BRITISH WAR FINANCE.

British War Finance, 1914–15. By W. R. LAWSON. (London: Constable and Co. 1915. Pp. vi + 367.)

War and Lombard Street. By HARTLEY WITHERS. (London: Smith, Elder and Co. 1915. Pp. viii + 171.)

Manual of Emergency Legislation. Financial Edition. To June 4th, 1915. Pp. 205. Edited by Alexander Pulling, C.B. Published by Authority. (London: Darling and Son. June, 1915. Price 1*s.*)

"THE financial position to-day is serious." This declaration of the Prime Minister, made in circumstances of more than usual formality, on November 2nd, 1915, suggests that a brief survey of the war finance, and of the financial problems that now confront us, may not be altogether untimely. Three weeks earlier the Financial Secretary, in a remarkable speech on the Finance Bill, had given what to the public generally was the first official intimation of the real nature of the situation, and of the uncompromising transformation of our ordinary economic life which it demands. It is further convenient for a review of the whole position that we have in the Chancellor's recent Budget speech authoritative figures and estimates which bring the necessary data for discussion nearly up to date.

Many similar reviews have already appeared, and anyone writing on the subject must, in particular, be under obligation to the works of Mr. Lawson and Mr. Withers mentioned at the head of this page, as well as to the admirable compendium of war legislation, edited by Mr. Pulling, the financial volume especially. Mr. Lawson and Mr. Withers both deal with the past rather than with the future: with the war crisis rather than with the fundamental finance problems caused by the war expenditure. But the history they have sketched so admirably, and the acute criticisms with which the books abound, are full of instruction for further inquiry. Their work will serve as a text for a good deal of what can here be said.

Mr. Withers's book may be first noticed as the earlier of the two. It seems to have been written in December, 1914, and naturally is almost exclusively concerned with the war crisis and the various emergency measures by which it was met. It is an oft-told tale, now pretty familiar to the public; but Mr. Withers's account, especially the part that deals with the bill market, will have permanent value. The position at the eve of the declaration of war was tersely summed up by Mr. Asquith last March.[1] "We were confronted at that moment with the double risk—the risk of a shortage of internal, and of a general discredit of international, currency." The shortage of internal currency was more or less universally experienced, by neutrals as well as belligerents. But international currency means, for the most part, the London bill: and the discredit of this currency, involving as it did a mass of paper estimated at 350 millions sterling, was a special danger of the gravest kind for the London market.

The shortage of internal currency was met in most countries by an expansion of the note circulation, sometimes of regular, sometimes of emergency issues. There seems generally to have been a run on the banks, as well as a remarkable scarcity of small change. On the Continent we find Governments, Banks, Municipalities, and even Chambers of Commerce issuing small notes; in some cases for values as low as a mark or a krona or a franc; even quarter franc notes were issued in France.[2] This scarcity of small change, it is said, was due partly to mobilisation needs, but mainly to hoarding. It does not seem to have been seriously felt in this country. Nor was there, so far as can be judged, any appreciable run on the banks,[3] apart from the inevitable demands of an August Bank Holiday, though contrary statements have been made. There is, at any rate, no trace of any such movement in the Monthly Bank Returns. The proportion of "cash" shown for the month of August was 20·1 against 15·2 for July; and the amount £125 millions as against £91½ millions. The July figures were quite normal, showing exactly the same proportion of cash as the previous year. Too much must not be made of these figures. Our bank returns are deplorably inadequate, concealing precisely what it is most important to know: "dim candles, lit to make darkness visible,"

[1] The whole statement will be found in *Lawson*, pp. 11, 12.

[2] M. Théry tells us (12 Nov., 1915), that the scarcity of small change continues in France, in spite of issues of 1 and 2 franc notes to the amount of 43,567,500 francs by sixty-six Chambers of Commerce.

[3] "Not even on a savings bank."—*Lawson*, p. 103.

as Mr. Withers aptly puts it.[1] Returns apart, however, it seems that so far as can be discovered by inquiry, there was nothing deserving to be called a run upon the banks. The public fortunately had entire confidence in them. It was the bankers, not the public, who were panic-stricken, and who, like the United States banks in 1907, did most of the hoarding. Some of them seem to have obliged their customers to take notes instead of gold, and so caused pressure on the Bank of England which might have had serious effects. The old tradition against direct rediscount with the Bank seems to have been thrown over. Mr. Lawson speaks euphemistically of the "extreme prudence" of "some of the clearing banks, who joined in the rush to the Bank of England, and dumped their own bills upon it" (p. 19).

