A TWENTIETH CENTURY ECONOMIC SYSTEM

The author has decided to remain anonymous, in the hope that his fellow citizens will insist, on this occasion, on doing their own thinking, and will consider these proposals on their merits, uninfluenced by the names and reputations of the protagonists on either side.

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" If our initial impulses proceed from the belief that things are so limited that our gain can only come from someone else's corresponding loss, then we have here the root of all envy, hatred and fear."

T. Troward.

INTRODUCTION

When the war is over the world will consist of nations with economies in a state of flux. Those which before the war were primarily producers of foodstuffs and raw materials will have secondary industries in different stages of development and with varying claims on their nations to be firmly established. On the other hand, nations which before the war were mainly manufacturing will have resuscitated their agricultural and primary industries: these, too, in each nation, will have firmly established claims to consideration in varying degrees.

It is fatal to approach this problem with the mentality of the 19th Century economists who assumed that the only proper objective of an economic system was to produce the maximum of real wealth with the minimum of labour, and therefore looked to "division of labour" carried to its extreme limits, not only as between people within the nation but as between one nation and another.

With the development of Power Production in the 20th Century, the problem of producing a sufficiency for all has been largely solved, and people are no longer content to accept it as axiomatic that the be-all and end-all of society, in its economic aspect, is to produce a maximum quantity of goods and services. They recognise that there are other values which they may choose in preference to still more goods and services.

It is useless to attempt to persuade or force nations to sacrifice the economic aspirations of their people, which are clearly well within their compass in the 20th Century, by arguments valid in the 19th Century. Industrial nations now realise that a population entirely urbanised becomes decadent and that a healthy agricultural community is an essential stabilising factor: these are considerations which they feel outweigh the saving of labour which would be effected if they relied entirely upon imports of foodstuffs from countries where they could be produced with less labour. Primary producing countries, on the other hand, recognise that they can never achieve full nationhood so long as they are unable to offer to their citizens within their own borders that wide variety of occupations which modern science has made possible: so long, in short, as those of their sons who are not content to be primary producers must emigrate to find congenial occupations. They, too, feel that this is a luxury which they can afford, and which they prefer to saving labour by relying solely upon imports of manufactured goods.

Against this 20th Century desire of nations for well-balanced, healthy and happy communities is advanced a perfectly true, but irrelevant, 19th Century argument that only by each nation specialising on what it is best able to produce and exchanging its surplus for the surpluses of other nations can maximum wealth be produced with minimum labour. Every advanced nation has millions of people set free by labour-saving machinery, i.e.

unemployed, and the argument is not likely to appeal to them that they could "free" still more if they would set their faces hard enough against the rising tide of 20th Century economic thought and would revert to 19th Century policies.

This does not mean that industrial nations will, in the future, produce all the foodstuffs that they require, nor that primary producing countries will produce all the manufactured goods they require. It does mean that an international trading system, based on the assumption that a nation will always welcome imports if they are cheap enough, is out of touch with modern reality and will constantly break down.

It is sometimes suggested that if larger political units could be formed, so reducing the number of tariff barriers and also the number of national currencies, the problem of the "favourable" and "unfavourable" balance of payments would be solved within that area.

In support of this contention it is asserted that there are no "unfavourable" balances as between, e.g., one English county and the rest of the country, or between one State and the rest of the United States of America. This is quite untrue. A "Distressed Area" is one which is obliged to "import" from the rest of the country but is not able to produce enough to pay for those "imports" with "exports" to the rest of the country. The result is that money is sucked out of the area. In this case, however, the Government taxes money—necessarily from the areas which have it—and spends it back into the distressed area in the form of relief, etc.

Even within nations where, through a long history, a strong sentiment of solidarity between the citizens has been built up, where throughout the country approximately the same standard of living and the same conditions obtain, the redistribution of money through taxation by the Central Government is by no means popular, and is only tolerated within limits.

Is it not then sheer fantasy to suppose that nations with no such traditional background of mutual responsibility, with different standards of living and ways of life, would agree to unite and remove trade barriers between one another, on the understanding that the flow of the common money within the Union, or Federal Area, from the poor nations to the rich, would be counteracted by the newly constituted Federal Government taxing the rich nation-members for the benefit of the poor?

National sentiment is a fact and it is not likely to be weaker after this war than it was before, so that it is useless to advance schemes which ignore it.

In the following memorandum an attempt is made to ascertain the factors which are potent today in determining national economic policies and to suggest the modifications in the economic system, both in its national and international aspects, which are immediately necessary to enable constructive forces to be released and disruptive factors to be eliminated. Unless international trade is changed from a struggle by the nations to get one another into unpayable debt, to a mutually advantageous exchange of real wealth, and unless the palpable absurdity of unemployment and poverty in juxtaposition is permanently removed, then fear, resentment and frustration, which these things have spread through the world, will destroy our civilisation. Economic systems were made for man : not man for economic systems. Political freedom is not enough. Nations now realise that, so long as there is financial and economic domination, political freedom is an illusion.

We are engaged in a war which is, at root, a War of Ideas. It is not enough to be negative —to expose and fight against False Ideas, although this is essential. When we can offer humanity a system which provides economic security and freedom, without the surrender of political freedom as a condition, we shall have armed ourselves with so powerful a weapon of propaganda as to ensure speedy victory. We shall have captured the imagination and enthusiastic support of men everywhere. General professions of good intentions after the war will not again be accepted. The necessary changes must be made now.

August, **1941.**

PART ONE

AN APPRECIATION OF THE ECONOMIC PROBLEMS AFTER THE WAR

The Short Term Position.

(1) When hostilities cease this country will find itself with its foreign investments greatly reduced and therefore in receipt of a smaller value of imports by way of interest on those investments. If we consider first the short-term position, it seems evident that Europe generally will have need of imports of all kinds. Food will be required in immense quantities. Machinery will be needed in order to change over as rapidly as possible from war to peace-time production, as well as to replace that worn out during years of high-pressure output, and raw materials of every description will also be needed. Until those supplies have been received and the change over has been effected, neither Europe nor perhaps this country will be able to pay for its imports with exports.

(2) During this transitional period, the United States and, in a lesser degree, other neutral countries will also be faced with an internal problem consequent upon the cessation of high-pressure production of armaments. Unlike the belligerents, however, the U.S.A. will not have large works of reconstruction on which to employ their people. It is therefore unlikely that they will

Neutrals will need to export but not import: ex-belligerents will need to import but won't have much to export.

wish to add to the internal employment problem, created by the closing down of armament factories, by stopping exports to this country and Europe owing to the inability of Europe to pay with corresponding exports to them. It is, on the contrary, evident that they would, under such circumstances, not welcome imports even if they could be made.

Basis of Marshall plan

(3) In short, Europe and this country will be in need of imports and may not be in a position to pay for all of them with exports. On the other hand, the United States will be in need of exports to ease their employment position at home, and for the same reason will be unwilling to take imports.

(4) Under such conditions it would be fatal to free the foreign exchanges. The exchange value of the currencies of this country and Europe, if offered for sale freely, would rapidly fall in relation to the currencies of the non-belligerents. This would mean that the cost of imports here and in Europe would be greater, so causing a rise in the Cost of Living. This would necessitate an increase in wages which, in its turn, would mean the issue of more currency to pay those wages. This would be the signal for speculators to offer forward still larger blocks of our currency for sale on the exchange. We should, in fact, go straight into the spiral of inflation by the same process as was responsible for inflation of the mark in Germany in 1923. The freeing of the exchanges is therefore quite out of the question during the transitional period and

Foreign exchanges cannot be freed.

exchange control would have to be continued for the above reasons, even if it were not thought desirable to make this a permanent feature of the post-war economy, a proposal which is advocated later in this memorandum.

