the Bank's own reserve, it is practically in the total reserves of the other banks, and it will all return to the central reserve in due course.

A foreign drain of gold arises from quite other causes. It will arise from a complication of causes. Gold may be taken from the Bank in order to liquidate the country's balance of debt to other countries. It is a common phenomenon, for instance, to see at certain seasons of the year large exports of gold to New York, Egypt, and South America. These exports are expected, and occasion no surprise. But sometimes they are supplemented by large unexpected withdrawals, there and elsewhere.

As an offset to these withdrawals, the Bank can replenish the reserve by purchases of gold in the open market. Each week gold comes to London from South Africa and often from India, and if the Bank can buy this gold it may obviate the necessity of raising the Bank rate. Sometimes, however, there is keen competition for these arrivals of gold, keen competition from the Continent or New York, and the Bank may be unable to outbid its competitors.

The Bank is bound to take all gold offered to it at the statutory price of 77*s.* 9*d.* per ounce. But competition will sometimes drive the price well beyond this figure, and continental countries sometimes buy the gold at a loss, as Germany did in 1914, if they are determined to have it at any price.

For many months before the outbreak of the war, the competition was exceedingly keen, so keen that for a long period the Bank of England was unable to purchase an ounce of gold. This competition was chiefly on the part of Germany and Russia, especially Germany, thereby affording presumptive evidence of her deliberate plans for war. But this competition and buying must be regarded as abnormal.

The normal buying and the normal competition arise when gold is wanted in the normal course of trading between different countries. If, for instance, the New York exchange is driven down to such a point that it is cheaper to send gold than to buy drafts, or exchange, then gold is bought and shipped. This applies equally when other exchanges are against this country.

Sometimes we can spare the gold so well, that it is better to let it go than to keep it; which proves the futility of having a greater mass of gold in the country than the country needs. At other times we may have too little, and cannot spare more, and it is at such times that another kind of competition starts: the competition of bank rates in the various European centres.

The object of raising the Bank rate is to raise interest here. When the rate is advanced, the joint stock banks immediately raise the interest they give on their deposits, and the rate of discount simultaneously rises. The latter, however, is not always instantaneously responsive, for the rise in the Bank rate may have been foreseen for some time, and rates may have risen already in anticipation. It is often possible to judge, in the light of experience, when the Bank rate will be raised.

The competition takes the form, therefore, of raising rates of interest; in other words, of making money more remunerative here than elsewhere. The Continent will probably send gold here, or keep gold here in order to earn the higher interest, especially in discounting bills, and therefore the export of gold may be stopped, and gold, at the same time, attracted here.

It does not follow that this is the inevitable consequence. This will depend, not entirely upon conditions here, but may be ruled by conditions elsewhere. There is no hard and fast rule, no sure working of the law of cause and effect. If other countries are determined to have the gold, they will take it, no matter how high the rate may be raised here, and in latter years the rate has not been so effective, probably, as in former years.

Whether it be effective or ineffective at given moments, it is one means we possess—some call it a weapon—of trying to replenish our national reserve from other centres, and of increasing the power of the Bank to buy gold in the open market.

We do not like the reserve to run down too low, because we fancy that a low reserve would create too much nervousness in the financial community. We do not imagine it would create a panic, but it may prevent undue nervousness should the Bank take measures to stop the drain. If gold flows here, it will in course of time make bank, or market money, more plentiful and cheap.

At the same time, of course, the trade of the country is necessarily penalized. It is not good for trade that there should be frequent fluctuations in the price of loans. It affects profits, the growth of capital, and prices, and it also affects the employment of labour. If too much has to be paid for bank loans, then it becomes too dear a process to convert fixed wealth into liquid capital, for users of capital may not then be able to employ it remuneratively. And this may be a precursor to trade depression and stagnation.

If at such times we could replenish the reserves from the provision of other legal tender, it might obviate it.

If money be sent here for investment at the higher rates of interest, it will increase the Bank's reserve and at the same time increase the supply of money. As the supply of money from the joint stock banks is dependent upon these gold reserves, their gold reserves will be increased. For some of this fresh gold will find its way to the banks. They can then convert more wealth into currency, and thereby stimulate trade.

When foreigners invest their money here, they earn their profits in the same way as our banks do. Their profits are a portion of the general wealth of the community. As profits can come only from the production and consumption of wealth, and not from the void, then they are a portion of that wealth. And if profits are a constituent of wealth, even if we call them a residue of wealth, then bank profits must come from the same source, and not from space.

Foreign banks, therefore, become possessed of a part of this country's wealth, for profits are purchasing power, and purchasing power cannot be intangible; it cannot be credit. In the same way, when we invest money in a foreign country—say, Argentina—we receive the interest in the shape of commodities, that is, in the shape of the country's wealth. They are this country's profits on that loan: something tangible, something Argentina and her wealth-producers part with, and something they would retain if they did not send it here.

Therefore the interest we pay on foreign loans here must also be paid in wealth. And if foreign bankers get their profit in the shape of wealth, so must our bankers get their profits in the same substance.

CHAPTER XI

THE FIDUCIARY CURRENCY

In speaking of the fiduciary currency of the country I will confine myself for the moment to that portion of it represented by Bank of England notes. The war-emergency Treasury note currency I will deal with later on.

All countries have a fiduciary paper currency. Some have a convertible currency, others an inconvertible, and others a partially convertible; but the dimensions of this treatise cannot be expanded by a comparison of the systems of different countries. Those who desire to be assisted by comparisons must consult other works.

Moreover, I wish to confine myself to our own fiduciary currency since the Bank Charter Act of 1844. Prior to then the banks of this country were permitted to issue their own notes, and to issue them in unlimited quantities, with the provision that they were payable in gold on demand.

There were people who attributed the various crises that occurred in different periods prior to 1844 to the over-issue of these notes. It was contended that this alleged over-issue brought about an inflation of the currency and encouraged gambling and speculation. Diverse views were held then, and diverse views are likely always to be held, as to the true origins and causes of financial crises. But whatever the views or causes may be there can be little doubt, human nature being what it is, that many joint stock banks abused the powers with which they were endowed. This privilege of issuing notes to an unlimited amount is a dangerous privilege to give to irresponsible institutions, and if the power be given it must be given to responsible institutions or one responsible institution.

This view probably was chiefly responsible for the Bank Charter Act of 1844. This Act provided that the Issue Department of the Bank of England should be separated forthwith from the Banking Department. Securities to the value of £14,000,000, which included the Government's debt to the Bank, were to be transferred to the Issue Department, together with so much coin and bullion that the total so transferred should equal the amount of notes then outstanding. Notes could be demanded from the Issue Department by any person in exchange for gold at the rate of £3 17*s*. 9*d*. per standard ounce.

It was further enacted that if any banker, having the power of issue on May 6, 1844, should relinquish such issue, the Issue Department should be authorized to increase its issue of notes against securities to the extent of two-thirds of the relinquished issue.

Bankers having the right to issue their own notes on May 6, 1844, were allowed to continue the issue under certain conditions, and to an agreed amount; but no provision was made compelling them to keep any reserve against their issues either in cash or securities. Should any issue lapse from any cause, it could not be restored, and no institutions were allowed to acquire the right of issue in the future.

It will be seen that the fixing of £14,000,000 as the basis of the note issue against securities, and not against gold, was a purely arbitrary sum. No matter how it was arrived at, nothing will alter its arbitrariness, and up to the present there has been no suspicion of ill, uneconomic results from this arbitrary figure. And being an arbitrary figure there seems to be no overwhelmingly strong reason why it should not be extended within judicious limits. We must bear in mind that in 1844 national and international commerce were not on the mighty scale they are now. We must bear in mind that the population of this country and its output of wealth were greatly less than they are now, and greatly less than they will be in the future, and if this arbitrary figure was judicious and safe in the first half of the nineteenth century, and in the second half too, a higher figure should be equally as judicious and safe half a century hence.

When we deal with a currency system in an arbitrary manner and control its workings in an arbitrary way, it is opposed to a scientific way. A scientific method may be an impossible method in a delicate system like currency, and therefore, if we must rely upon arbitrariness, this method can be made elastic and adjustable in a cautious, judicious way.

In 1844 banking was in its infancy. It has grown since then, but we cannot with assurance predict what developments are ahead of it, and fifty years hence the nation may look back upon the present system in much the same way as we look back to conditions half a century ago. We find that during the past fifty or sixty years the currency system of the country has gone through a tremendous metamorphosis. The banknote system—excepting the legal tender notes—has practically disappeared, and another paper currency has taken its place.

This is the cheque currency, the real currency of the country, because it is representative of the wealth of the country, as currency should be. It grows with the country's wealth and shrinks with the country's wealth, and this is precisely the automatic function an ideal currency should perform. A perfect currency should simultaneously expand and contract with the output and exchange of wealth, because a perfect currency should be that wealth in liquid form.

Let us for a moment examine what wealth is. Wealth has been defined by many economists, and the definitions and formulas have differed greatly. But we can be more in agreement, perhaps, as to how wealth actually comes into existence. Wealth is the product of two forces, and it cannot come into existence unless these forces interact. These forces are production and consumption. Wealth is not the product of production only, nor of consumption only. We cannot consume what has not come into existence, what has not been produced. We can produce without consumption, but it is consumption that converts it into wealth.

Articles of merchandise and raw materials are produced in order that they may be consumed. They would not be produced if there were no prospect of consumption. It is consumption that confers value upon products. If products were not converted into wealth they would perish; they would be valueless. There must be a desire for them. If there were no desire for them, labour and capital would not be spent upon consuming them. A desire must exist before production, or production must bring a desire into being. And when that desire becomes active, as distinct from passive, its activity becomes consumption. We know that in states of trade depression the markets are stocked with unconsumed and unconsumable commodities, and these commodities cannot, in the strict sense of the idea, be called wealth. They are perishing, they are valueless, because no one wants them, and vendors of these commodities face loss and sometimes ruin. They try every art known to them to stimulate desire for them in order to get that desire manifested in purchasing them.

To increase wealth we must necessarily increase production and consumption; in other words, increase supply and demand. This is the economic object of all civilized nations. This wealth it is their object to convert into money, for money is the reproductive product of wealth. Wealth cannot become reproductive, except in a most limited sense, unless it is converted into reproductive form, and banks supply not the entire, but the chief machinery for changing it into this form. If, therefore, their chief function is to change wealth into reproductive form, it is not creating credit.

Money is like the fruit ripened into seed. Fruits of the earth must be ripened into seed before they can reproduce their kind. If they perish before then, they do not become reproductive. When this new seed is sown in the earth, to be gathered into ripened fruit at the next harvest, it performs the same function that money performs when it circulates. It reproduces and multiplies itself, and the harvest springing up from it is new wealth.

The more wealth, therefore, that is transformed and reproduced and that multiplies, the richer, we say, a country becomes. Therefore, it follows that the transforming machinery should work with pace equalling the creation of wealth if the country is to reap the best harvests from its work. For every pound's worth of wealth coming into existence the means should be provided for transforming it into a pound's worth of money.

So far, the best means discovered is the cheque system. No legal tender system, based upon gold, could provide these essential means, because gold is not provided sufficiently, and cannot be provided sufficiently. The machinery we need can be made with no precious metal. If we desire perfect machinery, it is indisputable that no machinery could do the work so efficiently as paper machinery.

The paper currency system is, therefore, a great advance upon the old banknote system. It is transformed wealth, and as the cheques represent the deposits, rising and falling in amount with them, then the deposits must be transformed, reproducible wealth. The note system, based on no wealth, was credit.

Returning to the Issue Department of the Bank of England, we see that £11,015,100 of the total note issue is based upon the sum of money owing by the Government to the Bank, and that £7,434,000 is based upon other securities of a gilt-edged order, making a total of £18,450,000. The balance is based pound for pound on gold.

It will be seen, therefore, that if every note was presented to the Bank to be converted into gold, over £18,000,000 of these notes could not be converted. Some have suggested that in that event, in order to provide the gold, the securities could be sold for gold, the Government debt could be converted into bonds, and they also could be sold. But as this need could arise only in a panic, when every one clamoured for gold, and all who had securities were trying to sell them for gold, the Bank of England would find it impracticable to sell securities for gold. Such securities, if they are to be sold at all, must be sold at other times, and the gold must be acquired then if the note issue is to be made absolutely convertible.

Personally, I think the need is too remote, too much in the realm of dreams, to be entertained gravely. The gold could perform better services to the community than to be hoarded in this fashion.

Since the year of the Bank Charter Act we have had three serious panics in the country. Now the Act was passed to prevent panics. As it did not prevent panics, the theories on which the legislation was based proved untenable.

Panics are not automatic. It was probably thought by many that they were, and that they could be ended in automatic fashion. It is impossible to foresee how a panic will arise. According to every plausible theory, a panic should surely have been the immediate consequence of the European War. Not only should a panic have arisen then, but it should have been by far the worst panic this country has ever faced. But no panic resulted, and all plausible theories have been inoperative.

Previous panics have been allayed by the actual suspension, or by the potential suspension, of the Bank Act. That is to say, by the knowledge that the Bank of England would have power to issue note currency to any amount, unbacked by the deposit of gold. In other words, by the knowledge that sufficient legal tender would be provided, *at a price*, for the needs of all solvent people.

The need, then, is currency—just as a person prostrated by fever needs a tonic to restore him to convalescence. When the need is rightly met, all is well. To withhold the remedy would feed the disease. Instead of being checked, the disease would grow.

Panic is a disease of the mind, and it most often proceeds, like disease of the body, from excessive indulgence in a disease-producing cause. It will suddenly arise as an offspring of wild gambling and frenzied speculation, and it will infect people in a healthy condition who fear they will be victims of the scourge. And it is not only the duty of the State, but the highest wisdom of the State, to come to the help of the healthy.

We have seen how the State has performed this duty in the past, in the days when banking was immature, and we have seen how it has performed its duty, with perfect and instantaneous success, when the country became involved in the greatest crisis it has ever faced. And this is an experience from which, it seems to me, valuable lessons may be learnt.

CHAPTER XII

BANKING WEALTH

Having proceeded so far we may now be able to test, perhaps, with more sureness the kind of wealth a bank does transform, and the kind of wealth it should transform. On the character of the wealth sound banking should depend.

Wealth has degrees. There is the highest wealth and the lowest wealth, with infinite degrees between. How are we to distinguish the highest from the lowest wealth, to know the quality of that product which comes into being from the satisfaction of desire? I think it is *time* that will enable us to judge. That is to say, wealth is to be judged by its enduring qualities. The highest wealth is permanent, or lasting wealth; the lowest is fleeting, or transient wealth.

The most permanent wealth is food and air, because without this wealth humanity would perish, and banking systems with it. But air cannot be transformed, from reasons well known; but food can, and food satisfies the most lasting of human desires. Only universal death can destroy that desire.

Let us examine with closer scrutiny the typical bank balance sheet given in a former chapter. First of all comes gold. Now we regard gold as the most permanent form of economic wealth. What alone gives it this permanency is the law. It is not inherently permanent; inherently, it is no more permanent than are diamonds or corals. We know that the quantity of gold in the earth is limited, and that gold is perishable, and that it cannot be got below certain depths, because men cannot live beyond those depths. The time will come when gold will be exhausted, and it will then be necessary to find another substance to perform the functions allotted to it. As law has made it permanent wealth, so law could to-morrow, by its arbitrary decree, make it impermanent wealth. If gold were allowed to be, like diamonds, a mere commodity, then it would come in a low degree of wealth.

It is important, therefore, to be conscious of the arbitrary power that makes this low degree of wealth permanent wealth. Because law has decreed that it shall be in the highest class of wealth, then it comes first amongst a bank's assets, because this is the class of wealth that in certain circumstances would have to satisfy the strongest of human desires. Is it the wealth that a bank transforms? It is transformed, because though it lies in a bank's vaults, it is transformed into the same substance as other wealth and thereby becomes fruitful. In this manner it is able to multiply itself, not into gold, but into other forms of wealth. It multiplies itself into gold indirectly by stimulating and helping the production of it. When gold is brought to the Bank of England and converted into notes, it performs the same services as when it is taken to banks and is converted into that other form of paper currency, cheques. The gold gets into circulation, and is just as fruitful though it be circulated in the form of coin, instead of notes. It makes no difference whether this gold is retained in the vaults of the joint stock banks, or is placed in the keeping of the Bank of England. In fact, if it is placed in the keeping of the Bank of England, it can be made more fruitful, for the Bank of England re-utilizes it, and increases the potential amount of currency based upon it.

The next asset is the money at call and short notice. The money at call is, as already explained, practically the money lent to bill brokers, and forms a part of what is called a bank's liquid reserve. If in a time of grave urgency the bank "calls" this money from the bill brokers, it simultaneously "calls" in its loan deposits. It is understood that in those moments the brokers would be unable to repay their loans if they could not get the money from the banks. If, therefore, they cannot get the money from the banks, how can this portion of the deposits be withdrawable from the banks? If they were withdrawn, they would have to be paid in again the moment they were withdrawn.

We know that in those times, however, the loans would be called and the bill-brokers would have to borrow the money from the Bank of England. And this money being paid over to the creditor bank, the deposits would automatically fall, and the proportion of the gold reserve to the other deposits would automatically rise.

It is a conviction in Lombard Street that in those times the bill-brokers could get no money from the joint stock banks. That being so, what is called the credit superstructure does not appear to be so unwieldy as it looks.

The money at short notice presumably represents the money lent to the Stock Exchange at settlement times. Those to whom the money is lent owe the money to the bank, and when the bank asks for repayment the money must be got elsewhere, and it can only be got from the Bank of England on a certain class of security. Against these two classes of loans, security is lodged with the lending bank.

What class of wealth is this? The security for the money at call is of a higher class than the security for the money at short notice. The latter security consists of all kinds of Stock Exchange securities. The most fleeting kind of wealth we may call the wealth brought into existence by speculation. It is nevertheless wealth, for it satisfies a desire and is exchanged. But as this desire is quickly destroyed, then the wealth is either totally destroyed or partially destroyed with it. Even war produces wealth, but as this wealth satisfies only a fleeting desire its reproductive power is transient. It is like scattering seed on the rocky ground, little of which is able to take deep root. The harvest is scanty, and like all scanty harvests, it brings want and ruin in its train. It lessens the reproductive and, therefore, the consumptive power of labour, and thus directly affects harvests elsewhere.

Banks, therefore, in selecting the wealth constituted in Stock Exchange securities must carefully discriminate between the lasting wealth and the fleeting wealth; in other words, between high-class investment securities and speculative stocks and shares. This, of course, calls for intimate knowledge and sound judgment. These are qualifications all bank managers must possess. If they possess the qualifications and exercise the soundest judgment in selecting the highest type of wealth, then they put into practice all the principles of sound banking.

Now, there is no suspicion that these qualifications are not possessed and that this sound, selective judgment is not shown by the managers of our great banking institutions. This, therefore, is the basis of the community's confidence in them. That confidence is justified.

We need not minutely examine the bank's "investments." Not only do these constitute wealth of the highest class, but it is wealth not represented by loans and immediate liabilities. They may justifiably and safely be placed secondary only to the bank's gold, forming a portion of its liquid reserve. In the hour of danger or peril to the community, it should be the duty of the Government, should the need arise, immediately to transform this wealth into legal tender money.

Bills discounted represent another form of the highest wealth of the community, and the banks still adhere to the soundest principles in discounting them. These bills represent that class of wealth that has to satisfy the most enduring desires of the human race. Here, then, we see the best judgment at work. There are, of course, many varieties of bills of exchange. They may be placed in different classes, or categories, according to their endorsements. What is called in the market the "finest" bills are those endorsed by the leading banks, and they are called clearing bank acceptances. Banks accept these bills for small commissions, and they are more readily discounted then in the market, simply because they have behind them the highest class of wealth. Then there are bills accepted by merchants and other houses or firms which are not of the standing of the clearing banks. They are of an inferior category. The value of the acceptances and endorsements, and therefore the value of the bills, depends greatly upon the standing or reputation of the acceptors.

Now the banks discount, as a rule, only the "finest" bills, that is, the bills with the most reliable acceptances, bills accepted, say, by other banks. In exercising this discrimination they exercise the soundest judgment, and nothing higher can be expected of them.

Such bills as these are readily discountable at the Bank of England, and there is no sound reason why, in certain given circumstances, they should not be discounted even by the Government through the agency of the Bank of England. It might be in the interests of the country to do this, especially as the machinery could immediately be set in motion. And if the machinery could be set in motion immediately, then the bills should be as good a reserve as legal tender.

It is to be believed, too, that the soundest judgment is shown in the selection of the composite wealth aggregated under loans and advances. These represent the largest aggregate asset, but, at the same time, they represent the greatest proportion of the loan-deposits, deposits repayable to the bank. Such loans as these should be made of very short duration, renewable, of course, but renewable for short periods. Is it possible to make some kind of legal provision whereby in the event of a remote disaster such as a panic these deposits, representing liabilities to a bank, should be discriminated against and not be withdrawable on demand? Could not the position be made clearer, as I have hinted already, by segregating the deposit and current accounts? Were this hint adopted the amended balance sheet would appear somewhat as follows :—

Dr.

	£	s.	d.
Capital Authorized, £30,000,000			
Capital Issued	3,000,000	0	0
Reserve Fund	1,125,000	0	0
Current, Deposit and Other Accounts	8,908,141	17	8
Loans on demand and on short notice due by customers, as per contra	5,644,476	5	1
Bills discounted, as per contra	6,811,870	13	8
Loans and advances due by customers as per contra	16,218,748	12	6
Acceptances on behalf of customers	3,153,328	7	11
Rebate of interest, etc.	53,807	1	3
Profit	225,676	10	1
	£45,141,049	8	2

Cr.

	£	s.	d.	£	s.	d.
Cash in hand and at Bank of England	5,996,667	14	8			
Money at call and short notice as per contra	5,674,476	5	1			
				11,671,143	19	9
Investments				6,260,705	3	5
Bills discounted as per contra				6,811,870	13	8
Loans, advances, etc., as per contra				16,218,748	12	6
Liabilities for Acceptances as per contra ...				3,153,328	7	8
Freehold and leasehold premises				1,025,252	10	11
				£45,141,049	8	2

The answer might be that this would look too modest a balance sheet, and would give less scope for boasting of the growth of deposits. The deposits now look attenuated at less than £9,000,000, but look at the cash reserve against them! Close on £6,000,000! True, this cash melts at the Bank of England, but it gives the balance sheet a truer and stronger appearance. If it be sincerely desired to give greater enlightenment to the public, as many contend, then further enlightenment can be given in this way, which is by no means the last word in improving a balance sheet.

But there is too much competition between banks; too deep a jealousy and too keen a rivalry. This keen and jealous competition may be well amongst merchants and tradesmen, but it seems neither healthy nor dignified amongst banks. The work they do for the nation is too vital for this kind of competition to be encouraged. Perhaps it would be in the best interests of the nation if banks were nationalized, and made branches of a National Bank.

The main object of banks should not be that of the ordinary tradesman, who boasts loudly and sometimes vulgarly of the trade he is doing. There should be no incitement to this in banking, no incitement to dilate composite deposits, to swell profits and to strain dividends. With all this rivalry and incitement, this desire to gratify shareholders, it is wonderful how cautiously and soundly managed banks are. There should be no hesitation to perform their functions within the limits of prudence, but, at the same time, there should be no undignified display and boastfulness. This does not make the deep impression some imagine. On the contrary, it tends to generate the suspicion in many prudent minds that caution and safety are being unduly strained.

The public have not failed to notice that contrary policies have been adopted by the great banks in dealing with their profits for the year of crisis, 1914. Some reduced their dividends and others maintained them. Some allowed liberally for depreciation, and others allowed for no depreciation at all. Some provided for the future, others were content to let the future take care of itself. And what conclusions can the public draw from such divided counsels and irreconcilable policies? Able to agree as they often are on common policy, they were unable to agree on so important a policy as this. As one bank manager said to the writer, when discussing this matter: "Even if the dividends were earned, it was a matter of sound expediency in times such as these to reduce them. It would have strengthened their positions and at the same time have made a better impression on the public." And there was much wisdom in this view.

Applying, as we have done, severe tests to bank management, it emerges from them with great credit. Sound as the management is no bank manager and no bank directors would be vain enough to claim that ideal soundness has been attained.

CHAPTER XIII

ELASTICITY OR INELASTICITY?

One of the great subjects of controversy, on which it seems impossible to arrive at a common agreement, is whether the so-called loanable fund is elastic or inelastic. It is admitted, I think, in a general sense that in order best to help the trade of the country, it should be elastic, that is, should be able to meet all the needs upon it. This certainly should be the province of banking, and, what is more, it should be the province of Governments to provide sufficient money to meet the expansion of trade. It would be a foolish policy to shackle and bind trade, to arrest its growth, by restricting facilities for its growth. It would be like a foolish parent binding the limbs of his child to stay their natural growth and to keep him a dwarf and a freak, unable to do the work of a mature man.

As the banking system practically performs the duties which in its non-existence would have to be performed by a Government, then it devolves upon this system to feed and succour commerce and to give it every facility and every means for expansion. When

I said in Chapter XI that the transforming machinery should work with a pace equalling the creation of wealth, it was tantamount to the view expressed by others that the loanable fund of Lombard Street should be elastic.

Instead of calling it a loanable fund, a vast pool of money into which borrowers dip, a pool always filled by a perennial spring, I prefer to call it machinery for transforming fixed wealth into mobile capital, or currency. When I take my wealth to a bank I take it there because I cannot use it fruitfully as capital in its fixed form. As I wish to use it fruitfully the bank temporarily changes it into money for me, and in this new shape I can make full use of it.

Now, all who have practical experience of the banking system know there are times when the banks refuse to perform this office for wealth possessors. The machinery comes to a temporary stop. When we inquire why it has stopped, we learn that it is because the proportion of the reserve to the liabilities has fallen to too low a point. Others would say, it is because the pool had been drained too far, was being dried up, and that time must be given for money to flow in again. If we liken it to a pool we find that instead of it having been drained, it is really over-filled, and that what the banks desire to do is to stop the overflow and to let the water sink. The banks say they have lent too much, and must now lend no more for awhile; so they not only stop lending, but call in loans, which again shows that the fund is overflowing; it must be allowed to subside.

We also see at times, when the fund is overflowing, that banks are so eager to lend, that money is said to be a glut on the market and exceedingly cheap. It is offered at nominal rates of interest. Why, then, are there times when banks are eager to lend when the fund is supposed to be overflowing, and times when, with an overflowing fund, they refuse to lend? Why is it that at times when the fund is low they are willing to lend, and why at other times when the fund is low they are unwilling to lend?

These phenomena prove, I think, that it is not a fund of money in the real sense of the word. We can never tell merely by looking at the aggregate deposits of the banks whether they are able to lend at any given moment or not. We can easily delude ourselves by looking at the bulk of that fund. What governs what we may call the transforming capacity of banks is the quantity of gold they individually possess and general financial and international conditions. In times of uncertainty and apprehension, no matter from what circumstances or events these arise, banks may refuse to lend, no matter what the condition of the so-called loan fund may be. So far from lending when their deposits appear to be very high, they are anxious to diminish these deposits and gather in gold.

It follows that the more gold they hoard the less becomes the loanable fund. Therefore the more legal tender they accumulate at these times, the less money they lend. Which seems anomalous and paradoxical. The more money banks have at certain times the less they have. When the hour of nervousness passes they begin to lend again. The money in the shape of gold diminishes in proportionate quantity, therefore the loanable fund of Lombard Street apparently increases as gold apparently diminishes.

This fund is, at times, like a spring in a desert. The thirsty traveller sees it shimmering in the distance and hurries towards it in profound gratitude, thankful that his thirst is to be slaked and his sufferings are to be relieved at last. But just as he is about to put his lips to the tempting waters, a voice of warning stops him. He is not to drink, for the waters are too precious and must be preserved. Not a drop can be spared. So he does not slake his thirst, and perhaps afterwards succumbs to the torture he is suffering.

The spring is there, but he is forbidden to drink!

In the banks the source of money is there, but the gold must be preserved, and the community must depart unsatisfied, no matter what the consequences may be. The banks will not lend because they must keep and increase, not their deposits, their so-called loanable fund, but their gold.

These deposits, then, are not strictly a loanable fund, otherwise the more they grew the greater would be the fund. In fact, the fund would be inexhaustible, increased and not diminished by the demands made upon it. We know they are increased by loans. Therefore the best means of increasing the fund would be by increasing the loans, and we could then witness money actually piling up mountain-high in our midst. This could put all fables of money-making by magic into the shade.

Instead, however, of increasing the fund by lending as fast as physical resources will permit, the banks adopt the contrary policy. They stop making loans and simultaneously diminish the loans they have already made.

Whatever views the public may hold, bankers labour under no delusions as to the real nature of the loan-fund. They know well enough they do not lend out of that fund at all, for if they lent out of it they would inordinately increase it by lending and so make more profit. It helps to shed more light on the nature of the deposits. Why are banks anxious to diminish the deposits in times of anxiety and apprehension? That is to say, the loan deposits, and not the pure deposits? Why are they anxious to diminish the aggregate of the so-called money fund?

They wish to take away from their borrowers their power to withdraw, even temporarily, gold. If they take this power from them the banks know they will be in a far stronger position, even should the deposits diminish by fifty per cent. In their own language bankers say: "We must strengthen our cash position." This means, then, that the cash fund and the deposit fund are not one and the same thing. The cash fund is strengthened by weakening the deposit fund. Cash grows as the loanable fund falls.

If the loan deposits are thereby greatly diminished until the deposits are mainly what I have called pure deposits, it shows how the banks safeguard themselves when they think danger is coming. Their assets change. Gold takes the place of other wealth, and the banks are able the better to meet a run on the part of their depositors. They have automatically met the danger from the presence of the loan-deposits, and now they have only to face the danger from the pure deposits. They have fortified themselves for this by differentiating between the characters of their deposits, which in their aggregate are misleadingly called the loan fund of Lombard Street. The gold is the real lending fund.

This is done, too, often at a time most unfortunate for the general community. It is done at a time when the community should receive more and not less help from the banks. Banks ought to lend more freely in times of crisis than at other times, for it is that freer lending that will help the country to meet and get through the crisis. To stay help, to withdraw help already given, is to increase the difficulties of the general community, to feed alarm and apprehension, to aggravate the crisis. The banks do, therefore, what seems wise, perhaps, for them, but unwise for the community.

They are not to be blamed so severely as some imagine. They have to look to the law in the same way as the individual has to look at it, and they cannot be blamed for acting in accordance with law. It is, perhaps, the law that is unwise and not the banks. Communities must abide by the laws they make, and by the limited freedom laws allow. Laws are not the last word in human wisdom. Laws can be modified and improved upon.

Banks have to work within restrictions imposed upon them by the law, and if these restrictions become harsh in times of difficulty and crisis, then it is the law that is at fault and not the banks.

Banks must pay out legal tender to their depositors on demand. The Government restricts the supply of legal tender by enacting that gold alone shall be legal tender. Therefore the Government is not irresponsible for the manner in which the machinery works in all sorts of conditions.

If the supply of legal tender is restricted, no banking system, or any system like it, would be possible if the reserves in legal tender had to be equal, or nearly equal, to the deposits. If the banking system is to be worked in the highest interests of the community, then the gold reserves must necessarily be greatly less than the deposits. If the people of this country took to hoarding gold, then the banking system would eventually come to a stop, which shows again what the nature of the loan fund is. There can be no loan fund without gold, and in that case there could be no currency such as the cheque system of this country.

Ought we, then, to reform and modify the law? I can imagine the time coming when legal tender will not be confined to gold. But this is far distant. I think reform can come in the manner in which we have experienced it since the war. The Government could ensure free working in times of apprehension and crisis in the manner in which it ensured it in August, 1914, by the creation of emergency currency. What can be done successfully and beneficially once can be done again.

If there are times and occasions when banks stop lending and when they call in their loans, then it follows, reverting to market parlance, that the loan-fund is inelastic. If it cannot always and invariably respond to needs, then it cannot conform itself to varying conditions and circumstances. This fact, therefore, supports the contentions of those who say that the fund is inelastic. In my way I say the machinery is far from perfect. It always works with difficulty at the very time when it should work with ease. It will come to a dead stop at the moment when it should be working at high pressure.