(5) An attempt has been made in the foregoing paragraphs to show that it is in the true interest, both of the non-belligerent and lately warring countries, that during the transitional period goods should flow mainly in one direction—from the former to the latter. It may well be, however, that for psychological reasons a continuance into peace time of the Lease-Lend Act may not be possible without modification, and such a modified form is advocated in the following memorandum.

The Long-Term Position.

(6) When once the transitional period is passed, the difficulty for the countries lately at war will not be to produce enough to pay for their imports with exports, but the unwillingness of the U.S.A. to take payment in the only possible way, namely, in goods and services. This position would be immensely aggravated if, during the transitional period, the U.S.A. had insisted upon the late belligerents incurring huge financial debts to pay for their imports. Should this mistake of the last war be repeated, European nations would have to induce the U.S.A.—when once the transitional period was past—to take imports to pay for their exports, and also to take a further large volume of imports, against which the U.S.A. must export nothing, in order to pay the interest on the loans.

(7) The wretched financial history of the 21 years between the wars would be repeated.

No unpayable indebtedness.

Either the European nations *would have to stop imports from* the creditor neutrals, whilst trying to pay the interest on debts by forcing their goods into their markets, or they would have to continue to take imports on loan, so increasing the debts to the point where they would have to be repudiated. The atmosphere would again be poisoned by the mutual recriminations between debtor and creditor nations which made amicable relations impossible in the inter-war period. The creditor nation insisting upon payment and threatening the exchange rates of the debtor by selling its currency at what it would fetch: the debtor nation pointing out that it did not manufacture the creditor's money and could only acquire it if allowed to sell its own goods in the creditor's market. The attitude of the creditor nation under these circumstances may be summarised as follows. "Packets of pesos, marks, francs, and sterling are useless to me as they are only legal tender in their respective countries, and I do not wish to buy your goods. Your obligation is to pay me in my own currency, e.g., dollars. I realise that you do not manufacture dollars and that you can only acquire them by *selling goods in my market. I propose, however*, to stop you doing this by means of tariffs or quotas, but heaven help you if you are not successful in your efforts to defeat me in my attempts to stop you paying. If you are unsuccessful, I shall sell your currency on the

Foreign Exchange for what I can get, and knock your exchange rate down, so putting you through uncontrolled inflation. The alternative is that I loan you what you owe me at compound interest. This will, however, merely defer the day of reckoning which, when it comes, will be so much the worse."

(8) So long as the economic relations between nations produce, through the operations of the financial system, such tension, ill-will and fear, it is a misnomer to describe as Peace the periods between wars. Let us hope, however, that the lessons of the past have been learned. This hope is supported by the reflection that the American public lost their money by lending to ex-belligerents after the last war, and are not likely to subscribe voluntarily to such loans again.

Useless to rely on appeals.

(9) It is useless to rely, as in the 21 years between the wars, upon appeals to creditor nations to allow debtor nations to pay in goods and services: the reasons, under the present system, why such appeals must fall on deaf ears are considered in the following paragraphs. What is necessary is the establishment of a system under which creditor nations have the option of taking goods and services or nothing.

Why nations don't welcome imports.

(10) According to orthodox economic theory, a nation welcomes cheap imports and is thereby made richer. Division of labour results in a saving of labour, but owing to labour-saving devices the advanced nations have superabundant labour, so that this argument no longer appeals as it did in the 19th Century. Nations

now prefer the luxury of a well-balanced economy so that they can offer to their citizens within their own borders a wide choice of activities.

(11) Moreover, the 19th Century system implied willingness to see a native industry ruined by cheaper imports. This involved great insecurity, both for capital and labour. For labour it meant a constant threat of being out of work and learning new trades when young, with the knowledge that when middle-aged no new trade would bother to do the training. It meant willingness to move from one part of the country to another in search of work, with uprooting of homes, loss of friends, etc. One of the crying needs of our civilisation is a measure of material security and stability and this system can provide neither. It ignores human nature and will not be tolerated by the workers in the second half of the 20th Century.

(12) The old financial mechanism was, in fact, based on the assumption that the only reason why a nation's exports were not welcomed by importing countries was that they were too expensive and that, if cheap enough, they would be gladly received. The case of Japan has shown quite clearly that this theory is contrary to the facts. One nation after another has taken special measures to exclude Japanese goods because they are too cheap.

(13) The explanation is not far to seek. Mass production implies mass consumption, as goods are not produced for long if there are no buyers. Labour-saving machinery produces the goods previously produced by many men who would

have received wages with which to buy their own or other people's output. The machines now receive those wages in the form of interest on capital, but the machines do not consume their own output. Some of this money will no doubt come back into the hands of the workers in the form of wages for new capital production, but much of it will be used for purely financial speculation. Even when the wages of existing machines are distributed to the workers to make more machines, the problem is not solved. When completed, the new machines will facilitate the production of more consumption goods. This will necessitate a repetition of the cycle. With each turn of the wheel the speed is increased, until a major collapse occurs. The larger the total wages of all machines becomes, the more capital goods must be produced in the next cycle, if those wages are to be distributed to the workers, who alone can consume the product of the machines. The interest on the capital represented by the machines, i.e., the machine's wages, goes to a very small section of the community which is unlikely to increase its consumption of goods and services.

(14) There is therefore in each nation a shortage of effective demand for the goods which the nation is capable of producing, i.e., of money in the pockets of the people wanting to buy goods. The more highly developed a nation economically, the more is this so, with the result that the richer the nation the larger is its unemployment, other things being equal. The unemployed man has a right to say, " Is the reason why I have to go short and why my wife and

children are expected to go under-nourished, badly clothed, and badly sheltered, because there are not enough of these things to go round; if so, why should I not be allowed to produce more?" To this the answer must be, "No; the reason why you must go without is not because there is not enough but because there is too much: otherwise you would be employed." "Why, then," he would ask, "should I not be allowed to consume the 'too much' and then there would not be too much and I should be allowed to produce more?" To this the answer would be, "But you cannot consume because you have no Licences-to-Consume, i.e., money, and you can only obtain these by working to produce more." "But I am very willing to produce more," to which again he would receive the reply, "As I have already told you, there is over-production already and we don't wish you to produce more."

(15) It is evident that if each nation would distribute to its people internally enough purchasing power to ensure that there would be effective demand for 100 per cent. of its own output, then a nation could either consume the whole of its own production or it could exchange any percentage it chose for the production of other nations and consume that. It does not, in fact, welcome imports because it does not distribute enough purchasing power internally, and imports will, therefore, compete with its own production for the inadequate available purchasing power.

(16) How to distribute purchasing power to the mass of the people is therefore the most

pressing and urgent internal problem of every advanced nation. When a nation exports goods it serves out money in the form of wages to the workpeople making the goods. The goods leave the country but the wages remain behind in the pockets of the workers. They will be used to buy the surplus of goods awaiting consumption in the domestic market. Effective demand for goods has been increased without the supply of goods awaiting consumption in the domestic market being similarly increased. This is, however, true only so long as imports of consumers' goods or competitive non-consumers' goods do not come into the domestic market to pay for those exports. Hence tariffs and quotas. Hence also exports on loan. The cheaper imports are, the more likely are they to capture the entire market and so destroy the native industry, thus aggravating the problem of finding ways and means of distributing purchasing power to the workers.

(17) It is sometimes suggested that a solution to this problem would be to increase wages generally. It is, however, evident that a general increase in wages merely results in a general increase in prices, so that the two increases cancel one another out. Moreover, a rise in price will have put the country out of the world's markets. The total purchasing power is no greater than before. It is true that a technological improvement enables increased wages to be paid without a rise in price, but technological improvements usually mean the employment of fewer people and a larger proportion of the sale price of the product going in

wages to the machine, i.e., interest on capital.

(18) Social services represent another method of increasing effective demand by the masses: they are, in fact, wages in *kind, since they* relieve the worker of an expense which he would otherwise have to meet out of his wages.