To make the position clearer I will recall what Mr. A. C. Cole said in his controversy with Mr. Tritton.

"I entirely disagree," he said, "as to the inelasticity of this fund. My view is that the inelasticity is apparent, but not real. By this I mean that it is inelastic at any given moment because, in these days of competition, bankers lend all their available surpluses; but to say that the short loan fund is permanently elastic is quite beside the mark. What does inelasticity of the market mean? It means the want of power of the market to adjust itself to pressure or tension. Now, take the discount market. The supply of money always adjusts itself to the demand. Except in times of panic, good bills are always discountable in London. This Mr. Tritton practically admits in his paper. As regards the large amounts of Treasury bills, Exchequer bonds, etc., of which there has been a marked increase in recent years, owing to the [Boer] war, Mr. Tritton says it is not very clear from what source the funds so invested have arisen. This gives away his case, for it is an admission that the money has been forthcoming. In other words, the supply in the short-loan market has been increased because the demands upon it have been larger, and this will always prove to be the case. The short-loan market is really augmented quicker than any other fund. It is quite immaterial whether the funds belong to owners in this country or to capitalists abroad. The fact remains that the money is available when wanted, or, in other words, the short-loan fund is so elastic that it promptly adjusts itself to the demands upon it, though temporary recourse to the Bank of England may be necessary, while the adjustments take place. The apparent inelasticity of the fund is evidence of what I may call the efficiency of the short-loan market. By efficiency I mean that the total available funds in the market are in constant use. This is not a bad thing for the community, but it implies that on the least strain or dislocation of the machinery of the market, recourse has to be made to what is then the only available source of supply—the central institution. But as the Bank of England is always willing to discount or lend upon good bills, the supply of money in the market is never exhausted. It is simply a question (except in times of panic, which we are not here considering) of the rate of interest whether the money is forthcoming."

I cannot agree with Mr. Cole. If he admits that there is an exception, and the exception works in a time of panic, at the very moment when it is vital to the community that the exception should be removed, then he gives away his case. He admits that the supply is not inexhaustible, for it suddenly dries up when the need is greatest. To say that it is "inelastic at any given moment," that it is not permanently inelastic, and that there are times when borrowers are driven to the Bank of England, is inconsistent and illogical. If there are moments when it is inelastic, then it cannot be permanently elastic.

When soon after the present war complaints were made that banks were not lending freely, and when a warning to them came from the Chancellor of the Exchequer, it furnished further proof of inelasticity in times of difficulty and pressure.

Let us now examine further the machinery of the Bank of England and the rate of interest.

CHAPTER XIV

EXHAUSTIBILITY

If what is called the loanable fund were perfectly elastic and "promptly adjusted itself to the demands upon it," how is it that the value of money, called the rate of interest, is not more uniform? It certainly should be more uniform if it were a fund that automatically responded to the demands upon it, increasing as the output of wealth increased, decreasing when the output of wealth fell off. In a perfect system this would certainly happen; but sound as banking may be within its limitations, we must admit that it is far from being a system of perfection. The fact that the rate of interest is not uniform, that it rises and falls in a capricious and not uniform way, is further proof that the fund is not, as it should be in a perfect or improved system, elastic.

Experience shows us clearly that as demand grows the potential supply diminishes; therefore it cannot be a perennial, inexhaustible fund. If bankers find that the demand is growing, they advance their rates of interest. In other words, they demand a larger share of the profits of the community. They have two objects to serve in this. They desire to increase their own profits and they desire to check the demands upon them. From their point of view, it is better to lend a little at a high rate of interest than much at a low rate. In their annual or semi-annual speeches bank chairmen are pleased if they can show their shareholders that during a certain period the rate of interest has been high; for it is evidence to them that circumstances have been in their favour; that they have done good, profitable business. They lament times when interest has ruled low. And interest rules low when the fund is said to be overflowing, when the banks cannot lend as much as they would like. There are, however, as I have already pointed out, exceptions to this. It is no invariable rule, or law, or sequence, whatever we may please to call it, that interest is low when the fund is overflowing and high when the fund has fallen. Interest is governed by many causes extraneous to the power of banks to lend, and these causes often arise in an unforeseen, capricious way.

We may say, however, while recognizing the effects of irregular, uncertain causes, that the value of what is called bank money is affected by the well-known law of supply and demand, the law that affects the prices of commodities and of labour. In a general sense, when the supply of money is greater than the demand the rate of interest falls; when the demand is in excess of the supply the rate of interest rises.

Demand increases when borrowers multiply. Borrowers go in growing numbers to the banks. As the loans thereby increase, so the deposits increase. If, therefore, the deposits compose the loanable fund, the loanable fund increases. At last, however, the loanable grows so large that the banks say they can lend no more. Lend no more, when the loanable fund is greater than ever? But the banker shakes his head. He knows that though the loanable fund is greater than ever in appearance, it is smaller than ever in fact. He knows that the greater the demands made upon him the more his power of lending decreases, until the moment arrives when he has to say "Stop!" He sees that as the fund rises the proportion of the gold reserve falls. So he stops lending, lets his loans run off, whether secured on bills of discount or securities, and waits until that so-called loan-fund falls. And when it has fallen, when the loan-fund is less, then he can lend again, although to the uninitiated he has apparently less to lend.

How, then, does this fund promptly respond to the demands upon it if the supply of gold flowing into the banks does not keep pace with those demands? If the supply of gold, not loan-deposits, kept pace with the demands then, and then only, could the fund "promptly adjust itself to the demands upon it."

It is elementary knowledge in Lombard Street that when the Bank of England is able, week after week and month after month, to buy up all the South African and other gold coming into the bullion market, that it will tend to increase "credit" and depress loan-rates. We know that the gold will increase the supply of market money more surely than the growth in the country's wealth. This is because we know the gold will eventually find its way to the banks, increase their gold reserves, and enable them to lend more.

It proves, then, that the working of the fund, elastically or otherwise, is dependent upon the flow of gold into the Bank of England. This is because the law has decreed that gold shall be legal tender. Therefore, the supply of money for the help of commerce, for the fettered working of the banking system, is dependent in the ultimate resort upon the law of the land. It is not dependent in the ultimate resort upon the law of supply and demand, because a more powerful law controls the economic law. If the law, then, controls the supply of money, then the law must control the supply of wealth, and the law must control ultimately the prices of labour and of commodities.

When liquid capital is provided by the banks a charge is made for it. This rate of interest not only affects the amount of capital that shall be furnished, but it must affect the prices of the product that comes into existence from the use of that capital. If the merchant has to pay a high price for that capital, he must ask a higher price for his product, for he will not use that capital unremuneratively. The greater the abundance of capital employed in the country the greater is the quantity of wealth produced, and the cheaper the capital the lower are the prices of its products. That is to say, the greater are the chances of the community partaking of a larger share of that wealth. If they partake of this larger share it simultaneously increases the collective, or aggregate, powers of consumption.

It is indisputable that in times of trade activity the demands for capital grow. Times of depression are coincident with a decline in the demand.

In this chapter I am but repeating much of what I have urged in former chapters, but I am naturally anxious to make my argument as strong as possible by the help of wider and, I trust, clearer illustrations as I proceed. When we travel over a wide tract of country our vision is too weak to take in all its topographical features. We can see general features, but not the minute features which the botanist and the geologist would examine. The poet would see what the geologist would not see, and the botanist would see what would escape the naturalist.

So when we take a survey of the economic and financial world we see a mechanism which is not the same when examined minutely as when looked at from a distance. When we look at it from afar we cannot see those defects which on close examination we are able to find.

If rates of interest arbitrarily rise and fall, and the supply of capital is controlled in an arbitrary way, the general well-being of the community must be affected. We suffer when the monopolist takes advantage of the helplessness of the community to raise prices. We suffer when shipowners take advantage of accidental circumstances to raise freights and the price of food. We suffer when the colliery proprietors in the depth of winter raise the price of coal. We suffer also when the banks raise the rate of interest, thereby raising prices and affecting employment.

When prices rise, as they have almost uniformly risen in recent years, many theories are advanced as to the causes of this. Some attribute it to the increased output of gold. They mean by this that the output of gold has increased so greatly that more money, or more purchasing power, is placed in the hands of the community. Producers, observing this, raise the prices of their commodities. If this were so, the advance in prices would be general, and we should be no worse or better off than when prices are low. Wages would inevitably advance if prices were affected by this universal, not local cause. But it is asserted that wages have not advanced uniformly, while tradesmen on their part declare that their profits have fallen. Workmen and tradesmen alike say that they are poorer than they were ten and twenty years ago, and the housewife declares that a sovereign now will only go as far as fifteen or ten shillings went years back.

It is impossible to prove that such a rise is a consequence of an accelerated production of gold. It is an hypothesis, and an hypothesis it will remain, for it ignores a multitude of causes more important in their aggregate effect than gold.

It does not follow, then, that because at given moments capital may be dearer than at other moments, a general rise or a general fall in prices will immediately follow. Neither can we lay it down as an indisputable axiom that a 5 per cent. interest, say, is detrimental to trade, and a 2 per cent. interest is beneficial to trade. But we can say, I think, that a very high rate of interest is harmful to trade, particularly if it be prolonged, and that a constantly fluctuating rate of interest is more unfavourable for trade than a uniform rate, or a rate that varies but slightly.

A high rate of interest means dearth of capital, and dearth of capital must affect production and consumption and the output of wealth, just as a dearth of seed must affect the coming harvest. The community, therefore, must necessarily suffer from a dearth of capital, and as the community is largely dependent upon the banks for the supply of capital, then it follows that it is best for the community that the supply should be constant, that it should adjust itself to the demands upon it. If it could do this, then the rate of interest would tend to greater uniformity. At any rate, it would not rise and fall so capriciously as it does do. If it varied it would vary within narrower compass.

If this could be accomplished, if the supply of capital were less dependent than it has been and still is, upon extraneous circumstances, we may see steadier prices, and perhaps one happy effect would be less labour difficulties and less strikes. Strikes are, in many instances, the effect of constantly fluctuating prices. But the supply and price of capital would not alone put an end to fluctuating prices. I merely hint that it might help to correct those frequent and extreme fluctuations that cause so much discontentment, and so much envy, and so much misery.

It would be interesting to speculate what would happen if the Germans conquered us and took away our colonies and our goldfields. If Germany restricted or cut off the supply of gold to this country, what would happen to our loanable fund? How would it affect what we call the creation of credit? How would it affect the supply of capital? If the law remained as it is, and the banks could get no more gold reserves, then there would be no loanable fund and no supply of capital. But the law being what it is, the supply of capital is dependent upon the supply of gold.

Mr. Cole admits that on the *least* strain, or dislocation of the machinery of the market, recourse has to be made to what is then the only available source of supply, the central institution, where it is simply a question of the rate of interest whether the money is forthcoming. After admitting, then, that the machinery can break down and that then there can be but one source of supply, that supply can only be obtained at a higher price. If it is to be obtained at a higher price, then it is to be obtained at the general expense of the community. If capitalists will not pay that higher price, then this is tantamount to a lessened supply of money. As the Bank of England, too, will not lend on the same class of wealth that the other banks will lend on, a vast mass of wealth is excluded. Therefore a vast mass of wealth cannot be transformed into liquid capital. If no one will liquefy this wealth, then the production of liquid capital must be limited, and that capital must remain in its fixed form till the other banks restart their transforming machinery. If this be so, then the supply even from the Bank of England is not, as Mr. Cole would have us believe, unrestricted and illimitable. It is, after all, a restricted supply, regardless of the entire claims or needs of the community, for narrower discrimination is practised. The Bank of England may always be willing to discount or lend upon good bills. But there are other bills of a lower grade than this class of bill, and there is a vast quantity of wealth that is rejected by the Bank. If the lending is limited to good bills, and if the quantity of good bills is limited, then the supply of money from the Bank must be limited. To say that the supply is inexhaustible is, therefore, misleading.

We know, too, from experience that when the Bank has been lending for a time on good bills it has had at times to check these loans. And in order to check them it has raised the Bank rate. Why has it raised the rate? To replenish the supply that is said to be inexhaustible. Mr. Cole says it could get that supply from abroad, and therefore the fund would be replenished inexhaustibly. If, however, the supply from abroad were checked, as we can imagine it could be, would the fund be inexhaustible then? It would be interesting to know if, should the Bank Act be suspended in certain circumstances, this would fall in with Mr. Cole's idea, or conception, of inexhaustibility. Also if the creation of the Treasury notes falls in with that idea.

We know, of course, that since the war the Bank has lent enormous sums of money by discounting pre-moratorium bills of exchange. This may seem to furnish proof of the inexhaustibility of the fund. But while it has been lending it has been simultaneously receiving gold. There has been no competition for the gold from South Africa and elsewhere, and therefore the Bank has been able to procure it in the usual way. Then New York has been obliged to liquidate its indebtedness to us in large amounts of gold. But with all this, the proportion of the reserve has kept well below the normal. What would have happened had the rebellion spread in South Africa, and had the mines there been closed down indefinitely?

Even as it was, the Bank rate had to be maintained at an artificially high level compared with loan and discount rates in the outside market.

CHAPTER XV

THE THEORETIC LINE OF SAFETY

It will be clear, I think, from the analyses in the foregoing chapters that banks have not only a delicate, but a most difficult task to perform. So difficult is the task that it is impossible to give satisfaction to all classes of the community. They have to give satisfaction to borrowers, to their depositors, to their shareholders and, at the same time, to the critics who say they are ever alert and watchful that they are trading within safe limits.

What critics mean when they talk of safe limits they would not find it easy themselves to define with exactness. They know what they mean by sound principles of banking so far as lending on sound security goes. They know what they mean when they say that a bank must not engage in speculation, and that it must carefully scrutinize every class of wealth on which it lends. This seems to me a tacit acknowledgment that banks do not create credit in the sense that many suppose. It would come nearer the conception of credit creation if banks were allowed to speculate and attempt to create wealth out of nothing.

These critics lay it down as a first principle that a bank must have adequate gold reserves. If they do not have adequate gold reserves they put too great a strain upon the credit structure. But they cannot agree, they cannot even dogmatize, as to what an adequate reserve is. Yet the banks are adjured to give all the help they can to the trade and commerce of the country. If they refuse that help they come in for severe condemnation. They are condemned by the academic critics and they are criticized by the traders and criticized by their shareholders, and had not nature fortunately given bank managers very thick skins—which thicken daily in the environment in which they live—they would be deserving objects of commiseration. As it is, no one pities them, and in time they become accustomed to an atmosphere unwarmed by mercy. I have, indeed, met people who regard bank managers as little removed from callous brutes, men utterly indifferent to the appeals of those seeking to make their bit in a highly civilized community.

After all, the lot of a banker, like a policeman's, is a hard one, and he is very roughly handled at times by friend and foe alike: the friend beseeching him to look to his reserves, the foe caring for nothing so long as he can get his loan.

Why does the friend beseech him always to have an adequate gold reserve? Because the hour may come, suddenly, swiftly, without warning, when the phlegmatic Britisher will be in the grip of madness. The man who has calmly and resolutely faced the greatest crisis in his life; the man who has laughed at Zeppelins and air craft, whose courage has risen with his danger, is in a moment, in the twinkling of an eye, to lose his reason and go amok amongst the banks of the country, smashing everything in ungovernable fury. There will be no restraining him in that mad hour. No force will be powerful enough to bind him. He will wreck, and the populace will gaze on helplessly, until all are buried beneath the ruins of a once beautiful and mighty fabric.

It is because we fear this mad Samson will pull down the pillars, that we would make those pillars too strong even for his mighty strength. He would strain himself against them in vain. They would defy even the supernatural strength of madness.

It is feared that the reserves will not be large enough to meet an outbreak of panic. As the banks are bound by law to repay deposits in gold, or legal tender, if they have insufficient gold or legal tender, they will come to smash. And if one great bank falls, all will fall. The mighty structure will then be a heap of ruins.

Let us, then, assume that some day, we know not when, it may be to-morrow or it may be generations after we are dead and forgotten, a panic *may* come. It is said that the panic will surely be hastened if the highly-strung, emotional, fear-stricken Briton *thinks* the gold reserve is falling too low. He may never know for certain whether or not it is too low. But in some unfortunate moment, when, perhaps, he is a little out of sorts, he may *think* it is too low, and then it will be too late. Without staying to reason, without staying even to consider whether his disorder is physical or mental, or whether a sluggish liver has blurred his vision, he is at the bank doors before the maid has had time to bring in his breakfast. And when his mighty fists smash at those doors the doom of the nation has come.

What it is necessary to do, therefore, is to calm this nervous gentleman; to talk confidently and assuringly to him, to talk about politics, philosophy, poetry, the arts, anything but banking and bank reserves, and then when he is smiling to take him out and give him a good lunch.

This is John Bull as some people picture him. It may be a caricature, and John may resent it as a libel upon his traits and temperament, but we must accept it as a serious fact that some people have no faith in John Bull's common sense.

Regarding John, therefore, as a highly nervous old gentleman, who can never rest because of that bank balance of his, wondering day and night whether it is safe or not, and spoiling the peace of the household by his restlessness, what we must try to do is to convince the old man that his bank balance is perfectly safe. It may seem difficult to do this when we tell him that the bank has only £15 left of his £100; but it might be equally as difficult to set his mind at rest if we tell him that the bank has only £40 of the £100, for he will want to know where the other £60 is. Even £60 is more than John can afford to lose.

Well, all that we wiseacres must do now is to have a little confab together and agree upon the amount we shall tell him the bank actually has intact of his £100. Perhaps we shall agree that £15 is much too little. Perhaps to some £20 may appear to be insufficient. After talking it over and diagnosing in the most up-to-date scientific fashion John's nervous temperament, we agree that his nervous system can be made quite normal, as normal as our own, if we say the bank has £30 of his £100, or nearly one-third.

Thanks, then, to scientific calculation we have settled this problem. John will be immune now from nervous disorders, he will be able to sleep calmly o' nights, and will settle down into a nice, comfortable, affable old party, a perfect husband, and an indulgent parent, feeling that nothing now is wanting in the best of all possible banking worlds. Great mathematicians have assured him that the banks will never fail now they have £30 of his £100 in solid gold.

How agreeable it would be if we could settle this matter in a scientific way, calculating with mathematical precision how much strain the banking system will stand, and to a nicety what proportion of the reserve to the liabilities will for ever avert a panic. Unfortunately, mathematics will not help us in this. If we could only lay down a theoretic line of safety, knowing precisely how far to go and where to stop, how happy and contented we could be. The Philosopher's Stone could perform no greater miracle. The banks would then know exactly how much to lend, exactly how much deposits to receive, irrespective of gold production and wealth production, and the trade and commerce of this country could be governed perfectly in true keeping with our needs and the progress of civilization by that ideal law, rule-o'-thumb. It would be impossible to imagine then to what heights of greatness England would rise, or the reposeful content in which she would live. As, however, scientific precision is impossible, we must rule out this haphazard law.

We must still trust as well as we can to experience. So far experience has not failed us. This much can be said in its favour.

It is impossible to say what proportion of reserve will save banks in a possible panic. Perhaps eighty or ninety per cent. would not save them. Perhaps they might go under with a thirty per cent. proportion, when a thirty-one per cent. would have averted the disaster. Nor must we rule out of consideration when contemplating the theoretic line of safety the composite character of the deposits.

Banks are counselled to adopt two extreme policies. That is to say, to do the impossible. They are asked to lend freely to assist trade, and at the same time are asked not to lend or to lend sparely. During the early weeks of the war, for instance, they were urged to give liberal assistance to commercial men and others, and at the same time to increase their reserves and to be ultra-cautious.

Some critics, and the most distinguished amongst them is Mr. Walter Bagehot, urge them always to keep high reserves against the day of panic, and yet when the panic comes to lend freely. They cannot lend freely and simultaneously maintain high reserves. They cannot have high and low reserves at one and the same time. They cannot lend sparingly and cautiously in the same moment as they lend liberally and incautiously. They must either keep high reserves and assist commerce as sparingly as possible, or they must keep modest reserves and help commerce as liberally as possible. They cannot adopt contrary policies.

What should we say of the farmer who kept his seed in the barn and feared to sow it to-day lest a storm should arise to-morrow and destroy it? He must take his chances of a storm. And the country must take its chances of a panic.

But the chances are not so fearful as some imagine. Quite apart from psychological considerations, there is the country itself, the Government, behind the banking system. The country, the Government, cannot afford to see that system come to ruin. It is not as if the Government would be helpless. The Government has the power, and it should use the power to prevent the ruin. Moreover, it is the duty of the Government to prevent it.

It is the Government's duty because the Government does not allow free banking in this country. This may seem a startling assertion. Let us examine it.

If the Government enacts that gold shall be legal tender, and that banking deposits must be repaid on demand in their entirety in legal tender, then banking is fettered by law. It is not free banking in the full sense of the term. If banking is fettered by the capricious output of gold, it is not free banking; and if the commerce of the country is fettered by the capricious output of gold, then its freedom of expansion is fettered. If the output of legal tender currency cannot keep pace with the needs and requirements of commerce, then the limitations imposed are not in accord with true notions of freedom. We must work and progress as best we can within those limitations, whether they be wise or unwise.

Since the war the Government appears to me to have recognized this by the issue of Treasury notes. Had these notes not been issued, then it would have been the duty of the Government to have suspended the Bank Act. Having issued these notes, the Government could conscientiously ask the banks to assist in a time of crisis traders and others with the utmost liberality. If they were not so assisted, the bankers justly deserved admonition. But had the Government not have issued the notes and therewith have provided legal tender currency in ample measure, then it could not, conscientiously and justly, have bidden the banks to lend freely irrespective of their gold reserves. If, however, these reserves were to be replenished, then the banks were sufficiently safeguarded. There was no excuse for ultra-caution and timidity then.

I repeat, therefore, that what the Government has done once by way of duty and by way of wisdom and foresight, it can do again, and should do. The country must not come to ruin merely in deference to the apprehensive theories of some people, whose theories so far, though long and tenaciously held, have been like the passing nightmares of affrighted men.

In the days when Mr. Bagehot wrote his immortal work, banking was still in the experimental stage. It was slowly developing and learning from experience. As banking has developed, so has the psychology of the British race changed. As the confines of its knowledge have been enlarged, as each generation has arrived in a new environment, and as each generation has become more familiar with and habituated to banking, so are the probabilities of panic lessened. A panic, after all, has a psychological origin, and if, as I contend, the psychology of our race is on a higher plane, and is more dependable than it was half a century ago, then Mr. Bagehot's criticisms become less forcible as pyschological growth proceeds. They must not be taken, therefore, as our criterion to-day, because the test applied to them now is a different test. As the years go on the criticisms will become feebler, and with his profound instinctive knowledge of human nature, I think, were he alive to-day, Mr. Bagehot would modify those criticisms that deserved more consideration in his days than in ours. He would be the first to acknowledge, not only that the banking system has progressed greatly, but that the system is conducted on safer lines than in the times when he lived.

CHAPTER XVI

SOME PSYCHOLOGICAL PHENOMENA

It has been said, and said truly, that the law can exercise much restraint upon the freedom of the individual. It is powerless, however, to restrain madness. Yet it is precisely by artificial methods that we would attempt to restrain madness, to keep individuals and nations in a state of sanity. This cannot be done. If the problem we are dealing with is psychological, we must find a psychological solution. We cannot cure a spiritual disease by a material remedy. If we can grasp the potency of fear growing into that species of madness called panic, we shall be able to grasp the tremendous task of allaying that fear during its earliest symptoms. We should also grasp the immensity of the task when we conceive how the healers of the disease would themselves be afflicted by the disease, and that their fears would confuse their minds and paralyse their actions.

Long before the greatest war in history broke out, we were assured by financial and economic prophets that when it did break out this country would be in the throes of the most serious panic it has ever known, and thousands of our business men would go down to ruin in it. These prophecies were based upon the inadequacy of our gold reserves, and upon the top-heaviness of our credit superstructure.

These prophecies have not been fulfilled. We have had no panic, not even when the Bank of England reserve fell to the lowest point for many a year, not even when the rate rose swiftly to ten per cent. Thousands of our great business men have not been ruined. These are facts, not theories. They are realizations, not predictions. So far from there having been a panic, it has been very difficult at times, as all acute observers will testify, to realize that this country was at last engaged in a life and death struggle. It was prophesied, too, and with no doubts or hesitation, that the numbers of men thrown out of employment would be so great, that drastic martial law would have to be resorted to. These predictions also have not been justified. The percentage of employment has steadily risen, and this nation has pursued its affairs and avocations calmly under normal police law.

If we are to learn deep and lasting lessons from experience, this experience is of vastly greater value than theory. In Germany and in France also we see vast accumulations of gold, in comparison with which our own gold reserves are puny. Yet we not only raised immense war loans at a high price, but have helped other countries with loans, while our burdens were increased with the heavier taxes imposed upon us.

True it is that but for our navy, circumstances might have been greatly different. But had our navy been sunk, had Germany acquired undisputed mastery of the sea, had she been able to starve us, then no gold reserves, even though mountains high, would have saved us. The country could not live on gold alone. It would have perished, and its banking system with it. We cannot wage a life and death struggle with gold alone, nor with credit alone.

But when the former prophecies were made, no account was made of the navy. The panic was to come independently of the navy's power. The public, the moment war was declared, would realize that the gold reserves were inadequate, they would clamour for gold, the banks would close, and in a day or two the money market would be a deserted, silent place, stricken and devastated like some of the cities of Belgium.

Why did not this come to pass? Why were the prophets not trusty seers? It is said that the bankers met in conference to consider and exchange opinions upon the position. They knew well enough that they were no magicians, nor even ordinary conjurors. They knew they could not make gold out of nothing. What, then, could they do? Whether or not their consciences smote them I know not. Whether or not they bitterly repented and lamented the poverty of their gold reserves I know not. Whether or not they said to each other, in a hopeless, perplexed way: "I told you so," I know not. All I do know is that a saviour came, a *deux ex machina*, that he was received with open arms, welcomed with fervid gratitude, perhaps with tears, that he was venerated, and that some to-day, in their profound gratitude, would make him a duke.

Well, this saviour came and calmed that assembly; in a magical way, subdued all fear, removed all perplexities, daring to do, so some say, what some bankers themselves dared not even hint. Greatness of mind saved them and the nation and not the greatness of our gold reserves, and this greatness of mind has been acknowledged by all, not with the reluctance of envy, but in the spirit of sincere thankfulness. Greatness of mind, then, saved the nation from the consequences of that psychological evil, fear and madness. It was the right mental solution to a mental disease. The spirit saved the spirit.

So it has been throughout the ages. Greatness of mind has led nations on. Littleness of mind has brought them down. And who will deny that it is littleness of mind that has brought Germany down? A nation derives its greatness from the greatness of its greatest souls.

The nation was saved, then, in the hour of destiny by obedience to wisdom. We cannot imagine in the future a vaster crisis than the nation—yea, the world—

faced in that dark hour in August. It was not alone the magnitude of it, it was the suddenness of it. We were unprepared for it, and if wisdom could save us in this hour, what can we hope from wisdom in the hour of less peril?

Had wisdom not prevailed, had we abandoned ourselves to divided counsels and to folly, we might not have saved ourselves from the consequences had our gold reserves been much higher. They might quickly have disappeared. Theoretic lines of safety would not then have averted the wreck. They would not, with magic power, have kept the public back.

In that hour some would have cried hysterically: "Lend, lend, lend!" Others, "Save, save, save!" and only confusion and perplexity would come of it. But the public were told, by the representative of the Government, by the authoritative voice of the nation itself: "Be calm! All your wants will be supplied! The Government will supply them."

When a hungry multitude is clamouring for food, mad with hunger, and when the barns are filled, they are not appeased if told there is only sufficient food for a few. Tell them there is enough food to go round, even though it must be given sparingly, then the clamour dies down and the multitude becomes calm and patient.

We saw no multitude clamouring for gold. The clamour was merely anticipated. There may have been no clamour, but it was wise to anticipate and prepare for its possibility. At the right moment, therefore, the public were assured that money, not gold, would be forthcoming in any amount. It was money, not gold, that allayed the first symptoms of fear. With this money, no matter though it were paper, the public were content. The notes were instruments of law that placed them in an impregnable position, and in an impregnable position they knew they were safe.

The faith the public put in gold is probably greatly magnified. The public are not deeply versed enough in monetary and currency problems to understand the importance of gold as distinct from other money, especially legal tender paper. The ordinary man in possession of twenty £5 notes feels that he is equally as safe and as strong as the man in possession of one hundred sovereigns. We must not ignore this fact, nor minimize it, when we argue about high and low gold reserves. He knows that with notes he can be just as solvent as the man with gold, though he may think the notes a greater nuisance than gold. And this belief and trust of his, this calmness, are all essential elements of the psychological problem that confronts the currency theorist and the banker. They are not to be considered as mental phenomena independent of that problem. They go to make up its complexity.

London being a free market for gold it was feared in a crisis such as we have experienced, that the gold would quickly be withdrawn from the Bank of England and shipped abroad, and that in a short time we should find ourselves with no gold reserves. This did not happen. Granted that a great deal of gold was withdrawn from the Bank, this was only temporary, and since those days the Bank has secured gold at a pace no prophet ever calculated. Two predictions here have also been falsified. Neither the gold withdrawals, nor the gold arrivals and accumulations were on a scale forecasted by the theorist. Their pre-calculations went ludicrously astray.

CHAPTER XVII

EQUITABLE RESPONSIBILITY

If gold reserves alone are to be the test of sound banking, and if gold reserves alone are to save banks in the hour of crisis or panic, then the obligations of banks towards the highest interests of the community are weakened. If their wealth, their investments are to be valueless in a time of crisis, to be so ignored, that is, as to be worthless, to be taken no account of, are not to keep them solvent and safe, then on what grounds of reason and justice should the community demand that banks should confine their trading to the highest class of wealth? On what grounds can the community demand that they should in all seasons and in all times do that great work for trade and commerce which neither the Government nor any other institution does? Why should the banks be asked to do all the sacrificing within the limitations imposed by the community and the community not come to their help, sacrifice nothing at all, in the hour of the community's troubles? For the crisis, when it comes, is the nation's and not solely the banks' crisis. If the crisis be none of the nation's seeking, it will certainly be none of the banks' seeking. If, however, the crisis be the effect of over-speculation on the part of the community, it would be mean action on the part of the community to appeal to the banks to save it from the consequences of its own folly.

I urge that, in a time of national crisis, which has taken the nation by surprise, which is no consequence of its own folly, the responsibility should be shared by the nation and the banks. It is possible that it was this high sense of justice, this high sense of equity, that inspired the measures that were taken last August, and that brought the country safely through the crisis. Had it not been for this higher inspiration and deeper vision, and had we trusted alone to narrow instinct and lack of insight, confusion might have reigned, and the consequences might have been as serious as those foretold by the prophets.

If we are to lay it down as a rigid, unwritten law, a law existing only in the conscience of an irresponsible community, that banks must save themselves only by their gold reserves, then by what divine or earthly sense of justice shall we demand that banks shall not speculate? Are the banks to be the keepers of our consciences, as well as of our purses? The banks must live. And if instead of building up their deposits on sound wealth, they build them up on unsound wealth, and keep that proportion of reserves which critics demand they shall keep, then they will have fulfilled their duty from the standpoint of this narrow conception. Suppose they speculated and kept even higher reserves than those laid down by the mathematicians, content with the higher profits made from speculation, by whose standards of equity are they to be judged?

If high gold reserves alone can save them, or should save them, and they possess these high reserves, then they can be saved even if they speculated. If the oracles say so, it must be so. If sound wealth be useless to them, then unsound wealth could not be more useless. If they could not get legal tender for sound wealth, for gilt-edged securities, they would be no worse off with brass-edged securities.

As I have already insisted, it is something beyond lack of reason to ask banks in the same moment to lend freely and to save their gold reserves. It is as unreasonable as asking an ordinary man to be generous and prodigal and at the same time close-fisted and thrifty.

Take that measure of the Government whereby it arranged with the Bank of England to discount, without recourse to the holder, all approved bills accepted before the declaration of the moratorium, guaranteeing the Bank against any loss it might incur. This was, of course, placing a burden on the shoulders of the community which was a perfectly equitable burden. But quite apart from its equity, it was, in its lowest aspect, an expedient burden. That is to say, if the nation had refused to shoulder this burden, it would have had a far greater burden to bear in the dislocation of trade and its incalculable losses.