(19) Public works have also been tried on a large scale. Instead of a small dole, full wages *can, under this method*, be paid to the unemployed, so that they are able to consume the surplus of goods overhanging the market. To be effective, it is essential that the public work upon which the unemployed are engaged would not otherwise have been undertaken. If the work is competitive with the normal activities of private enterprise or public authorities, it would merely result in the newly employed receiving the wages, whilst the men with whom they were then competing would be thrown out of work and receive none. This is not, however, an insoluble problem and it is not the main objection to this method of enabling a people to consume all the goods they are capable of producing, or alternatively, the goods of other nations which they exchange for their own product.

(20) The main objection is that it is *financially* cheaper to pay men a small dole to do nothing than to pay them wages to produce real wealth: that in order to acquire the money with which to employ them, the State must either tax it from the citizens or must borrow it at interest; but if it taxes the money from the citizens it is merely taking purchasing power away from employed citizens in order to give

it to unemployed citizens, and is not thereby increasing the total purchasing power of the community: if it borrows the money at interest it adds to the National Debt and so to the annual interest charge which, in its turn, involves further taxation to pay that interest. This objection applies also to the method mentioned in paragraph (18).

(21) Public works traditionally take the form of rearmament. Industry is stimulated over a very wide range and the unemployed are rapidly absorbed. The wages paid to them will be used by them to buy the surplus output of the rest of the community. Effective demand for goods is increased, whilst the volume of goods awaiting consumption in the market is not increased. Moreover, the financial indebtedness resulting from this form of public works can be represented as a temporary and emergency expenditure rather than as a permanent feature of the economic system. In its early stages, whilst it is consciously being used to ease the unemployment problem, and so avert revolution, it is very effective, but it invariably results in other nations taking fright and starting an armaments race which can only terminate in war.

Under-Consumption and Unemployment synonymous.

(22) No excuse is made for having considered at some length Under-Consumption, which is synonymous with Unemployment, since it is submitted that this is a root problem which must be solved, unless all hope of the survival of our civilisation is to be abandoned.

(23) There is a further reason why nations are anxious to export and not import. Under the

The struggle for "favourable" balances.

existing system, the pre-occupation, in the economic sphere, of the statesmen of all nations, must be to ensure an active "favourable" balance of payments. If successful, a nation gets other nations into unpayable debt: if unsuccessful, other nations get it into unpayable debt. If some nations have "favourable" balances, other nations must have "unfavourable" ones. International trade has therefore degenerated into financial war, instead of being an exchange of goods and services to the mutual advantage of both parties.

(24) If a measure of stability and security is to be assured in the future in the economic relations of nations, the new system must be designed to make impossible the sale by private individuals on the foreign exchange of the currencies of their own and other nations. No nation can hope to maintain its economy in equilibrium with the world, i.e. its imports of goods and services in balance with its exports of goods and services, if it is open to individuals, through fear of conditions in their own country, because they can see a rake-off, or a better rate of interest in some other country, or because they wish to bring about a political crisis by rocking the exchanges, to offer for sale on the foreign exchange massive quantities of one nation's currency for another.

(25) The Macmillan Committee recognised the right which individuals had to do this under the old system as a great potential danger. Within three months of their Report, the danger which they had foreseen

materialised and caused a major economic crisis.

(26) From 1936 onwards the French nation was subjected to rising internal prices and the ruin of many of its citizens through the action of individual Frenchmen who, apprehensive of the future, sold francs and bought sterling, so knocking down the French exchange rate. They bought this sterling, not for the purpose of buying English goods nor to pay their debts in England, but because they preferred to hold their personal fortunes in the form of sterling in London rather than in the form of francs in France. By striking in this way a series of blows at the economic stability of their own country, they created the very conditions of chaos from which they were fleeing.

(27) When, in 1938, this small group of foreigners scented a European war in the offing, they decided that they preferred to hold their private fortunes in the form of dollars in New York rather than sterling in London. The sudden throwing of this large mass of sterling on to the Exchange market caused a sharp fall in the value of sterling, in spite of the fact that, within a year of war, this country parted with large quantities of gold to America to counteract the effect of these sales.

Other problems.

(28) It will be necessary, if peace is to be established in the world after the war, to adopt an international trading system which will enable the following additional problems to be settled amicably :—

(*a*) The unwillingness, consequent upon their industrialisation, of primary producing countries, more particularly the Dominions and India, to receive imports of certain manufactured goods, which previously they had imported freely.

(*b*) Nations with different internal economic systems must be enabled to live in the same world without those differences constituting a threat to the continued existence of one another's internal systems.

(*c*) The movement of people from over-populated to under-populated countries. The objection of the latter to receive immigrants is due to the unemployment of their own people and will disappear when that problem is solved.

SUMMARY

1. Whilst the ex-belligerents are reconstructing their countries and their industries, they will have need of imports in excess of their ability to pay in exports. (Par. (1).)

Transitional period.

2. During this period, the U.S.A. and other neutrals will have to reabsorb their war workers into peacetime production and will have need of exports but not of imports. They will perhaps object, however, to extending Lease Lend procedure into peacetime unless in a modified form. (Pars. (2), (3), (5).)

3. To float loans in the U.S.A. to pay for these surplus imports would probably be impossible, because the people would remember that they lost their money after the last war and understand better now that they would inevitably lose it again. Even if it were possible, it would be undesirable to float loans because it would greatly accentuate the troubles of the U.S.A. when the transitional period was passed, since they would have to adjust their economy to receive imports in payment of interest on loans, as well as in payment for their exports. It would mean their having to receive imports in excess of their exports by way of interest on the loan. (Pars. (6), (7).)

4. Foreign exchanges cannot be freed (4).

5. Useless to rely on appeals to creditor nations to allow their debtors to pay in goods

Long term position. and services: it is necessary to establish a system under which they have the option of taking goods and services or nothing. (Par. (9).)

6. There are two main economic pressures, under the present system, which ensure that such appeals will fall on deaf ears. The first is the unemployment problem at home: the second the struggle for "favourable" balances of payment under threat of getting into a position of unpayable indebtedness. This second pressure has resulted in international trade having become a financial war instead of, as it should be, an exchange of goods and services between the nations to their mutual advantage. (Par. (23).)

There are also certain subsidiary, though nevertheless important, considerations which make a nation unwilling to accept unlimited quantities of cheap imports. Whilst it is no doubt true that maximum wealth can be achieved by each nation specialising in what it is best able to produce, and exchanging the surplus for those goods which other nations are best able to produce, modern war calls for such a variety of commodities that nations are not willing to become entirely dependent on other nations for the production of such commodities. Apart, however, from war, nations are anxious to be able to offer to their own citizens within their own borders that choice of occupations which modern science has made possible. (Pars. (10)-(16).)

7. A number of methods have been employed to increase the effective demand without in-

creasing the number of goods awaiting consumption in the market: improved technique is necessary. If nations would give their own people enough purchasing power to consume 100 per cent. of their own production, no nation would object to a proportion of its products being exchanged for the products of other nations, their people having enough purchasing power to consume their own output or the output of other nations which they might exchange for their own. (Pars. (17)-(22).)

8. The sale by private individuals on the Foreign Exchange of massive quantities of one nation's currency for another should be prohibited. Unless the new system is designed to make such sales impossible, there can be no stability and security in the economic relations of nations. The sudden and unpredictable upsetting of the Exchanges caused in this way was recognised by the Macmillan Committee as a great potential danger. This buying and selling of other nation's currencies may have, and frequently has, no relationship to trade, although it may so disturb the nation's economic system as to have serious social and political consequences. (Pars. (24)-(27).)

9. Other problems requiring solution. (Par. (28).)

PART TWO

CONSTRUCTIVE PROPOSALS

International System

Causes of international friction removed.