It would not have been just to place this burden entirely on the shoulders of the banks. In such a crisis the entire community had to face the perils as a whole, and sink or swim as a whole.

When in the end the gains and losses are weighed, perhaps we shall find that the gains, moral and material, greatly outweigh the losses.

What was the duty of the banks, when this measure was proclaimed, towards the nation and towards themselves? Looking at it from the low standpoint of self-preservation, what was their duty? From a low and a high standpoint alike it was their duty to help the Government, help the nation, through the Bank of England. They could not give that effective help by hoarding their gold, by getting it from the Bank of England, by sending borrowers to the Bank of England, by refusing help to legitimate needs. Yet this is what some critics counselled them to do—counselled them to increase and not ease the difficulties of the Bank of England.

If the country could depend calmly and securely on the Bank of England, with the Government behind it, then the banks also could depend upon it.

The Bank of England was the bulwark of England. That bulwark could be weakened and not strengthened by the hoarding of gold. If the Press and others admonished, and wisely admonished, the citizens not to hoard gold, then it was illogical to ask the banks to hoard it, for they would be hoarding the citizens' gold. These contrary counsels were opposed to all reason, and yet to this hour I see them advocated in some quarters in the Press.

The Bank of England needed all the gold it could get as a basis for the discounting of this huge mass of pre-moratorium paper. Gold subsequently poured in from the gold mines and elsewhere, yet notwithstanding this mighty inflow, the proportion of the Bank's reserve to the ever-growing deposits kept comparatively low, far below the normal proportion. It was in the interests of the country that the Bank should get this gold from any quarters to enable it to make a success of the remedial measure and to ease the country's financial burdens. How, then, could it at the same time be in the interests of the nation for the joint stock banks to take gold from the Bank, to hoard it and not to send it there?

Such action as this would have been inconsistent with the fervent gratitude the bank chairmen and the country have felt towards the Government and its advisers.

Furthermore, what made it additionally ill-advised on the part of the banks to hoard gold and pile up their reserves, was the subsequent proclamation by the Government to the effect that the Bank of England, on the authority of the Government, would advance the necessary funds to meet acceptances for which cover was not duly forthcoming from clients, until one year after the close of the war. This removed all necessity to hoard gold and to pile up reserves, and it justified the rebuke of the Chancellor of the Exchequer to those banks that refused necessary accommodation to legitimate business. It was also a rebuke to those critics who have seen no refuge for the country in the dark hour of trouble except in hoarding by the banks and parting by the public. That is to say, they counsel the public not to demand gold, and they counsel the banks to keep it. If, therefore, the public are not to demand gold, and if the banks are to accumulate it in their vaults, then it means that in a crisis we can do without gold, and that, after all, the credit which the banks are said to create will alone save us. They are told that if they will only go on creating this credit they will enable us to pass safely through the crisis. It comes to this, that the advice given places us in mental confusion. Actual experience, therefore, seems to be trustier than illogical advice.

What has been the direct consequence of this discounting of pre-moratorium bills and this great inflow of gold, despite the issue of a War Loan to the prodigious amount of £350,000,000? In the words of the money article, day by day and week by week, money has been a glut on the market, and has been lent on nominal terms, while discount rates have also fallen to nominal quotations. In other words, the great joint stock banks, in spite of themselves, have seen their gold reserves rising to an unprecedented extent. Of what benefit to the country is this great mass of idle gold? It is unproductive. It serves no useful purpose if it cannot be employed. It is like the grain in the barns perishing because it cannot be consumed. Yet in spite of this state of things, due to the supply of liquid capital exceeding the output of wealth, there have been those who have lamented the fall in discount rates lest this should turn the exchanges against us, and gold should be taken to New York or elsewhere. Would it not be beneficial if some of the gold did go? If it went in payment of wealth received, the gold would then become productive. The right service of gold is to help to produce wealth, and if it does this it performs the services deputed to it by the community. When gold passes from one nation to another in exchange for wealth it never passes permanently. I might just as reasonably urge that when I pay gold to my tailor for my dress suit I part with the gold for ever. I should part with it only in the event of my immediate decease, or if I became a non-producer, or in other ways were deprived of all claims on the general wealth of the community. An idle man, with pockets filled with gold, is a burden on the community. He is no helper, no benefactor. So a nation, idle, with mighty safes filled with gold, will become stagnant if this gold is not scattered broadcast in the shape of capital that energizes the productive and consumptive capacity of man and the land.

The value of gold will ever inhere in its wise use, not in its non-use.

"It has been well said," remarked Sir Felix Schuster, in his recent annual address, "that it is one of the paradoxes of finance, that at the moment when the world's capital is being squandered in war the value of loanable capital in Lombard Street has actually depreciated." Sir Felix meant, of course, that there was no great demand for capital, that it was greatly in excess of needs, that loans consequently were cheap, and that banks could hardly lend profitably. I see no paradox in this. If the creation of bank money is to be regulated by the supply of gold only, it is an orthodox consequence. Since the outbreak of the war the inflow of gold has been greater than ever experienced. This has given the banks power to lend more, to liquefy more wealth, because their reserves have increased, and the proportion of these to the liabilities has correspondingly risen. But though a great deal of wealth has come into existence, it must not be overlooked that a great portion of it is not the kind of wealth banks lend on. This was partly due to the closing of the Stock Exchange, the subsequent restrictions on business there, and the destruction of trade between the belligerent and other countries. Securities of a high class were scarce, and bills of exchange became scarce, and while many industries, notably the cotton industry, severely suffered, other industries, especially war-provisioning industries, became abnormally busy. There was deadlock for months in some of the foreign exchanges, especially the New York and Russian exchanges. While the kind of wealth on which banks lend fell off, the mines continued to produce gold, thus showing again how independent this output is of real wealth production. Had the gold mines also ceased working at the beginning of the war, have suspended operations for many months, we should not have seen, perhaps, loanable capital in Lombard Street so excessive and so depreciated as it was.

Sir Felix saw a great danger in this great mass of money and its cheapness: the danger of its turning the exchanges against us. But this danger could have done no more harm than the stoppage of the gold mines had the rebellion spread in South Africa. The danger can be easily exaggerated, especially at a moment when we can see far ahead, and see the gold still coming to us in an uninterrupted stream from the mines.

Even had the New York exchange turned against us, it would turn round again in due course, as it always has done and always will do so long as international commerce proceeds.

By no jugglery can we, in the existing system, make cheap money dear, any more than we can make cheap apples dear. It can be done by cornering; but no cornering of money is possible. If banks cannot lend at 1 per cent., they certainly cannot lend at 2 per cent. Human nature must be re-created first. If men will not part with bills of discount at 1½ per cent., they will not part with them at 1¾ per cent., and there is no law, written or unwritten, that will compel them to do this. The law of supply and demand operates as irresistibly in this case as when we buy apples at an old lady's stall.

If there be great danger in a great abundance and cheapness of money, then there must be a great danger in an abundance of gold, which is the source of the cheap money. Logic teaches us this. Reduce the gold, hoard it or throw it in the ocean, then the supply of Lombard Street money will decrease and loanable rates will rise.

CHAPTER XVIII

CORRELATION

It may now pertinently be asked: Is it possible to keep high gold reserves in the joint stock banks, taking them as a unit, and simultaneously a high reserve in the Bank of England? By high reserves I mean, of course, a high proportion, for this is what we all mean. What is the test of a high reserve? There is no other test than the ratio of the gold reserve to the liabilities. We cannot test it by a quantity of gold *per se*. We cannot say that a hypothetical quantity is sufficient and a hypothetical quantity insufficient. A reserve must be related to something. When we speak of gold reserves we speak correlatively. They are not something standing apart, in the air, as it were, an independent quantity.

If, then, when we speak of gold reserves, we are conscious of their relation to something, what is this something? Is it their relation to the nation's commerce as a whole, the nation's needs as a whole, or merely the restricted relationship to bank liabilities? What critics mean is the relation between them and the bank liabilities. But banks are units of a system. They are not a whole in the same sense as the Bank of England is. They are independent entities. There are large banks and small banks and medium-sized banks, and they have liabilities corresponding to their size. Must the small bank have in its safes exactly the same *quantity* of gold as the large bank, irrespective of its liabilities? Or must the small bank have, not the same quantity, but the same *proportion?* Or are we to aggregate all the liabilities of the banks of the kingdom and all their gold reserves and say whether or not the total quantity of gold is sufficient or insufficient? Even then we must ask: Sufficient for what? Sufficient to meet the total liabilities in a time of crisis? This is what we mean. We mean a ratio, a hypothetical ratio that is to save us from disaster.

Now this ratio is constantly fluctuating. It is fluctuating hour by hour, day by day, week by week, month by month, and year by year. It is impossible to keep it rigid. The critics know this, and they say that only an approximate ratio is wanted. But as we can never foretell, never pre-calculate what an approximate crisis will be, an approximate panic, or an approximate run, an approximate ratio may not save us. If mathematics alone will save us, and not common sense, then we must have mathematical precision, seeing that we are dealing with figures, not brains and temperaments.

The only way to keep up an approximate ratio is, not to buy gold, as many advocate, and hoard it, but to stop lending, to call in loans, and so raise the ratio figure. Then we can have a relative high gold reserve. We are speaking, of course, in an ideal sense, for there can be no simultaneous precision in these movements amongst a number of independent banks, whose business varies hour by hour.

However, in order to maintain their high ratio banks must cease to lend when this ratio threatens to fall. It is useless buying several millions worth of gold—if it could be bought—only to lend more upon it, increase the liabilities and not alter the habitual proportion.

If, therefore, banks cease to lend in order to keep up a high ratio of reserves to liabilities, what will be the inevitable effect of this upon the reserve of the Bank of England? They will drive borrowers, as has been explained in former chapters, to the Bank. As the Bank begins to lend, so will the ratio of its reserve to its liabilities drop. Mr. Cole says the Bank of England will always lend *at a price*. If, then, the Bank's ratio drops, then the ratio of the reserves of the joint stock banks must fall, seeing that they hold their reserves at the Bank of England. The ratio will then drop in proportion to the aggregate bank liabilities of the kingdom.

The only remedy, then, is for the Bank of England also to refuse to lend. But Mr. Bagehot and other critics say this would bring on and aggravate a crisis. So far from refusing to lend, banks, they say, must lend liberally, with both hands. How, then, are the Bank of England and the other banks to lend liberally without increasing their liabilities and reducing the proportion? The proportion could be maintained only by an inflow of gold proportionate to the rise in the liabilities. How are we to start this inflow at the critical moment and maintain it?

It cannot be done. There can, however, be an automatic inflow, but only of legal tender notes, and legal tender, from the standpoint of bank solvency, is as potent as gold. We cannot produce gold at will, but we can produce paper at will.

Our gold reserves should be controlled, as I have insisted already, not solely by the arbitrary output of gold, but by the output of the nation's wealth, and by the nation's needs, and no artificial obstacles should arrest the growth of national wealth. We do put obstacles in the way. Banks must keep an eye on their approximate reserves. This is why they refuse to lend at times, and send wealth-producers to the Bank of England. We have to put up with this in our present system. But to say that some hypothetical ratio, which no one can agree upon, will save us in certain grave, incalculable contingencies is as untenable as many another economic hypothesis which has no relation to the complexity of human character and temperament.

But the theorists have insisted in years past, it is not the national needs we have to consider in a time of crisis; it is the international claims upon us. Look, they say, at the enormous foreign credits here, placing unlimited power in the hands of foreigners to take gold from us *in the time of war.* Well, the war has come, the greatest of all wars, the war we and the world most dreaded, and all these pre-existing fears have not been realized. Foreign credits are offset by foreign liabilities here. Instead of gold being taken abroad in great quantity the exact opposite has occurred, and why should it never recur? Gold has come to London in quantities never dreamed of and never experienced, proving that the dimensions of this hypothetical danger were greatly magnified.

Since the war we have had too much gold and too much capital, even at a time when unemployment was low. I mean too much bank capital.

It follows that, as conditions of banking are at present, we cannot have high proportionate gold reserves in the joint stock banks simultaneously with a high proportionate reserve in the Bank of England. This can only be done by stopping the wheels of commerce, or slowing them down by advances of the Bank of England rate to attract gold from abroad. But the gold must flow in as rapidly as the liabilities rise, unless the Bank of England stops lending too. Trade must be penalized whichever action be taken, and merchants and others would rather have low ratios than be penalized. They would suffer, and the country would share their sufferings. To refuse to lend would have serious consequences and would be the surest way to hasten a panic.

CHAPTER XIX

THE SUPPLEMENTARY INFLOW

If there must be in the country, for the benefit of the country's trade and commerce, for ensuring its prosperity, a loanable fund, why should no provision be made for what I call the supplementary inflow? If no provision of this kind is made by a nation, how can we reconcile this with national foresight? In carrying on business on the soundest principles of finance business concerns allow amply for contingencies by building up reserve funds. If this be sound in individual business, it should be sound in national business. We cannot logically have contrary business principles for the nation and the individual, for in that direction confusion lies.

The nation trades on its capital. It is a vast undertaking, with a colossal capital. It incurs huge liabilities, but against them it has huge assets. Why should it not have amongst these assets large hidden reserves?

Some wealth depreciates, while other wealth appreciates. Some wealth is destroyed, while new wealth is created. Wealth is not destroyed by war alone. It is destroyed by new desires, new inventions—which destroy the wealth brought into existence by former inventions and bring ruin on some industries and men,—new fashions, and by lack of hope and diminishing confidence. On the Stock Exchange in recent years we have seen continual depreciation. But other assets may at the same time have greatly appreciated.

We cannot get more gold than nature will produce, and every ounce taken from her store lessens that store. And the store will diminish as the future needs of the world grow.

The gathering of the gold and the garnering of it, like the garnering of seed we fear to sow, must be done at the expense of our wealth production. The harvest of wealth must be less because of the scantier seed sowing; in other words, because of the diminished capital employed. Instead, therefore, of the gold coming out of the nation's profits, it would come out of the nation's capital, for unused capital is not used capital.

Gold is our capital in a fundamental sense. If all the gold in the world were suddenly destroyed, banks would cease to exist. Whence, then, could we get the means of multiplying our capital? The productive machinery of the country would become inert. International trading would cease, because international exchange would cease. Bills of exchange would be as worthless as old newspapers, for they would be unnegotiable. We should have to get a substitute for gold.

We try to attract gold to this country because it is gold that keeps the capital-multiplying machinery going, as oil keeps other machinery going. If we always had a sufficiency of it there would be no occasion for high Bank of England rates. If there be just a sufficiency and no more, then we cannot spare any for hoarding purposes.

It would be wise of the nation to have at its command a potential supplementary supply, not of gold, but of legal tender, for legal tender can perform all the offices of gold as national currency. Gold is given its potency because it is made legal tender. It has no other vital potency. Therefore paper, or any other substance, can be given equal potency by law.

Now, the necessity of having this supplementary supply has been tacitly acknowledged. The acknowledgment is implied in the provisions of the Bank Charter Act and the provision of legal tender notes based on debt and securities. This provision, as I have pointed out already, is arbitrary. It was fixed at a time when no man had the visionary power to foresee and forecast the great development of banking in this country and the vast development of its national and international trade. It was fixed at a time when the country was groping towards a greatly improved currency system, a system that has helped in an incalculable degree the growth and development of our commerce.

But in the recent crisis it was not this potential supply that the nation actually tapped. Before it could be tapped it was necessary to suspend the Bank Charter Act. Instead of this happening, a new and unlooked-for supply was forthcoming in the shape of the Treasury notes.

This issue of Treasury notes brought a new fiduciary currency into existence, and the issue was on all fours with a free Government loan—a loan, that is to say, on which no interest was paid. It provided not only currency for the country, but "silver war-bullets" for the Government. The issue performed all the essential services which the supplementary fund I advocate should and would perform.

I am convinced that the alarm felt throughout the country in those first critical days was magnified. There was certainly some apprehension; but no good purpose would be served by magnifying it. It is indisputable, too, that even this moderate apprehension disappeared the moment it was known that a large amount of legal tender would be issued in the shape of £1 and 10*s*. Treasury notes.

The notes were based on what we call the credit, or wealth, of the country. The public placed their confidence in them because they felt they were placing confidence in the wealth and power of the country, in themselves as a nation. They could have no sounder basis. The nation was indifferent to the convertibility or inconvertibility of the notes. All the country was conscious of was that the notes were legal tender and as good as gold.

Theorists attach too much importance to the effect upon the public mind of an issue of inconvertible notes. The great mass of people does not understand convertibility or inconvertibility, certainly not in the deep sense critics imagine it does. It understands, however, confidence in the Government, and this confidence is of greater worth than are vague ideas of convertibility. The mass of the public is ignorant of monetary and currency problems, but it is not ignorant of the power of the Government and the power of the law. When the mass of the public had these notes—and even postal orders as legal tender—in its possession, it knew it had purchasing power equal to the denomination of the notes, and that was all-sufficient. This explains the public's satisfaction and calmness. Moreover, it is a phenomenon of deep psychological importance.

There were sections of the public—merchants, financiers, bankers, academicians, theorists, and pressmen—who knew that the notes, though issued as convertible, had behind them no gold backing. But even many of these were not erudite students of currency. Nevertheless, they could not help feeling and acknowledging that the right and wise thing had been done. And as for merchants, bill-brokers, bankers, and other people who wanted legal tender currency, they cared not so long as they could get it. This was their chief concern. It was a matter of indifference to them whether the notes were convertible or inconvertible.

Perhaps the most fruitful point for controversy at this juncture, now that we have experienced the benefits of the policy, is whether it would have been better to have suspended the Bank Act and have issued Bank of England notes, or to have done what actually was done. Much can be urged in support of each policy. Bank of England notes would have obviated any confusion arising from two distinct species of fiduciary paper currency.

The great virtue and convenience of the new notes was their low denomination. It would have created needless difficulties, perhaps, to have given power to the Bank of England to issue such notes. Confusion, therefore, was greatly lessened by making the Treasury notes of low denomination and by keeping the Bank of England notes at a high denomination. As a fiduciary note, currency should be as simple as possible and not complicated, the distinction between the denominations should conform to the idea of simplicity.

I think it would be wise to teach the people that the currency of the country is in reality based upon the wealth of the country, and not upon an extraneous thing like the capricious production of gold. This would assist it to grasp more easily currency problems. What would be the state of this country with a mountain of gold and no wealth? Currency being issued on a basis of wealth, it is issued on something solid and durable.

A certain London evening newspaper wrote in this wise several months after the outbreak of the war: "The puzzled public which draw its cheques and accepts the cheques of others with a firm and pathetic belief in the value of 'a scrap of paper,' was a little scared at first when the value of securities tumbled down and it had to accept notes in place of its accustomed solid coin. People began to ask whether the alleged wealth of the country was supported by anything solid at all, or whether we had not been living on a fiction. Fortunately, time has proved that it is very substantial indeed."

Quite so. The wealth of this country is the most substantial possession the country has. But, all the same, there are many fallacies in the above passage. The public were not puzzled, and there is no pathos in its belief in the value of cheques. It was not scared, even for a moment, when it had to accept notes, no more scared than it has been when it has received Bank of England notes. It took them with inquisitiveness, but also readily and gladly. People did not ask if the wealth of the country was "alleged" and whether it was a fiction, and I think it is foolish to put ideas into the heads of the public which originally were never there.

Is it absolutely necessary to issue a *limited* amount of Treasury or other legal tender notes based on gold? Or may the amount be unlimited? In a war of world-wide magnitude, the Government and the nation had to take account of the vital fact that, not only might our commerce be destroyed by the enemy's navy, but that it might be impossible to bring gold over to this country. This had to be foreseen and provided for. The joint stock banks, however high their gold reserves, could not alter this. Therefore it was necessary, apart from these reserves, to meet immediate emergencies by the issue of legal tender notes. Though afterwards the Bank of England was credited with enormous amounts of gold, this gold did not come to London. It was placed to the Bank's account, or credit, in South Africa, Australia, and Ottawa. This restricted probably the supply of gold coin at a time when there was an unprecedented demand for small currency for our military requirements and in our vast military camps. Though some industries may have slowed down greatly, others worked at high pressure, thereby probably more than offsetting the inactivity of others. And allowance must be made for the thousands called to the colours who might otherwise have been parasites. By joining the army their aggregate consumptive powers increased. All these developments had to be pre-calculated, apart from the positions of the joint stock banks and their preparations for panic. It was not the time to hoard gold, but to see that legal tender currency was provided in ample measure.

Ample measure is not superabundance, and if the needs were just met nothing further was necessary. Assuming, therefore, that they were just met and no more, we may ask whether or not it would be wise to withdraw the notes when the war is over and normal conditions are restored. It is, perhaps, too early to reply in dogmatic fashion.

We must take into consideration that we may never again see a world-war and never again face a crisis such as we faced in August last. But I see no powerful objection to the notes remaining. We may regard them as the nucleus of the nation's reserve fund, the liquefying of its hidden credit, or wealth reserve, as the veritable "I believe" in the immeasurable potential wealth of the country. The War Loan is another such reserve, a reserve representing the present and future credit, or wealth, of the country. The country's potential wealth is the security behind it. And the Treasury note issue may be regarded as part of the loan, for the gold "ear-marked" against it has probably come out of that loan. If the notes were redeemed and the gold released again, the gold would go into circulation and form part of the banks' reserves as before. By retaining the gold the Government would have that store of gold which critics have been asking for. So far as they are concerned, therefore, their wishes would be fulfilled. They could gaze with satisfaction on this store of gold, for the delicate problem has been solved as to who should buy it and store it and bear the expense of it.

Evidently it is the intention to have a gold reserve equal to 100 per cent. of the notes in issue. I see no urgency in this, no vital necessity. The notes could be based partly on gold and partly on Consols. I think a reserve equal to 50 or 60 per cent. in gold would be ample.

If posterity is to benefit more from the war than the present generation, why should it not bear a goodly part of the burden?

It may be objected that Consols are a depreciating security. They are an appreciating security also, and years hence they may have a much higher value than they have now. Gold also appreciates and depreciates continually, measured by the prices of securities and commodities. And the entire wealth of the country is constantly appreciating and depreciating.

If the credit of the nation years after the war becomes much higher than it is now, then to secure the notes on the credit of the nation is to secure them on something that will rise in value.

This issue would not be like the varieties of paper issues in Germany, whose credit has depreciated and will continue to depreciate as her wealth diminishes and becomes less negotiable. She cannot, as we can, pay for goods entirely with goods, owing to the destruction of her commerce. She must pay in gold; in other words, she must live on her capital. And she cannot live on her capital and speedily renew it. There must be considerable destruction, because it cannot quickly reproduce itself.

I would, therefore, base part of the new issue on a sound security like Consols, which is representative of the country's credit, or wealth. The notes themselves are representative of its wealth, therefore Consols would be an extra security. I would not advocate the withdrawal of the notes, because the machinery has now been provided for possible use at a future crisis. The machinery could be set in motion again without resorting to the cumbersome process of suspending the Bank Charter Act. It gives us a provision for unknown contingencies.

To keep a limited amount of Treasury notes in existence should be no more a potential danger to the future of our financial fabric than the issue of a huge war loan. On the contrary, they should help us the better to bear the burden of a war loan if there be no improvident, or over-issue of them. They should be no greater menace than the sudden, prodigious output of gold which we could not use. We would not declaim against the imports of huge quantities of gold each week and the corresponding increase of currency. If so arbitrary an increase could do no harm and would be considered beneficial, then a limited supply of other currency, such as our Treasury notes, should not be harmful. And if the discounting of millions of unnegotiable pre-moratorium acceptances, creating currency in such abundance as to make it exceedingly cheap, is not harmful, then the issue of a limited quantity of Treasury notes, against which the Government is setting aside an equal quantity of gold, should not be harmful. To predict that it will bring economic evil in a distant future that cannot be foreseen, is as valuable as many another theory that has failed to stand the test of reality.

It should be no more harmful to the future than the issue of Bank of England notes has been, based on a book debt and securities, during the last seventy years.

CHAPTER XX

CREDIT AND CIVILIZATION

I have endeavoured to argue that our banking system and a purely credit system are not identical. A perfect credit system would be based entirely on faith, or profound belief in individual and national integrity and honour. Tradesmen know what kind of credit this is. They know that men may have huge and safe balances in banks, yet may be rogues. But a bank's faith is not of this implicit and profound character. A bank demands material evidence of faith, and it places greater value and trust in the matter than in the spirit. Our banking system is ahead of the banking systems of other countries, but this is largely because our economic organism is older, our national character stronger, our freedom greater. Our so-called bank credit rests primarily on national wealth and secondarily on character. A bank will not lend on character alone. Character is not the wealth it is ready to transform.

It will not lend to the poor man, however noble in character. But it will lend to the rogue who has sound security and other solid wealth. If it can have no faith in the rogue's character, it has faith in his wealth, and it takes care to have his wealth first. Banks, therefore, are not judges of morals. A man's private morals are not their concern, only his wealth. They desire to know nothing of a borrower's private virtues or vices, they are only concerned about his financial or business standing.

Therefore, if it be credit, it is a business, or wealth credit, a non-moral, not a moral credit, and the superstructure of credit on which the visionaries gaze is not a moral superstructure.

If the banks lent only on accommodation paper, "kites" and such things, this would approach nearer to our ideas of credit. For accommodation paper is not representative of real wealth, though it may be manufactured by a house of strong financial standing. But banks, I believe, are most vigilant in distinguishing between "kites" and genuine bills of exchange, thereby demonstrating unmistakably their hesitation in depending solely upon business character, and not upon sound, genuine wealth.

Credit is said to be evidence of civilization; the higher the civilization the higher the credit, or belief. Barter was the evidence of barbarism. As man becomes more intelligent, as his knowledge expands, as higher ideals lead him on, so he conceives loftier codes of ethics. As he grows more humane so he learns to have deeper trust in his neighbour. Knowledge teaches him how his life depends on the services rendered him by his neighbour, how he would struggle, and perhaps die, without his neighbour's help. Knowledge growing into wisdom teaches him the still higher truths of altruism and morality. The wise nation, therefore, endeavouring to live by the higher morality, is greater than the nation that has not yet reached this mental and spiritual stage.

The text of this chapter has been partly suggested by a pregnant passage in Mr. Hartley Withers' book, "War and Lombard Street." The value of the passage lies in the fact that it echoes the views of many. Let us examine it and endeavour to grasp the ideas behind it.

"After all," says Mr. Withers, "you cannot have credit without civilization, and at the beginning of last August civilization went into the hands of a Receiver, the God of Battles, who will in due course bring forth his scheme of reconstruction. When the five chief nations of Europe turn their attention from production to destruction, it is idle to expect any system of credit to go unscathed. Credit depends on the assumption that goods produced will come to market and be sold, and that securities that are based on the earning power of production will fetch a price on the exchanges of the world. War on the smallest scale weakens this assumption with respect to certain goods and certain securities; if its scale is big enough it makes the assumption so precarious that credit is shaken to its base."

When we contemplate and analyse civilization we see two aspects, or conditions, of it. There is a moral civilization and a non-moral civilization. Many would contend that Germany presents a type of non-moral civilization and that Great Britain and other countries present types of moral civilization. An advanced stage of economic civilization is not essentially and implicitly an advanced moral or ethical civilization. In moral civilization the Esquimaux may be our superiors. In economic civilization they are our inferiors. This is largely due to environment. Rivalry in commerce is not essentially moral rivalry. We can, indeed, call it a mercenary, or sordid rivalry, in which virtue and honesty play minor parts. We may flatter ourselves that, as a nation, we would gladly be more virtuous if other nations would let us. This is, at least, an admission that other nations "do not play the moral game." Out of this rivalry wars have sprung, and the present world-war is one of the fruits of the envy begotten of our commercial supremacy.

What is the kind of civilization, therefore, that went into the hands of a Receiver? Germany is fighting for low civilization, the allies for high civilization. Indeed, it is said, and not without truth, that it is not civilization warring with civilization, but civilization warring against barbarism. The motives of Germany are debased, the motives of the allies lofty. If the allies, as all believe, have been raised in this contest to a high plane of morality —I might even say to a high plane of spirituality— then moral civilization may gain, and a higher order of credit, or belief, may come of it.

From a narrow economic standpoint Germany's civilization has been high and may continue high. But after the war, what will be the state of her moral civilization? Lower than it has ever been, for morally she will be degraded. No nations will be able to put credit, or trust, in her. She will have forfeited moral trust, forfeited all moral credit. But will she have forfeited all economic credit? Should she rehabilitate her economic credit, it will enable us to see more clearly the distinction between moral and economic credit.

Her economic state will for a time surely be weaker. Her finances will be in disorder; her powers of production and consumption will be weakened, and it will take her a long time to repair the ravages to her economic system. This will apply also in some degree to the allied Powers. They, too, will have to repair damage to their respective economic systems.

But we may easily over-estimate the exertions and the length of time needed to repair those ravages. If the allies are victorious the moral gains will, at any rate, be enormous, and these will be tremendous assets to set against the liabilities. Should they be conquered we may, indeed, woefully contemplate the future.

Should, however, the allies be victorious, why should credit be shaken to its base? Instead of being shaken, the base of credit may become stronger than before. If a higher civilization be the outcome, then credit must become stronger, because its moral foundation will be stronger than before.

What is it we mean when we talk of the destruction of wealth? What wealth is this war destroying? The war is certainly producing wealth, even though it may be the most fleeting wealth. The production of some kind of wealth may temporarily cease, and where the war has been waged there may have been great destruction of wealth in devastated cities, towns and villages. But other permanent wealth is being produced. Military stores and materials are being produced in prodigious quantities; but these cannot be produced without increasing the consumptive capacity of the nation in other directions, and consumption is necessary to the production of wealth. We also have to produce to pay for the materials we get from abroad and to provide the materials bought from us by other belligerent countries. There are now less parasites in this country and more producers. Even soldiers consume, though they may produce nothing. But do we always rapidly increase wealth when, in non-warring times, production far outruns consumption? Nothing is more familiar than the destruction of wealth by over-production. The over-produce not only perishes, but the powers of consumption are diminished when over-production throws great numbers out of work.

While, therefore, capital and wealth are being destroyed—that is to say, a vast amount of capital is spent that is not reproductive—while soldiers are killing and not producing, they are consuming, and those who take their places as new producers can also consume more, and therefore can, even during the war, continue to repair the destruction going on. While destruction is proceeding, construction and creation are also proceeding. It cannot be all destruction and no construction. Who, then, can say how much greater the destruction will be months hence than the total construction, and how long it will take to repair the residue destruction?

We cannot confidently estimate. We know we shall have greater burdens to bear in the shape of extra taxation. But the conclusion of the war may greatly lighten these burdens if the blessings of a complete and lasting peace be as great as we hope they will be.

What we truly mean by economic credit is economic confidence. If we eliminated the word "credit" from our economic vocabulary and always used its synonym confidence, we should have a clearer grasp of our ideas. I think Mr. Withers will agree that he really means confidence. If so, we may amend the passage and say, "We cannot have confidence without civilization. . . . Confidence depends on the assumption that goods purchased will come to market and be sold—that is, consumed—and that securities that are based on the earning power of production, which power comes from wealth, will fetch a price, high or low, on the exchanges of the world."

We ascribe depression in trade to a lack of confidence. We never say trade is depressed in consequence of a lack of credit. When trade is depressed there is often an abundance of what is called Lombard Street credit. Therefore a scarcity of confidence is frequently coincident with a superfluity of banking "credit." How, therefore, can they be one and the same thing?

It is confidence that increases wealth, because it imparts the energy to produce and consume. Capital without confidence is impotent, as impotent as a weapon in the hands of a paralytic. Confidence can, perhaps, re-create as quickly as war can destroy.

If, therefore, victory in the present war comes to the higher nations and to the greater number of nations, these, together with the neutral nations, will be revitalized by confidence. They will have a moral and a spiritual re-birth. There can be no prolonged exhaustion, no prolonged prostration in such re-birth. On the contrary, it will bring economic regeneration and re-creation.

As the prospects of ultimate victory become more assured the re-birth and re-creation will begin the sooner. There are, indeed, no signs of moral or economic prostration in this country, and I do not believe such signs appear in France and Russia.