(29) Past experience has shown us that it is useless to rely upon appeals to nations to take payment for their exports and for interest on their loans in the form of imports (goods and services). The first essential, therefore, is to establish an international trading system under which, if nations wish to take payment, they will have no option but to take it in goods and services—otherwise making a present. Such a system would have the merit of leaving each nation free to determine how much import and export trade it wished to do. It would make subsidies and other devices for the artificial stimulation of exports pointless, unless the nation were similarly prepared to increase its imports. Anti-dumping laws could deal with attempts by individual manufacturers to unload unwanted surpluses should the importing nation consider that such prices would have a disruptive effect on its own market. Instead of the bickerings and recriminations which accompanied the old system, under which fruitless attempts were made to persuade nations to play the game by taking imports in exchange for their exports, there would be a solid foundation for trade negotiations, since each nation would be as much concerned with its import as with its

export trade. Moreover, it would enable nations with totally different internal economic systems to trade together amicably without that trade being the means by which one internal *system could threaten the continued existence* of another.

(30) As has been pointed out, this country after the war will not be entitled to receive a large volume of imports by way of interest on loans, against which, therefore, it has to do no corresponding export. The countries which were our debtors in the past were distributing wages to their people for producing the goods which they sent to us by way of interest on loans. The exports left the country and nothing came back. The wages, however, had been distributed and were used to buy what remained. Effective demand was increased without increasing the supply of goods awaiting consumption in their market. If we cannot have the same value of imports after the war as before, it will not be because we could not very easily produce additional goods for export to pay for them, but because the late debtor nations will not be prepared to take payment in goods because such additional imports would increase the number of goods awaiting consumption in their markets, whilst the amount of purchasing power distributed would not be increased. These additional imports would, in fact, be in competition with the goods already in their market, for such purchasing power as there was. It is therefore essential that nations should improve upon the methods indicated in paragraphs (16)-(19) for equating effective de-

mand with supply. It is evident that the late debtor countries would very readily accept additional imports if their people had enough of their own national money (pieces of paper and book-entries) to buy them—when once those imports were in their countries—in addition to and not instead of the goods already there; the problem is not insoluble.

Industrialisation of primary-producing countries.

(31) It must further be recognised that the Dominions, India, and a number of other markets, are being rapidly industrialised during the war, and they will insist upon protecting and building up their secondary industries for the reasons set out in the Introduction. If then a satisfactory solution is to be reached without relations becoming strained, it is clear that this cannot be done by the methods of persuasion and conference which proved so fruitless during the inter-war period.

Remove question of trade barriers from international to national arena.

(32) It is submitted that it is necessary to establish a system of international trade under which the problem will be fairly and squarely placed on the shoulders of each nation, as to how it proposes to take payment for its exports: if it does not take payment in the form of imports, it will merely have made a present of its exports. The matter will then be one for settlement, not as between nations, but within each nation as between the exporting industries, which will wish to continue to export, and the new industries, which will be faced by the dilemma of seeing their best customers, the export industries, ruined, or

allowing imports in to pay for those exports. It would no longer be possible, as in the past, to satisfy both parties by stopping imports with tariffs, so as to protect the new industries, whilst continuing to export primaries, and then, under threat of knocking down the exchange rate of the buying country, compelling it to get into unpayable debt. It is unlikely that the workers of any country would for long be content to export their real wealth and receive nothing whatever in return—not even an admission of unpayable indebtedness.

(33) No doubt the solution reached would vary from country to country. In so far as a country decided to restrict imports, to that extent it would restrict exports, so leaving other export markets free for those nations who wished to do a larger two-way overseas trade.

(34) The United States has already shown the way to the new system in the Lease-Lend Act.

Lease-Lend Act.

She has there accepted the principle that nations can only pay for goods and services with goods and services. She has also recognised that you can take a horse to the water but you cannot make it drink: that the importing nation can give the exporting nation a claim to its goods, but that it cannot make the exporting nation buy those goods against its will, and should not be under obligation to do so. A conventional rate of exchange between the dollar and the pound has been fixed by agreement. The goods shipped from the United States are paid for by the United States Government and the Act provides that payment for them may ultimately be made by the importing country in kind or property or any direct or indirect benefit which the President deems satisfactory.

Modifications of international system.

(35) The changes which would be necessary to convert this mechanism from wartime to peacetime uses, whilst not altering the underlying principles, are, it is submitted:—

(*a*) That the conventional agreement between the two countries as to the fixity of exchange should be continued. Similar conventions should be made with the Dominions, India, the Colonies, and any other countries which cared to participate, thereby automatically determining the exchange rates between themselves: the exchange rate when once fixed would be invariable, as it would not be subject to the Law of Supply and Demand.

(*b*) That instead of the United States Government paying the American citizen for his exports, the private American trader should draw a bill in sterling on the English importer and should discount that bill with his ordinary commercial bank, which should be under obligation to rediscount it with the American Exchange Control. Any credit which the American exporter might wish to give to his English buyer would be reflected in the discount rate which he would be charged by his bank. Evidence that such a bill would be offered for rediscount would be necessary before the goods could leave the United States. The English importer, on taking up the documents, would pay his sterling, through his own bank, into the English Exchange Control, and the United States Exchange Control would be given a blocked credit for that amount. Only when an American importer bought goods from an English exporter and the process was reversed—the English Exchange Control then having a blocked credit with the United States Exchange Control—would the first credit in this country be cleared. International trade would, in fact, be done by a system of contra account.

The above is a simple example of bilateral trade, but multilateral trade could be provided for by the Exchange Controls of the participating nations having representatives at an International Exchange* where blocked credits in one country could be exchanged for those in

* The International Exchange would in no sense be an International Bank nor would it be the body with which all the nations would hold their debits and credits. Psychologically it is important that each nation should know in which countries it has uncancelled credits, so that it may take steps to clear those credits either by taking more imports or by restricting its exports to them. The responsibility which this scheme places squarely upon each nation to keep its own imports and exports in equilibrium, must in no circumstances be transferred to a Central International Clearing Bank. If a Central International Bank were entrusted with this task instead of each nation being free to solve its own domestic problem in its own way, we should once more be back to the old condition of financial war to control a central monetary authority which, in its turn, would control the domestic affairs of so-called independent nations. In practice, such a system of central international monetary control means that whilst effective pressure cannot be put upon the strong creditor nations to take payment in goods against their wishes, great pressure can be brought to bear upon the weak debtor nations to lower their prices in an attempt to force their goods over the tariffs of creditors unwilling to receive payment in the only way open to the debtor, namely, in goods.

another at the conventionally fixed exchange rates: the primary responsibility for establishing a contra account, by importing from the country to which a sale had been made, would remain with the exporting country. If it did not wish to do so that would be its affair and not that of the importing country, which would have done its part by establishing the necessary credit. The importing country would be entitled to cancel the credit, under a Statute of Limitations, if it were not used within seven years. The principle is that with which we are all familiar in internal trading: if you have a credit with a shop, you cannot take it out in cash but you clear it when you take goods.

Interest on loans would similarly be paid into the Exchange Control of the debtor country as a blocked credit to the account of the creditor nation's Exchange Control, which would pay its own nationals for it in its national currency. This blocked credit, too, would similarly only be cleared when importers of the creditor nation bought goods, in this way enabling the debtor nation to acquire an offsetting blocked credit in the creditor nation's Exchange Control.

It will be appreciated that an exporter would receive payment when he exported his goods, in his own currency, and that an importer would make payment in his own currency when he took up the documents. Neither importers nor exporters would be at all concerned with foreign exchange, but solely with the honesty and solvency of their opposite numbers. If an importer failed to pay in his own currency for the goods, then the Exchange Control of the exporter's country, which had rediscounted the bill, would have recourse against the bank which had discounted it, and the bank, in its turn, would have recourse against the exporter. Moreover, there would be no room for a black market, as an exporter could not ship his goods without discounting his bill. As, therefore, he would already have been paid, there would be no temptation for the foreign buyer to acquire the seller's currency on a black market to pay him twice.