More evil is done by pessimistic prediction than we dream of. No man is gifted to see into the economic future. We have seen already many dark visions dispelled. There are many prophets amongst us—some are on the directorates of banks—already dressed in the mantle of woe, bidding us prepare for the day of sorrow, when we shall gather the aftermath of want and misery. The day of sorrow has indeed come, but, with all respect to the penetrating vision of these seers, the long day of joy may dawn for us when this night is ended.

CHAPTER XXI

CONFIDENCE AND GREATNESS

CONFIDENCE, I have said, is, in the production of economic wealth, the vitalizing element. In economics it plays the part that faith plays in religion. Confidence and credit have like derivations, like connotations. Confidence is a confiding in, credit a believing in. But, we must ask, a confiding or believing in what? Confidence, the spirit of economic prosperity, is distinct from what is called Lombard Street credit. Confidence is vastly more potent than Lombard Street credit. If confidence be dead Lombard Street credit cannot of itself revive it. But confidence can revive Lombard Street credit. When the nation is prostrate and languid confidence alone can revivify it. It is the economic tonic.

In the money article it would excite derision if we wrote: "In Lombard Street to-day confidence was again in superabundant supply, and lenders were offering it on nominal terms. Confidence over the night could be obtained in liberal quantity from $1\frac{1}{2}$ per cent. downwards, and for a week at no more than $1\frac{3}{4}$ per cent. In fact, balances of confidence were unlendable. Owing to the cheapness of confidence the discount market was again exceedingly weak, and rates continued to fall."

Yet, it is said, we have built up in this country a vast superstructure of confidence, or belief, based on a slight foundation of gold.

Now there may be in Lombard Street, and often is, a vast amount of "credit," but merchants and the public have not the confidence to use it. Why? To quote Mr. Withers: "Credit depends on the assumption that goods produced will come to market and be sold and that securities that are based on the earning power of production will fetch a price on the exchanges of the world." In other words, if we have no confidence in the future, we are afraid to spend our money: So we eke it out, or hoard it, or practise thrift and live in misery. And if we cease to buy we cease to consume, production diminishes, goods perish in markets, and men are thrown out of employment.

When we say the credit of the British Government stands high, we do not mean that the credit-money of the Government has a high value, or price. We mean that confidence in the British Government—that is, in the British nation—is exceedingly strong. When, therefore, foreigners buy British Consols they buy them because they know they can have strong confidence in British wealth and British character: not because our joint stock banks have high gold reserves, nor because London is the world's banker and a free market for gold. Foreigners know that our gold reserves are insignificant compared with the gold reserves of the leading continental countries, but they know that Great Britain is the richest and the *greatest* country in the world, and the British Empire the richest and greatest empire the world has seen.

Confidence, therefore, is based ultimately upon *greatness*, and our greatness as a nation and an empire was never more strikingly demonstrated and vindicated than during the war crisis. Greatness can exist, therefore, apart from gold reserves.

Let us look back upon the years preceding the crisis. Let us go back to the American crisis in 1907. This crisis was the result of a lack of confidence in America's economic and moral greatness. It was the result of scandalous dishonesty, the kind of dishonesty that we know to be impossible in this country. Yet London could not but be shaken by the panic there. London was, indeed, shaken by it more than by the crisis last August. The United States took gold from London in huge quantities at a loss, and the Bank of England rate, in order to try to stop these exports, had to be raised to a high figure for an indefinite time. Some of our banks were even accused of assisting the United States to the hurt of our own banking position. But the storm was faced and weathered. Years before then it had faced and weathered another great storm in the Baring crisis. These historical happenings show

how mightily strong is that superstructure we have raised in our midst, whether it be a structure of paper or of iron.

Then came the Morocco crisis, which was the beginning of the Stock Exchange depression, and which has culminated in the European war. When I speak of Stock Exchange depression I distinguish it from trade depression, for depression on the Stock Exchange often coincides with trade activity. The Morocco crisis brought the fear of war upon the world. If Germany was prepared one day to fight she began to make financial preparations for it. There can be little doubt that she prepared insidiously for this by depressing in recent years values on the Stock Exchange, selling securities to weaken us and strengthen herself. This culminated in the colossal selling weeks before the war, and in the heavy purchases of gold in the London bullion market.

There were, however, other unhappy events. There were the revolution in Mexico, the financial crises in Argentina and Brazil, the political and financial crises in France, the Balkan wars, the labour upheavals in South Africa, the epidemic of strikes in this country, the failure of the Birkbeck Bank, the Home Rule crisis, and the financial troubles of our colonies and heavy borrowings on their part. One trouble quickly followed another, peril succeeded peril, and never, perhaps, has the world struggled amidst such political and financial trials. They were years of darkness, and the dawn of a new and a brighter day seemed remote. The nations were groping, knowing not what new peril would confront them. Then the greatest peril of all came in the world-wide catastrophe.

These constantly occurring troubles could not but gradually weaken confidence in the future. When a man gropes his way in an impenetrable fog, in a place strewn with snares and pitfalls, ignorant of his whereabouts, knowing not whether he is progressing or going round in a dangerous circle, he cannot feel confident of avoiding a fatal end. He can trust only in hope and in his destiny.

This nation trusted in its destiny. Amidst these multiplying trials and difficulties it trusted in the strength of its own soul. Therefore, while prices were falling on the Stock Exchange, trade was growing and booming. More capital for trade was needed. So wealth in the shape of securities was turned into cash capital, which helped the downfall in stocks and shares. There was no lack of confidence evidently in our economic position and future. Our economic prosperity is not dependent upon Stock Exchange speculation. The Stock Exchange has often boomed and flourished during economic depression. This is because, when we have idle capital or surplus, we gamble with it, or invest it, if we cannot employ it profitably in business and commerce. We must never, therefore, assume that when inactivity reigns on the Stock Exchange and prices fall there, and stocks and shares become depreciated, that the nation is losing confidence, and that economic stagnation has come. If prices fall on the Stock Exchange through political and other causes, and because merchants and others are turning securities into cash, the aggregate value of the nation's wealth may be rising and accumulating far in excess of the depreciation on the Stock Exchange. It is probable that this has been so in recent years. Banks, for instance, have had to write down their investments year after year, yet they have earned large profits and have easily maintained their dividends. They could not have done this unless their losses in one direction had been counterbalanced by their gains in another. So it has been with other great financial institutions. They have easily kept out of the bankruptcy court.

We have had a remarkable demonstration, then, of the power of confidence even in recent years and in last year's crisis. The measures taken by the Government did not weaken that confidence, but strengthened it.

Take the moratorium, the first real moratorium this country has experienced. Had academic critics been told in the beginning of July that war would break out in the beginning of August, and that the Government would declare a moratorium, I believe they would unanimously have predicted disaster, complete and irretrievable. If they foresaw disaster as the certain end of a steady increase in armaments, nothing short of the fall of the skies would follow a moratorium. Nothing would more surely precipitate a panic, for if anything would bring about a state of bewildering confusion it would be a moratorium.

Once again, then, the imaginative vigour of these prophets was overrated. It was not equal to the strain of foreseeing the probable effects of unexperienced causes. The position was tackled, not by pedants, but by practical minds; not by nervous pedagogues, but by bold experts. And the shallow-minded and timid amongst us were amazed. We were veritably awe-stricken by the cool skill of our financial mariners steering us in safety in the unchartered waters of an unknown sea.

The prolonged Bank holiday, the indefinite closing of the Stock Exchange, were also decisions that in prior contemplation would have filled with terror the hearts of pundits, who unhesitatingly would have pronounced the doom of the mighty British Empire. The closing of the Stock Exchange would, in their convictions, so have stricken down confidence that it might never arise.

Then there was the subsequent arrangement made whereby those who had made loans to the Stock Exchange could obtain from the Bank of England advances up to 60 per cent. of the value of the securities held by the lenders against loans outstanding on July 29th. The Bank of England was not to press for the repayment of these advances until one year after the conclusion of peace, or after the expiry of the Courts (Emergency Powers) Act, 1914, whichever should happen first; nor would it demand in the meantime further margin.

This arrangement has also been highly successful.

The fixing of minimum prices for high-class securities on the Stock Exchange was another prudent step. It was artificial, but no one will pretend that the position in this country and throughout the world was a natural position. Measures of precaution and of defence were as necessary to protect the financial as the military citadel. Were they not taken, the consequences that might have followed might in all probability have been immeasurably worse than the consequences of restricted liberty. These minimum prices prevented attacks from the enemy, and, therefore, destruction by the enemy. The defensive position was greatly strengthened by the further restrictions imposed by the Treasury when the Stock Exchange reopened. These were designed to prevent wholesale selling by enemy countries and investors; and capitalists in this country were thereby saved from the incalculable losses such sales might have occasioned.

All the measures taken by the Government in this unprecedented crisis must be tested by their success. Two or three years hence we shall be able to survey them in clearer perspective and in truer proportion. But we can say with assurance even now that they have been successful. The real measure of that success we may calculate with greater certainty some day.

The banking position and the banking system have stood calm amidst it all. Even had the banks or the nation possessed that hypothetical reserve advocated by some, and had it at hand in some safe corner of London, this would not of itself have made the position more secure. Other remedial or precautionary measures would still have had to be taken. Had it not been the particular measures that were actually conceived and taken, there would have been others. But we happened to be fortunate in the measures that were adopted, measures that deepened and strengthened the nation's confidence.

CHAPTER XXII

FROZEN WEALTH

We are now in a position to look more closely into the wealth of the banks and at their position in the early days of the crisis, and to regard them from what I call the standpoint of confidence. Many happenings were foretold years ago by the prophets as the outcome of a European war, but they never foretold the closing of the Stock Exchange, nor foretold a moratorium.

I think it will be safe to say that in the closing days of July no one in this country dreamed that the Stock Exchange would be closed. I think it will be safe to say that if this had been foreseen, many would undoubtedly have predicted disaster as its consequence. Though the Stock Exchange may be regarded by moralists and puritans as the shrine of Mammon, a place frequented only by gamblers and parasites, it came home to them, as it came home to the entire nation, that the institution plays a vital part in our economic organism. If we destroyed it, we should have to set up a similar institution in its place. It is the market for the exchange of certain essential species of the community's wealth.

The closing of the Stock Exchange not only froze up a considerable portion of the wealth possessed by banks, but a far mightier portion of wealth possessed by the general community. The banks could not liquefy their wealth, and the community could not liquefy its wealth. Their wealth was useless to both. There was no market for it, and when markets no longer work, the machinery of exchange, of production and distribution, works more slowly, and in some directions comes to a standstill. This was one market, but, as I have said, it was a vital market. Its closing restricted the power of the banks to liquefy capital, it restricted the facilities of merchants, tradesmen, and others to exchange investments for cash, or liquid capital. In other words, it had the same effect as the destruction of a vast amount of capital, and trade and employment suffered accordingly.

Banks, therefore, found themselves in possession of unsaleable securities, those they held as collateral for loans and those in which their reserve funds were invested. The Stock Exchange owed to them approximately £80,000,000. Unable, therefore, to realize this wealth and to call in their loans, their position was considerably weakened.

Then there was that other mass of wealth held as security against advances to customers, which in such times was also unrealizable. The market for this class of wealth was practically destroyed. The exchange machinery came to a stop.

It was inevitable, too, that on the outbreak of so colossal a war, the foreign exchanges would break down. International trading was thrown immediately into a state of confusion. It was faced with all the complicated risks of sea-warfare, contraband declarations, neutral nation rights, insurance, freights, and the thousand and one unforeseen difficulties arising from warfare between great maritime nations. Debtors to this country could not remit money or goods to liquidate their debts, and debtors here could not redeem their debts abroad.

As pointed out in former chapters, prophets always confidently foretold that one immediate result of such a war would be a raid on our gold stores by foreign countries. Our actual experiences showed how feeble were these imaginings. They were too feeble to foresee the impossibility of exporting great masses of gold abroad. Our navy would stop their exportation to enemy countries, whilst risks of capture, freights and insurance would stop their export to neutral countries. It was rumoured that the British Government placed an embargo on exports of gold. This is highly improbable, for the embargoes imposed by the war were sufficiently preventitive; certainly so in the early months of the war.

But apart from these tremendous difficulties and obstacles, it was vastly more important to discover that we had greater power to take gold from foreign countries than foreigners had to take it from us, thereby again destroying theories. It was revealed that this country was, indeed, the world's creditor; that nations were indebted to us, not we to them. This was why, with few exceptions, notably the French Exchange, the exchanges went in our favour. This was violently so with the New York Exchange, which consequently broke down completely. America was greatly in this country's debt, and as it could not liquidate in the ordinary way by buying exchange on London, New York had eventually to send gold to Ottawa. This, together with our subsequent huge military purchases in the States, gradually improved the position, and in a few months the exchange was working normally.

Our banks called in credits from abroad, but our debtors, with all the good will in the world, could not remit the funds. Not only did this place the discount and accepting houses in serious difficulties, but the banks were involved in these difficulties. The wealth, therefore, which in normal times the banks regard as next to their cash reserves in matter of quality, was practically of no avail. Bills of exchange became as frozen as Stock Exchange securities, and naturally enough the banks forthwith ceased to discount bills. And as the bill brokers depend on the banks, they could not discount. Moreover, it was useless at first to call in loans from the bill brokers, for they could not get the funds. So the deadlock was complete.

What, then, was the most expedient thing for the Government to do in these unprecedented circumstances? Let things take their course? Let the problem solve itself? In that direction disaster lay. Even though the banks might stand up, the nation's commercial and economic position could not stand up. Dire confusion would have resulted; ruin would have followed; there would have been unemployment on a vast scale; and the nation would have been in an infinitely weaker position than it was to face and conduct the war. The problem was solved by the moratorium; and the difficulties and complications arising out of the moratorium were subsequently removed by degrees by the other measures adopted.

It was impossible for the highest human wisdom to grasp in its entirety and instantly the vast problem that had to be faced. No guidance was to be got from tradition or precedent. It was like sudden ruin overtaking an ordinary prosperous and comfortable household. The disaster not having been foreseen, and no provision having been made for it, the head of the household is in a state of bewilderment. He cannot at first see and think clearly. It is only by force of will and self-control that he finds a way to battle with his troubles and difficulties, and to minimize and overcome them.

So with the Government of the national household. It had to exercise self-control, self-will, act boldly and act firmly, adopting what appeared the wisest course, not staying to ask what our forefathers did or would have done. The nation's ancestors never had such trials and difficulties to face, such problems to settle.

The only action the wisdom of which I have doubts, was the rapid advance in the Bank of England rate to 10 per cent. It is possible that this would have had graver consequences had the bulk of the public understood the meaning of it. To those who understood it looked like the symptoms of panic. Fortunately, the bulk of the public did not understand the significance of it. In its ignorance it regarded it as something wisely and inevitably done, a greater safeguard and, therefore, a measure designed to strengthen and not weaken its confidence in the banking and financial position.

Those versed in its meaning were able to discount its importance. Now, however, that recent experiences have greatly enlightened the public, it would be well to take this lesson to heart.

The object of raising the rate was, presumably, to protect the Bank's reserve, and to draw gold from abroad. No rate, however, will protect the reserve in the day of world-wide panic, and no rate will bring gold here in such a world-war. Scarcely was it raised than it had to be brought down again. If it had to be legally raised to 10 per cent. before emergency currency could be issued, the sooner this piece of red tape is destroyed the better.

However, it is hardly likely that a crisis of the dimensions we have experienced will recur. Should it recur some generations hence, the Government in those days will have experience and precedent to guide them.

Though the greater part of the wealth of the banks was frozen in these early days, owing to the circumstances I have mentioned, and they had only their cash wealth to carry them through, there was no panic. The stability of the banking structure was not assailed by a tempest, and its position never seemed in real peril. A zephyr might have blown about it, but not a hurricane. Its foundations never swerved visibly. Let us recall, too, that the crisis occurred at an unfortunate time in the days when there are heavy calls upon the banks for holiday cash. If they paid depositors largely in notes, they fulfilled their legal obligations, and their action in this respect must be judged in the light of the legal restrictions on which I have laid emphasis in former chapters. If depositors had to go to the Bank of England to exchange their notes for gold, this was no proof of a panicky run on the Bank of England. Moreover, there can be little doubt that in all their elaborate scheming prior to the war, the Germans prepared to start a panic by a fictitious run on the Bank. But this plan failed as egregiously as their plans to bring about revolution in India and the colonies.