(*c*) The participating nations would have to undertake to maintain their internal general price levels stable. They would, in other words, guarantee the value of their currency by undertaking that a unit of it would buy approximately the same satisfaction in goods and services in seven years' time as it did at the time of the Agreement, i.e., that taken over the whole range of commodities within that country, it would buy approximately the same satisfaction or standard of living.

The value of a currency depends upon what it will buy in the country where it is legal tender. If prices rise, a unit of money will buy less and is therefore worth less. If prices fall, a unit of money will buy more and is therefore worth more. An honest measure of value is, therefore, a unit of money which has a constant purchasing power. National currencies would, under the foregoing scheme, be immune from external attack, thereby making the problem of maintaining stability a much simpler one, as well as removing fear. A change in the internal monetary technique is advocated later, which would eliminate the factors which now make difficult, if not impossible, the task of maintaining a stable internal general price level by monetary means.

"Our Jim" must keep step with the Regiment.

(36) If *these proposals were adopted*, a country, e.g., Japan, which dropped its general price level with the idea of underselling other nations, would merely get itself into difficulties. It would become a good country to buy from and a bad one to sell to. Its exporters would receive their yen from their own Exchange Control, on rediscounting their export bills. Its Exchange Control would find itself with growing blocked credits in the Exchange Controls of the other nations, whilst the other nations would find themselves with diminishing blocked credits in the Japanese Exchange Control, so that when cancellation took place, Japan would find itself with outstanding uncancelled credits in the Exchange Controls of the other nations. The other nations would merely point out to Japan how foolish she had been in making it impossible for herself to take payment, and that unless she restored the ability of her importers to take what they had previously been able to take, her unused credits would, at the end of the seven-year period, be cancelled under a Statute of Limitations. She would, in fact, merely have made a present to the rest of the world of her exports, and at the same time reduced the internal purchasing power of her people, a result which, if pointed out to them, they would not be likely to welcome.

(37) Similarly, should a country indulge in internal inflation, so causing a rise in the internal price level, it would become a good country to sell to but a bad one to buy from. Other nations would consequently find themselves with uncancelled blocked credits in the Exchange Control of the offending nation. Not only would there be a great outcry on the part of the exporting industries in the offending nation against their own Central Bank for having failed in its first statutory duty, i.e., to keep the price level stable, but the other Exchange Controls would clearly not be prepared to go on indefinitely accumulating uncancelled balances. They would, therefore, give notice to the offending nation that they would be obliged, as from a future date, to limit the total value of the export bills of their nationals which they would be prepared to rediscount. The offending country would, in this way, through its own action, already have lost some of its export trade and would subsequently, if unrepentant, lose some of its import trade.

(38) This system differs from the old in that any nation getting out of step with the world would be obliged to get back into step again, whereas, in the past, any nation which dropped its general price level and undersold the other nations, took gold from them and compelled them to lower their price levels. The regiment was expected to get into step with "Our Jim" whereas, under the proposed new technique, "Our Jim" would be compelled to get back into step with the regiment.

(39) It should be possible, with improved monetary technique, to reach and maintain great trade activity without a steep rise in prices, followed subsequently by a slump in trade activity and a disastrous fall in prices. When the Effective Demand for goods is increased so suddenly and largely that current production cannot be speeded up fast enough to keep pace with it, stocks begin to diminish and prices to rise. The first impetus upwards may be given by a relatively small increase in demand from the ultimate consumer, or it may be due to psychological causes. The upward movement when once started is, however, carried forward by the urgent and largely increased demands of the holder of stocks, whether manufacturer, wholesaler dealer, or retail trader. His action is based upon fear and greed. The fear that if he does not buy now prices will go still higher and the hope that if he does buy now prices will go still higher and he will reap the benefit. The result of his action is, in fact, to drive prices higher. When prices are falling he holds off the market in the fear that if he buys now his competitors will later buy at lower prices, and the hope that if he does hold off prices will go lower. The effect of his holding off is to drive prices lower. This psychological factor could, it is submitted, be reversed and made to work in favour of stability under the monetary technique advocated later in this memorandum.

The Trade Cycle.

Reverse the psychological factor.

(40) The technique under which the Bank of England contracted the cash base of the Joint Stock Banks, so compelling them, if they were to maintain their ratio of cash to deposits, to reduce their deposits by calling in loans, was always effective in stopping the boom and forcing down prices. The trouble arose when prices reached the point of equilibrium and then passed it and a major slump supervened. Existing technique was incapable of stopping the fall in price at the point of equilibrium. It was for this reason that the monetary authorities hesitated *to check an upward rise in price at its* inception: they might so easily convert an incipient boom into an uncontrollable major slump.

(41) It is clearly necessary, if the trade cycle is to be eliminated, that the technique for raising prices or for stopping a fall in price at the desired point should be as effective and speedy in action as the technique for bringing prices down.

The technique for raising the general price level or stopping a fall must be made as effective as that for lowering it.

(42) The reason why it is ineffective under the present system is not far to seek. The bulk of the purchasing media in any modern State consists of book entry money, and this can only be created and issued by the Joint Stock Banks if borrowed at interest.

(43) When currency is contracted and loans are called in, with a view to checking an inflation and bringing prices down to the point of equilibrium, traders, in order to repay their bank loans, are forced to throw their stocks of goods and securities on to an unwilling

market to acquire the money with which to repay their loans. This means that soon there is a surplus of unsaleable goods overhanging the market. The ability to buy has been restricted, whilst supplies of goods on order from the manufacturers, now running to a high percentage of capacity, continue to pour into the market.

(44) When prices reach the point of equilibrium, it is necessary to stop the downward fall by increasing the Effective Demand for goods without, at the same time, increasing the supplies overhanging the market. This, under the present technique, the banks are incapable of doing directly, as they can only increase the total of purchasing media by making loans at interest. Already the deflationary policy will have rendered many previous customers uncredit-worthy, and those who remain credit-worthy are not likely to wish to borrow money to produce more when they cannot sell what they have already produced.

Why the present technique is indirect and therefore slow and uncertain.

(45) The banks are therefore driven to the alternative course open to them. On their cash base, which has been enlarged by the Bank of England, they create additional credit and with it buy Government securities on the Stock Exchange.

(46) This buying of securities by the banks will have the effect of driving up the sale price of Government securities on the Stock Exchange, so lowering the interest yield. The public, finding they get a lower interest yield on Government securities, will start buying preference shares of industrial companies until

their yield is lowered, and then they will start buying Equities. In short, a boom on the Stock Exchange is engineered and money is now described as "cheap."

(47) This is designed to have the effect of restoring confidence, so as to induce people to spend more freely, and the object can easily be defeated if other happenings, political or otherwise, counteract the favourable impression created by the Stock Exchange boom. This will explain why the Quantity Theory of money is now being questioned. An increase in the quantity of money in issue will only raise prices when it gets into the hands of people who will spend it on buying consumption goods. When the volume of money seeking investment is increased in the way described in paragraph (45), it may do one of two things. If it merely inflates the Stock Exchange value of existing securities, it will have no effect upon the price level, and the result which might be expected from the Quantity Theory of money will not follow. If, however, confidence is restored and the pressure of this new money seeking investment, with consequent low interest yield, results in its being used for new industrial or commercial enterprise, e.g. the building of new factories, the enlarging of existing ones, then this new money will raise prices: it will get into the hands of would-be consumers in the form of wages, dividends, etc. This will also explain the great emphasis which is always laid in financial circles on the importance of confidence.

The Quantity Theory of Money.

(48) If, however, confidence is restored, then the public will start buying more freely and manufacturers will go once more to their banks asking for advances to finance larger production. At this point, unless the Bank of England again increases the cash base of the Joint Stock Banks, the latter will be obliged to sell their Government securities on the Stock Exchange in order to give advances to industry: so that as the boom starts in industry, the slump is started on the Stock Exchange. Hence the so-called "Trade Cycle."

When "confidence" is restored, an uncontrollable swing upwards follows.

(49) An undesirable by-product of this system is to make speculation more profitable than production: in fact, if inside knowledge is possessed, selling for a fall ceases to be speculation as it is betting on a certainty.

(50) The point, however, which it is here sought to make is that the present machinery for raising prices is so uncertain and slow that stability of the general price level by monetary means cannot be obtained without greatly improved technique. The present method is uncertain in its effect because it depends upon the successful creation of confidence, which frequently is conditioned by circumstances outside immediate monetary control, and it is slow because it is indirect and operates, if at all, through a long chain of cause and effect.

(51) It should be borne in mind that the objective of the old technique for raising prices or stopping a further fall was to increase effective demand for goods without increasing

the number of goods awaiting consumption in the market. In order to achieve this objective it had, however, first to create a boom on the Stock Exchange in the hope that this would lead to people feeling themselves richer and so spending more money which, in its turn, would result in unemployed being reabsorbed into industry, so increasing their purchasing power. The ultimate objective was, therefore, to give unemployed men full wages instead of a dole. This points the way to the new technique which, if it is to be successful, must enable this final result to be achieved by direct, certain and immediate action. Confidence in business would then be founded on fact and there would be no need to rely upon creating optimism—often groundless. In the following paragraphs an attempt is made to outline the steps necessary to establish such a new technique.

(52) At the beginning of the last war the total bank deposits equalled £1,000,000,000. At the end of the war they equalled £2,000,000,000. Since 1938 total bank deposits have risen from £2,277,000,000 to £2,991,000,000 in July, 1941. It is therefore necessary to consider how the nation's total purchasing media came to be increased in this way. The matter is explained by the following authorities:—

The late Sir Edward Holden (Chairman of the Midland Bank):

"Nearly all loan transactions of the Banks create credit. To understand this statement clearly, assume that all banks in the country are combined in one bank and that a customer borrows from it, say, £100,000, but does not withdraw actual cash, then two different kinds of transactions are seen to take place. In London the £100,000 would be placed to the credit of the borrower, who would most probably at once begin to draw out the amount by cheques to pay for purchases. The cheques would go to the credit of the sellers of the goods and when the whole sum had been drawn out, there would still be the whole of the £100,000 credit outstanding, although it might stand to the credit of a great number of persons. Technically we say of such transactions the loan has created a credit of equal amount."

Governor Eccles, President of the Federal Reserve Bank of the United States:

"The Banks can create and destroy money. Bank credit is money. It is the money we do most of our business with, not with that currency which we usually think of as money."

Mr. R. G. Hawtrey, a prominent economist and one of the chief officials of the Treasury:

"When a bank lends it creates money out of nothing."

Mr. J. M. Keynes, the well-known economist:

"There can be no doubt that all deposits are created by the banks."

The Encyclopædia Britannica (14th edition):

"Banks create credit. It is a mistake to suppose that bank credit is created to any important extent by the payment of money into the banks. A loan made by a bank is a clear addition to the amount of money in the community."

Mr. McKenna, Chairman of the Midland Bank:

"When a bank makes a loan to a customer in the ordinary course the loan will be drawn upon by a cheque by the customer upon the bank and paid into someone else's credit at the same or another bank. The receiver of the cheque, however, when he pays it into his own account, will be credited with its value and thereby a new deposit will be created. In the same way, when a bank buys War Loan or makes any other investment the purchase money goes to the credit of somebody's account and increases the total of deposits."

Sir Ernest Harvey, Deputy Governor of the Bank of England, when giving evidence before the Macmillan Committee on Finance and Industry in 1931, made it clear that when the Bank of England bought securities it increased the cash base of the Joint Stock or other banks through which they were bought, so enabling them to create, on that base, a far larger structure of credit.

(53) From the foregoing it is evident that increases in bank deposits during the last and the present wars were brought about by the Government borrowing from the Joint Stock Banks, the Bank of England having first increased their cash base. It is also clear that this newly created purchasing media derived its sole value from the fact that citizens were prepared to part with their goods to the Government in exchange for it, being assured that other citizens

would, in their turn, similarly part with goods. Its acceptability derived, in fact, from the trust which the citizens had in one another and in the law of the land. The only thing likely to shake that trust would be a rapid fall in the purchasing power of a unit of money through a steep rise in prices (*vide* paragraphs (35*c*); (56); (57*e*); (59)).

(54) This new purchasing media having been created by a stroke of the pen, the cost to the banks of its creation was negligible. Paper money and book-entry money, of which the vast bulk of the purchasing media of any modern State consists, are practically costless to create. *It is evident that, at the moment of creation, such money cannot be the property of any private citizen as no service has been rendered for it, whereas when created it becomes a demand on goods and services which will be honoured by all citizens.*

Modifications of internal system.

(55) These considerations point to a reform of the internal monetary system which, if adopted, would make the maintenance of a stable internal price level practicable and would also solve the problem of unemployment.

(56) In a progressive society there is annually an increase in the total amount of goods and services produced for consumption. If all the available labour, raw materials and capital equipment were fully employed, the annual increase would be far greater than it is. If a corresponding increase in the amount of purchasing media is not created and the same amount of money has therefore to do service for

an increased number of transactions (assuming the velocity of circulation is the same), prices at which each unit can be sold must fall. If, therefore, it is desired to maintain a stable price level, there should be an annual increase in the total amount of purchasing media corresponding to the total annual increase in the amount of real wealth to be distributed. This issue of brand new purchasing media should, it is submitted, be spent into existence by the State, involving therefore no capital debt and no interest charge, instead of being lent into existence at interest by the private banking system, the State often being the borrower.

(57) The changes necessary would be as follows:—

(a) To pass legislation making the Joint Stock Banks' existing convention, namely, that they must hold a minimum of 10 per cent. of their total deposits in liquid cash, legally binding upon them, at the same time taking powers to require them, as circumstances demand, to hold a higher ratio of cash. (Note.—This power has already been taken in the U.S.A.) They should, at the same time, be relieved of any legal liability to their depositors to hold a higher ratio of cash than might be specified from time to time under this statute.

In practice, the State has always come to their rescue and declared a moratorium when the public have wanted more cash than the banks hold. The legal position should now be made to conform with the facts.

(b) That the Bank of England should be

converted into a Public Utility Company with a Governor and Deputy-Governor only removable, on a Petition of both Houses to the Crown, for misconduct, so that subject to their carrying out their statutory obligations, they would be as immune from party political pressures as are the Judges.

(*c*) That this National Central Bank should be the sole Bank of Issue of all sorts and kinds of purchasing media, whether metallic, paper or book entry. To give effect to this it would be necessary to ascertain total deposits throughout the banking system on a given date. Any further expansion of the total of bank deposits, through the Joint Stock and other private banks issuing more new loans than were offset by old ones being repaid, would thereafter be prohibited.

NOTE.—It must be remembered that every minute of every day old loans are being repaid to the banks and that these can be lent to new borrowers without any expansion of total deposits. This proposal would not, therefore, interfere with the normal lending functions of the Joint Stock Banks. It merely ensures that when the national economy demands an expansion in the total amount of purchasing media, whether cheque money or paper notes, it shall come into existence, in the first place, by being spent into existence by the State without capital debt or interest charge, instead of being lent into existence by the Banks, at interest.

(*d*) As the new technique, described in par. (*f*) below, would be used when an expansion of the total of purchasing media was necessary, Open Market operations by the Central Bank would only be employed when contraction was necessary.