So far as the depositors were concerned the banks had little need to claim the protection of the moratorium. The system soon began to work as smoothly and as perfectly as in normal times.

For all that, it is a pity that years ago the Government did not take power on its own behalf, or give provisional power to the Bank of England, to issue legal tender notes of £1 and 10*s*. denomination. Notes of high denomination are useless for ordinary currency purposes. The recent crisis has demonstrated, once and for all, their uselessness. Because this provision had never been made, and because the country had no machinery for providing small currency in emergencies, new machinery had to be improvised. This entailed delay, which, though it had no grave consequences, resulted in needless loss. It was responsible in chief measure for the prolonged holiday, which was a joy to some people and a sorrow to others. However, now that we have the machinery, let us keep it to use, not to abuse. After all, very little of the new paper currency has been needed.

Having, then, in the crisis only their cash reserves to rely upon, those reserves which some critics have constantly insisted have ever been too slender, the banks came through comfortably, successfully, thoroughly justifying the confidence reposed in them. This confidence has strengthened as the days have gone by. It shows that confidence is of greater value than "credit." Such a statement takes on the aspect of a paradox. Though wealth was frozen, and though the creation of the highest class of wealth was greatly slowed down, verging on stoppage, still confidence remained. This appears to me to be confidence not only in the soundness of our banking system, but confidence in our entire economic structure, in the wisdom of Government, in the wealth of the nation, in the strength of our army and navy, in the holiness of our crusade, and in the strength of our national character. But would this confidence remain were our banking system to fall? As Mr. Lloyd George said in Parliament, the mere knowledge of the currency facilities being available gave confidence. That is, it strengthened confidence in the nation's financial fabric.

CHAPTER XXIII

SOME CONCLUSIONS

In writing this work I need hardly say—for it will be apparent to all who have laboured through it—that I have had two main purposes in view. I have written it as a guide to the student of the money market, and I have written it with the object of learning some lessons which, I think, are to be learnt from the unique experiences of the financial world since the outbreak of the war. There is much contentious matter within its pages, but this is inevitable in dealing with a subject so profound and intricate, so profound, indeed, as well nigh to baffle human vision to see clearly, steadily, and wholly its vast complexities. The financial fabric is something that has grown up in our midst as a mysterious thing. It has arisen not only out of our needs, but out of our national character. It is no invention that has suddenly revolutionized fashion in banking. It has been an economic evolution, a product of environment, and who will say that its evolution has reached its final stage? The environment has been gradually, inevitably, imperceptibly created and modified by national character, that is to say, by national psychology. This explains its distinction from other systems. Other systems in the world are likewise products of national character, products of circumscribed environment. This is why they differ, and why there is no scientific precision. There may come a time when the world will have an international banking system, but that day is far distant. Meanwhile systems must remain national.

It is important, therefore, for the student to understand that it is a psychological product, a something that has grown up out of the soul of the nation. It is difficult to be clearly conscious of this, to regard it as a something not purely scientific, something not independent of human nature as are mathematics. Banking is a part of our economic system. Political economy has been called a dismal science. This is a delusion. It is neither a science, nor is it dismal. Students of political economy have made it look dismal because they have regarded it as a science, in the making of whose laws and in the shaping of which human nature and constantly changing character have no part. Political economy is a branch of psychology. The subject is human nature, in the same way as ethics or religion is human nature. It deals with temperament and the soul, and the temperament and the soul are not strictly scientific subjects, like geology and astronomy. We might just as reasonably describe religion as the science of theological economy, and ethics as the science of moral economy, as describe social intercourse as political economy. If political economy means the law of the State, then laws are made by the citizens of a nation and are being constantly modified. They are not laws beyond the control of man.

The banking system is in our control and we can make laws to modify it as we please, and as our wisdom dictates, or counsels. In gold there is nothing marvellous. The world has given it certain powers through its laws. One nation has largely imitated another in this respect, until all the leading nations have adopted it as the basis of their systems. They have imitated each other in the same way in evolving their naval and military systems. The day may come when they will look upon gold as something barbaric, in the same light as we regard the iron currency of primitive nations. A thousand years hence ours may be spoken of as a primitive age.

In this work, then, I have endeavoured not only to be analytical and critical, but to be constructive. Many of the theories that are still held tenaciously I cannot accept. I cannot accept the theory that banks are creators of credit and build up an unsubstantial and dangerous structure. When we talk of banking credit and national credit we talk of two distinct conceptions. Yet both kinds of credit are based fundamentally on national wealth and national character. It is said that banking credit is based on gold and national credit on national wealth. Why is not national credit also based on gold? We glory in a towering national credit, because it is something to be proud of, a monument to our greatness. Why, then, should banking credit raise strong apprehensions?

Before we talk glibly of banking credit it would be more profitable, first of all, to get a clear conception of what credit is, and having got that clear conception to define it clearly. Joint stock companies talk of other credits. They describe revenue as credit, profits as credit, debts owing to them as credit, their financial standing as credit. Ideas of credit, therefore, are greatly complicated, and no wonder they lead to confusion. We even talk of Germany's credit weakening, notwithstanding the great mass of gold she possesses.

It is when we talk of credit and confidence as one and the same thing that the confusion becomes greater. We talk of the superstructure of credit raised by banks, and grow dizzy as we strain our gaze towards its apex; yet we speak in the same breath of the profound confidence we have in banks. We cannot at the same moment have profound confidence in them and yet gaze apprehensively upon the system. The repose and the fear cannot both be rational states of consciousness.

Our confidence in banks reposes in our trust in the wealth they possess and in the wealth they transform into money. Without that confidence they could not exist, despite their credit. But without confidence the nation itself could not exist. It is national confidence that supports the State. It is national confidence that brings national prosperity. Destroy confidence and you destroy wealth and prosperity.

As regards bank reserves, I think we can do in the future what we have done in the past—trust them to keep a fair average proportion. As things are, we must not expect the system to work with perfect elasticity. This cannot be done with inelastic gold as a basis. We cannot have an absolutely safe mathematical ratio. Whatever the ratio be, it alone will not ensure us against disaster. Only the Government—that is, the nation—can ensure us against disaster. It is the duty of the nation to do this, and it is also a prudent course to take. We had an exemplification of this in the recent crisis. Experience is a safer guide than theory.

But the Government, in its turn, has the right and the duty to insist upon sound banking. It should allow no institutions to spring up calling themselves banks which cannot be conducted soundly. This is not safeguarding the community. Such institutions should be differentiated, and should have their proper designations. I think the fewer the banks the better, therefore I favour amalgamations. This is because I think they could be brought under more complete control and could be more soundly and safely administrated. In fact, I would go to the logical extreme and make them branches of a State Bank and not independent entities.

It is because they and the Bank of England are independent entities that we cannot simultaneously have high reserves in the joint stock banks and high reserves in the Bank of England unless both stop lending simultaneously. A joint stock bank singly can keep a high proportion because it can make all its branches conform to the common policy. But as the banks are not branches of the Bank of England there can be no common policy. This has its grave disadvantages at times. We may evolve in time to closer union, to a more consistent and uniform system. This certainly lies in the path of social evolution.

As to where the reserves should be kept, I do not think, as the system is at present, that this is a question of vital importance. The reserves appear to me to be safer in the Bank of England, because thereby they place greater obligations upon that Bank, and this comes nearer to our notions of unity. Behind the Bank of England is the Government, and behind the Government is the State. One thing is certain. Wherever the reserves be, they will not suffice of themselves to save the banks in a state of ungovernable panic without the help of the Government. And all the banks must stand or fall together. And if they stand or fall together their reserves must be pooled in some fashion and somewhere.

The Government can save them in these grave, but, happily, remote circumstances, by setting the machinery at work to produce legal tender currency.

The wisdom and efficacy of this have recently been strikingly demonstrated.

Many critics have foretold disaster from the inadequacy of the gold reserves against the liabilities in the Post Office Savings Bank. The Post Office Savings Bank and the joint stock banks perform distinct functions. The Savings Bank does not lend. It does not transform wealth into liquid currency. It is a huge State safe, where public savings are kept in safety, and it performs the functions of the old silver teapot in the household. Being a purely State or National institution, it is a national liability. It has behind it the entire wealth of the nation, and it is absolutely safe unless the nation be swallowed up in the seas. And if it were swallowed up the depositors would not need their money.

Gold, after all, performs but limited functions. It is becoming less necessary in the internal economy of the State owing to the growth of cheques. Gold is merely a symbol, and we should not bow before it in abject obeisance. It is even becoming of less importance in its international functions, and I think the European war will lessen its importance still further. European nations have collected it more for war purposes than for commercial. This has been the case with Germany, which, in the consciousness of its determination to fight for world dominion, amassed the gold as a war chest. This gold is not in circulation, but is lying idle in the Reichsbank, in order that the Government may flood the country with various sorts of paper currency. This paper currency will in time be so inflated as to become greatly depreciated. This is the danger run, the danger of inflation and depreciation, yet we never dream of the inflation of our cheque currency, because it grows and contracts with our output of wealth.

The depreciation of paper currency is evidence often that a nation is living beyond its income. We know the fate awaiting the individual when he "outruns the constable." In order to avoid insolvency he must live more frugally, live well within his income, and liquidate his debts. Then, in time, he will be free and will not live in dread of his creditors.

If a nation lived within itself, built a huge rampart around itself, and had no commercial intercourse with other nations, if it could live a happy, contented community, on its own resources, then an inflated currency would have no ill effects. It would not necessarily bring bankruptcy and ruin. It would be like a private individual living on his own resources and on the fruits of his own labour, interchanging nothing with his neighbours. Such a hermit would be indebted to no man. He would depend on nature alone, and if nature failed him, or sickness overtook him, then he would die.

But civilized nations are not hermit nations. They live by mutual help, by mutual trading. They deal with each other and they deal on the system of barter, in the absence of an international currency. Gold is a species of barter and passes from nation to nation in all respects like an ordinary commodity. Imports are paid for by exports, and exports pay for imports. When, however, a country imports more than it can pay for in exports, it must either cease to import, or pay for the excess in gold, securities, or some other form of payment. If it has to pay in gold it may be living beyond its income and be paying for its exports out of capital. If the gold be hoarded and the paper currency be multiplied and inflated an automatic rise in prices results. This is tantamount to a depreciation of the paper currency, for this currency can then purchase less. What is called the credit of the nation falls. That is to say, belief in its soundness weakens. This encourages imports from foreign countries and discourages exports, and the indebtedness to foreign countries increases. Should this go on indefinitely, the country will get deeper and deeper into debt and nearer to insolvency. It will have to pay for its imports with its gold, or stop importing. And if it stops importing, it might stop importing vital products. Powers of production and consumption will necessarily weaken, and that country will get into the plight Germany has got into. In time its credit and currency will become so debased that foreigners will not risk exporting commodities, lest they should lose more than they gain, for the debtor country's paper will become of less value.

In the case of Russia, her currency also became depreciated in terms of sterling value. This arose from a different cause. Russia's exports to England

and other countries were stopped by the closing of the Baltic Sea and the Dardanelles. A little went by the Archangel route, but, of course, it was wholly inadequate. Russia, therefore, was unable to liquidate her national indebtedness by her exports, and the exchange went so greatly against her—that is to say, the rouble became so greatly depreciated in terms of our gold currency—that it was impossible for Russian merchants to get remittances to send to this country to liquidate their indebtedness here.

The war crisis has been invaluable in teaching us deep lessons. Had there been machinery for the ready provision of legal tender currency the moment the war was foreseen, a moratorium might have been unnecessary, with all its complications and confusion. A prolonged Bank holiday, with its inconveniences, might likewise have been obviated. The crisis has shown enlightened nations how terrible the risks and consequences of war are. It has been invaluable in revealing the spiritual, material, and financial strength of Great Britain and the Empire, and in setting up precedents for future guidance in the financial as well as in the military and commercial spheres. And the heavy financial burdens shouldered by the nation may not in the long run be so heavy as some fear.

APPENDIX A

THE following pre-war Bank of England return, of June 24th, 1914, may be regarded as a normal return, and it can be compared with the abnormal return appearing in Chapter IX.

ISSUE DEPARTMENT.

	£		£
Notes issued ...	56,753,275	Government debt	11,015,100
		Other securities ...	7,434,900
		Gold coin and bullion	38,303,275
	56,753,275		56,753,275

BANKING DEPARTMENT.

	£		£
Proprietors' capital	14,553,000	Government securities	11,046,570
Rest	3,160,254	Other securities ...	39,994,619
Public deposits ...	18,074,214	Notes	28,050,150
Other deposits ...	44,915,911	Gold and silver coin	1,624,988
Seven-day and other bills	12,948		
	80,716,327		80,716,327

The proportion of the reserve this week was $47\frac{1}{8}$ per cent.

APPENDIX B

MR. AUSTEN CHAMBERLAIN AND MR. LLOYD GEORGE ON GOLD RESERVES

WHILE this book was in the press, interesting views upon the note currency and the gold reserves were expressed in the House of Commons by Mr. Austen Chamberlain and Mr. Lloyd George. They coincide largely with my own views. The opinions were expressed during the discussion on February 23rd on the Chancellor of the Exchequer's statement on the financial arrangements made with France and Russia.

Mr. Austen Chamberlain said, to quote from the report in the *Morning Post* :—

" Mr. D. M. Mason the previous night urged the Government to withdraw the Treasury notes now in circulation here. He (Mr. Chamberlain) had held for a long time that gold in the pockets of the people was not a very useful reserve for any national purpose, that we carried about the same amount of gold whether it was a time of crisis or not, and that that gold was not readily made available for the international currency when the need for it in that capacity arose. Therefore, he held that the internal circulation of gold was, on the whole, wasteful use of it, that it was an out of date use of gold, and that the greatest development of our financial system had been the substitution of paper for gold. The largest substitution had been in the form of the cheque. Provided that the issue of notes was not an artificial inflation of the currency but a response to a real need for currency, then the more they could substitute notes for gold for internal use the better, and the more economical, the more civilized, and the more advanced the currency system became. What he cared about was seeing a large reserve of gold centralized for use in an emergency, and if they had secured the reserve of gold and the emergency arose, then the most foolish thing they could do was to fail to use the gold. The gold was got together in order that in an emergency, when the exchange went against them, the adverse balance of the exchanges might be corrected by the use of the gold, and unless the gold were used in that way it seemed to be a pure waste of it to hold it in reserve. That was not a doctrine that was popular in any foreign country that he knew. But it was a sound doctrine, and he hoped that the whole influence that we could bring, through the Chancellor of the Exchequer, in the councils of the Allies would be directed to making them use their gold resources freely when those gold resources were required. They had to study the psychology of the people. If the Government used their gold freely they very soon restored confidence in the public mind. He hoped that our influence would be used to persuade our Allies that in this matter the boldest course was the safest course, and that States were as unwise to hoard gold as individuals within States were." (Hear, hear.)

Mr. Lloyd George, in the course of his speech, said: "As to the matter of currency, he was completely in agreement with Mr. Chamberlain, who put the position so effectively that he could not usefully add anything. He thought it desirable that there should be considerable reserves of gold in the Bank of England or in the

Treasury, and equally desirable that it should be freely used whenever the emergency arose. We were on the road to a much more efficient use of our gold reserve if we used paper currency within safe limits. Our issues of paper currency were well within safe limits. (Hear, hear.) Not only so, but there was no country to be compared with us in this respect. Foreign countries, he thought, had always been nervous about using their gold. The fact that we used it freely showed that was not our view. There was too much disposition even to-day to worship the golden calf. (Laughter.) This country had always gone on the principle that the gold was there to use whenever there was a demand for it, and that practice had never failed us up to the present. It was true that we had never had such a strain put upon it as during the past few months, and it was probable that that strain would increase during the next six or twelve months, when our purchases abroad would be much heavier than ever before, and our sales to other countries considerably less. He did not like to prophesy, and he hated bragging, but he did not mind saying that the resources of gold we had got would carry us through any emergency that we could possibly foresee. (Cheers.) That was his firm conviction, not merely from his observation, but from careful inquiries in the City and elsewhere. He agreed, however, that there was no special merit in paying debts in gold where paper would do equally well, and thought it wasteful, burdensome, and not particularly useful."

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