(*e*) The primary duty of the Central Bank would be to maintain the internal price level stable, i.e. to maintain the new standard value of the £. For this purpose the Board of Trade would issue a general price index figure which the National Central Bank would be under obligation to maintain at 100. If it saw that index figure falling, it would not, as in the past, talk about over-production, but under-consumption. It would consider how much more purchasing power in the pockets of the people would take the surplus goods off the market and restore the index figure to 100.

(*f*) So long as 10 per cent. remained the Joint Stock Banks' legal ratio of cash to total deposits, the National Central Bank would issue any new money which might be required in the ratio of nine book entry £s for every paper £ printed. Instead of the Central Bank spending the paper £s into existence, as in the past, by buying gold, so creating a base upon which the Joint Stock Banks would later lend at interest nine times that amount into existence, the National Central Bank would itself create both £9 book-entry and the £1 paper and would credit the Government's account with this newly created money. It would then be the duty of the

Government to spend the £9 book-entry into existence by buying for the community something more useful than gold, e.g. slum clearance, roads, adequate pensions for old people, etc. These things would cost the nation the labour, raw materials and capital equipment (previously unemployed) necessary to make them, and also to make the food, clothes, etc., which the men employed in making them would buy with their wages, i.e. the surplus of goods overhanging the market and causing the slump. There would not be in addition, as under the present system, a financial debt at interest, i.e. a double cost—real and financial. When circumstances demanded the employment of people on capital work *rather than on the manufacture of consumption* goods, the Government could spend this new money by buying back and cancelling Government securities, so increasing the volume of capital seeking an outlet. It could also be used to remit taxation, so stimulating both investment in capital goods and the purchase of consumption goods.

For example, suppose the National Central Bank, seeing the general price level falling, decided that another ninety million pounds should be placed in the hands of ultimate consumers, the National Central Bank would credit the Government account with ninety million and would print only ten million notes. Let *us next suppose that the Government then* drew a cheque for ninety million pounds in favour of a contractor who had engaged to clear slums and build houses. The contractor would pay that cheque into a Joint Stock Bank to his account. The Joint Stock Bank's deposits would now have risen by ninety million, but the Bank would, at that moment, have no corresponding increase of ten million of cash as a base for that new deposit. Its cash ratio would, therefore, for the moment, have fallen below the legal minimum. However, on presentation of the cheque at the National Central Bank it would receive, in exchange, ten million paper pounds. It would once more have restored its legal ratio. It would have a fresh book entry of ninety million deposits, and a fresh ten million of paper notes. There would, therefore, be no room for further creation by the Joint Stock Bank.

It will be appreciated that the ten million of notes must be held by the Bank against the time when the depositor wishes to have them in lieu of his book entry money, i.e. cashes a cheque, so cancelling some of his ninety million of book entry money and taking notes instead.

(58) It is, perhaps, inappropriate to develop the question of technique in this memorandum.

Equating Effective Demand with Supply.

The underlying change in conception involved in the foregoing proposals is that action would be directed towards equating Effective Demand with Supply, and would even sometimes be used to stimulate Supply, whereas hitherto all efforts have been directed towards equating Supply with Effective Demand by the scrapping of useful capital equipment, the limitation of output, and the destruction of food and other material wealth for which there was certainly a Human Demand, although not an Effective one.

Increased national wealth reflected in larger money incomes instead of lower prices.

(59) Another change in conception is that the price level is maintained stable and increased supplies are reflected in more money being distributed to buy those additional supplies at the same price. The old conception, based upon the notion that gold, the quantity of which was limited, gave value to money, looked to a fall in price when supplies were increased, so as to enable the same amount of money to buy the additional goods because they were cheaper. It is, however, evident that a change in the general price level not only alters the incidence of long-term contractual debt as between one citizen and another within a country, but also is capable of imposing great hardship and injustice as between creditor and debtor nations, besides compelling other nations to alter their general price levels if they hope to remain competitive in the world's markets. In short, there can be no reasonable degree of stability in international trading relations if any one major nation, by altering its general price level, can disturb the internal economy of every other nation in competition with it.

(60) It may also be useful to consider the

psychology of the proposed change. Under the old system, when prices rose traders bought heavily, so causing prices to rise still more. When prices fell traders held off the market for still lower prices, so causing them to fall further. Under the proposals set out above traders would know that when prices fell new purchasing power would speedily be put into the hands of the ultimate consumer through the Government spending new money into existence. The trader would therefore rush in to buy before this happened, so bringing prices back to the point of stability without official intervention. Similarly, when prices rose above that point, the trader would know that the Central Bank would contract currency and credit, so forcing prices down again. He would therefore hold off the market waiting for this to happen, so again making official intervention unnecessary. The present psychology would, in fact, be reversed with beneficial results. (*Vidè* Par. (39).)

Helpful change in psychology.

(61) Whilst there are many minor points which cannot be mentioned within the scope of this memorandum, there is the following major point.

(62) Although the general price level could, in this way, be kept stable, special measures will, it is submitted, have to be taken to ensure that the gap between the prices of manufactured goods and primary products does not, in its turn, open and close in the indefensible way it has done in the past. Throughout 1920 wheat averaged 11/8 per bushel; during

Different price systems for primaries and industry.

1925, 8/2; and in 1931, 3/4. Then during the month of January, 1938, the price was 7/5, whereas in November of the same year it was down again to 3/4. During 1939 it touched the lowest level ever recorded at less than 3/-. The average price per lb. of wool (Merino 66's clean basis) in 1924 was 76¾d. In July, 1937, it was 38½d. and July, 1938, 24d. Cotton (American middling) was 8d. a lb. in March, 1937, but had fallen to 4½d. by November of the same year; the average price for 1924 having been 16½d. Rubber, which was 35¼d. a lb. in 1925 and 2⅓d. in 1932, was 12d. in March, 1937, and 5¾d. in May, 1938. Tin, which was £283 a ton in March, 1937, was £163 by May, 1938. Copper, which was £72 a ton in March, 1937, was £35 by June, 1938.

(63) Primary producers are still the majority of the human race, and it is bound to cause a serious convulsion of the economic system when the prices which they can obtain for their output are liable to fall so steeply and so unpredictably; whilst the prices of manufactured goods, which they wish to exchange for their output, do not fall correspondingly, and their fixed obligations, debts, etc., do not fall at all. They find themselves able to claim, in exchange for their product, a far smaller quantity of manufactured goods than before. Not only do they suffer an injustice, but the manufacturing countries with ruined customers have to restrict output and dismiss men from their employment, so again destroying effective demand. It is evident that these results will follow so long as primary producers depend for the price they are paid on

the haggle of the market, whereas the manufacturer charges an administered price, i.e., cost of production plus profit, and will not for long produce at much less than that price.

(64) There are many different ways in which the primary producer could be assured, under all circumstances, a reasonable return for his labour, together with a further reward on results by way of an incentive. It is, however, evident that the extreme instability and insecurity which was so marked a feature of the old economic system, cannot be cured unless this problem is boldly faced. In this connection, the equating of Effective Demand with Supply should ensure that never again in the future would the conscience of humanity be shocked by the spectacle of food being destroyed whilst people went hungry.

SUMMARY

International Trading System

1. It would be fatal to rely, after the cessation of hostilities, upon persuasion, conferences, and trade negotiations, to avert the outbreak of a financial and economic war more ferocious than anything yet experienced. Nations are in such different stages of development, politically, socially and economically, that any international trading system requiring for its successful working some measure of equality and uniformity in these matters must accordingly be ruled out as impracticable. (Par. (29); (30).)

2. On the contrary, a system is necessary which will leave each nation entirely free to settle its own internal policies without fear of external interference. (Par. (29).)

3. The above can be done by placing upon each nation the sole responsibility of deciding how it proposes to take payment from the outside world in goods and services for its exports of goods and services and for interest on loans, under penalty of having credits abroad which it does not clear in this way cancelled after a period of years. This would mean, in practice, that if a nation wished to export, it would either have to import or make a present of those exports. (Par. (32).)

No doubt the solution reached would vary from country to country, some preferring more overseas trade and others more protection for home industries. (Par. (33).)

4. Such a system would remove the question of trade barriers from international to national arenas, the width and height of trade barriers being a matter to be fought out within the nation between the export and import interests on one side and the industries wishing protection on the other. In so far as a nation decided to stop imports it would, to that extent, stop exports unless it wished to make a present of them. Surplus exports could no longer be used to get other nations into unpayable debt under threat of knocking down their exchange rate. (Par. (32).)

5. In view of the industrialisation, during the war, of the Dominions and India it has become especially desirable, if friction with them is to be avoided, that the maintenance of a two-way traffic should not be dependent, as in the past, upon outside persuasion and pressure. (Par. (31).)

6. As a regular instrument of national export policy, subsidies and similar devices would be pointless. Anti-dumping laws could deal with attempts by individual manufacturers to unload unwanted surpluses should the importing nation consider that such prices would have a disruptive effect on its own market. (Par. (29).)

7. The way to the new system has been shown by the Lease-Lend Act. The following three principles are there recognised:—

(*a*) That nations can only pay for goods and services with goods and services.

(*b*) That an importing nation can give the exporting nation a claim to its goods, but it cannot make the exporting nation buy those goods against its will and should not be under obligation to do so.

(*c*) That a conventional rate of exchange between two currencies should be fixed by agreement and should not be subject to the Law of Supply and Demand, i.e., should not be bought and sold. (Par. (34).)

8. The modifications necessary in Lease-Lend procedure to make it suitable for peace-time use. This proposed system differs from the gold standard system in that any nation getting out of step with the world through allowing its general price level either to rise or fall would be obliged to get back into step again, whereas, under the old system, any nation which dropped its general price level and undersold the other nations, *took gold from them and compelled them* to lower their price levels. The regiment was expected to get into step with "Our Jim" whereas, under the proposed new technique, "Our Jim" would be compelled to get back into step with the regiment. (Par. (35)-(38).)

Internal System

9. The Trade Cycle. The old technique of contracting currency and calling in loans was quickly effective in forcing down prices, but when once the desired price level was reached, it was incapable of stopping the fall until a major slump had run its course. It is therefore necessary, if the trade cycle is to be eliminated, that the technique for raising prices or for the stopping of falling prices at the desired point should be as direct, effective, and speedy as the

technique for bringing prices down. (Par. (39)-(41).)

When once the slump is under way the banks cannot inject new credit to stop prices falling by lending to industry, because many previous customers are no longer credit-worthy and those who are do not wish to borrow money to produce more as they cannot sell what they have already produced. The banks are driven to the alternative method of injecting new purchasing power by creating credit and buying securities on the Stock Exchange, so causing a Stock Exchange boom. This is intended to create confidence and so induce freer spending by the public, which, in its turn, would result in unemployed people being re-absorbed into industry. (Par. (42)-(48).)

The effect of the Stock Exchange boom may, however, be offset by happenings in the political sphere, and the effort to increase Effective Demand in this way may be defeated. (Par. (47).)

The technique is inefficient, uncertain and slow. A method must be found to achieve the ultimate purpose of the old technique, namely, an increase in effective demand without a corresponding increase of goods awaiting consumption in the market, by direct, certain and immediate action. (Par. (50)-(51).)

10. Since 1938 total bank deposits have risen from £2,277,000,000 to £2,991,000,000. Many eminent authorities are quoted to show that this new purchasing media was created by the banks and lent into existence. Its acceptability derived from the trust which the citizens had in one

another and in the law of the land. It is evident that, at the moment of creation, such money cannot be the property of any private citizen or corporation, as no service has been rendered for it, whereas when created it becomes a demand on goods and services which will be honoured by all citizens. (Par. (52)-(55).)

11. In a progressive society there is an annual increase in the total output of goods and services which necessitates a corresponding increase in the total issue of purchasing media unless prices are to fall. It is this annual increase in the total of purchasing media which, it is submitted, should be spent into existence by the State without any capital debt or interest charge, instead of being lent into existence by the private banking system. (Par. (56).)

12. The reform referred to in the above paragraph would afford a means of stopping a fall in prices and would also solve the problem of unemployment. The measures necessary to give effect to it are set out in paragraph (57).

13. The underlying changes in conception involved in the proposals are:—

(*a*) That action would be directed towards equating Effective Demand with Supply and would sometimes be used to stimulate supply, whereas hitherto all efforts have been directed towards equating Supply with Effective Demand by the scrapping of useful capital equipment, the limitation of output, and the destruction of food and other material wealth. (Par. (58).)

(*b*) That the price level should be maintained stable and increased supplies would be reflected in more money being distributed to buy those additional supplies at the same price; instead of, as in the past, the volume of money remaining static whilst the price level was lowered, so that more supplies could be sold, with the same amount of money, for a lower price per unit. (Par. (59).)

The objections to the second method are that a fall in general price level in one nation upsets the internal economy of every other nation, and it also alters the burden of contractual indebtedness, both as between citizens and internationally.

14. Under the proposals there would be a helpful change in the psychology of traders. (Par. (60).)

15. Although the general price level could be maintained stable, the gap between the prices of *manufactured goods and primary products* might still open and close, as they are sold under two quite different price systems. It is necessary, therefore, to take special measures to ensure greater stability in the prices of foodstuffs and primary products. (Par. (62)-(64).)

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DITOR

Economic lessons from 1930s

From Mr Edward Holloway

Sir, In the current debate on Britain's road to hyper-inflation I suggest there are some lessons to be learned from the 1930s. Fifty years ago the problem was deflation, not inflation. Following the return to the gold standard in 1925, the amount of money in circulation was reduced. By 1930 there were nearly three million unemployed, there was a steady appreciation in the value of money, prices fell, often below the costs of production, bringing bankruptcy and ruin to many producers of wealth. We were told to "tighten our belts" and had to accept a 10 per cent cut in incomes and a reduced standard of living.

At the same time the country was full of unsaleable goods, foodstuffs rotted in the ground, milk was poured down drains while children were undernourished. Typical headlines in the press of those days were "Enough wheat to last for two years", "Coffee burned by the ton", "More tea than we can drink".

The *Sunday Express* commented: "The world is full to the overflowing with the greatest surplus of goods in history." In a search for the remedy for this dilemma—"poverty in the midst of plenty" the economists and financial experts (with some notable exceptions) searched in vain for the answer to the problem. They looked everywhere except in the realm of a deflationary monetary policy where the true reason was to be found. Those of us who urged that more money should be put into circulation to enable people to buy what was already available were dismissed as monetary cranks.

What is the relevance of this to the present situation? The answer is to be found in the fact that since 1945 successive governments have reversed pre-war policy by pumping more money into circulation without regard to the increase in the quantity of goods and services available to be consumed. As in a deflationary monetary policy the value of the monetary unit appreciates, so with an inflationary monetary policy the value of the monetary unit depreciates. Both are wrong and the results are calamitous.

Those who refuse to admit the importance of money supply in the inflationary situation are guilty of the same error as those who refused to recognize that the pre-war deflation was also a monetary phenomenon.

In her speech in Parliament yesterday (February 28) the Prime Minister made an important pronouncement. She said: "Experience shows that the only way of attacking inflation is to keep the money supply closely related to the output of goods and services. Whenever governments have not followed this simple rule—when money is in greater supply than goods—inflation has resulted." Thank goodness for Mrs Margaret Thatcher!

Yours faithfully,
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February 29.