When we consider the absolute inadequacy of our reserve position, even for ordinary emergencies, the bankers' panic is intelligible enough. They were well aware that if the public generally had demanded in gold 5 per cent. of the sums standing to their credit, whether for purposes of export or hoarding, or even for extra pocket money, the whole system would have collapsed. It would have been impossible at that time to obtain assistance from the Bank of France, as on three recent occasions. Again, we stand alone among the great commercial countries in having no provision for emergency issues of legal tender money. In other countries the National Banks can make such issues. The absurd Act of 1844 makes this impossible in England, and thus deprives our note of that elasticity which is the special virtue and *raison d'être* of this form of currency. In France, Germany, and the United States further provisions had been made. In the United States the Aldrich-Vreeland notes were ready, and were issued to the amount of over £75 millions, besides a Treasury issue of nearly £25 millions, and the usual Clearing House certificates. In Germany small notes had been introduced before the war. The report of the Bank tells us that in France similar notes "were prepared and sent out in good time to every part of the country." The issue began on July 31st. Nothing of the kind existed here, though it had long been foreseen that it would be required. We were as unprepared financially as in a military sense.

The abler bankers had constantly protested that more substantial reserves were necessary. It was considered enough to say in reply that the Bank of England, in virtue of its peculiar

[1] Even these meagre returns have been suspended since June last. Nothing could be more calculated to destroy public confidence.

position in the market, could always create credits amply sufficient to meet internal requirements, and that England, as a creditor country, could always command gold from abroad. But it is obvious that Bank of England credits could not meet a run on the banks for gold. No doubt a great creditor country can always meet a sudden strain by withdrawing accommodation from those whom it has taught to expect it. But this is not usually considered good banking. It is certainly bad business. Here it is hard to agree with Mr. Withers. He assumes that our banks acted in this way, and finds in the deadlock thus produced the best proof of London's supremacy in finance (p. 78). To others it will seem a proof of weakness. Nothing is more likely to endanger that supremacy than action of this kind: two or three such financial victories would be fatal. We may be fairly sure that nothing but extreme necessity would have driven English bankers to such a shift. Even creditor countries require strong reserves if their banking reputation is to be maintained. There was a smart set of City writers who went still further in their opposition to larger reserves. If prudent banking, they said, meant sitting on a heap of gold, then any fool could be a banker. The real art of banking consisted in the economy of gold. There seems confusion here. By all means economise gold in the circulation and in the outlying banks. The last place for such economy is the central reserve. But these were the views which have prevailed in the City.[1]

Thus the outbreak of war found us with a banking reserve so cleverly "economised" that, as just stated, a 5 per cent. run on their huge deposits would have broken the banks. The situation would have been an anxious one in any case. But it was made incomparably more serious by the complete collapse of the great markets which are so intimately connected with the banks, and which, as Mr. Conant so justly maintains, it is a primary function of the banking reserve to support. Next to their "cash," the banks rely chiefly on three lines of resources. There is the money at call, their holdings of bills, and their securities. As to their securities, the London Stock Exchange closed on July 31st. Wall Street "did not open." Most other bourses were already

[1] It is only fair to mention that leading bankers are believed to have agreed on a scheme, a few weeks before war broke out, which if it had been adopted would have distinctly improved the position, though not perhaps in quite the best way. But this scheme, of course, required the assent of the Bank of England, and the reform of the Act of 1844. Nor would it have been really effective until it had been in operation for two years or so, nor unless more adequate banking returns had been set up. It was too late.

closed. It was clearly impossible to realise securities. The bill market too was paralysed. The Bank of England acted with its customary public spirit, but could obviously only deal with a fraction of the bills current. As for the call money, it has always been an open secret that the short loan market is the danger point in times of general crisis.[1] The system is only possible on the assumption that what one bank calls, either another bank or the Bank of England will be ready to lend. It must inevitably break down whenever there is general pressure. Thus the bankers found that what they usually regard as their liquid assets were now, in Sir Edward Holden's phrase, frozen.

It was a desperate position, and it was not eased from the bankers' point of view by the fact that Government had conceded a Bill Moratorium. This Bill Moratorium was probably an inevitable measure. It seems in some form or degree to have been everywhere adopted. But it did not improve the banking situation, except in so far as the banks were acceptors. The bankers not unnaturally came to Government for relief. What their demands were we can only conjecture. The concessions they obtained were stupendous. First the Government very wisely extended the August Bank Holiday by three days: a period not so long as to cause alarm, and yet long enough to give time for consideration. It then proceeded to provide emergency currency on a scale never before dreamt of. The Treasury were to issue full legal tender notes for £1 and 10*s*., payable in gold at the Bank; and the bankers might obtain advances of these notes, at Bank rate, up to an amount not exceeding 20 per cent. of their deposit liabilities—say a total sum of £225 millions. The same Act empowered the Bank "so far as temporarily authorised by the Treasury . . . to issue notes in excess of any limit fixed by law." Postal orders were put on the same basis as to legal tender and redemption at the Bank as the currency notes. Further, Scottish and Irish notes were made full legal tender, and banks in Scotland and Ireland were not under obligation to pay their notes except at their head offices, and might pay, if they thought fit, in the currency notes.

These provisions might have been thought amply sufficient to maintain cash payments. But on the same date (August 6th) as they were enacted, the moratorium already granted in regard to bills was made with certain exceptions general. Thus cash payment became optional, not only from banks, but generally:

[1] Lord Goschen insisted upon this in his speeches on the Baring difficulty in 1891.

the only important exception from the banking point of view being that notes were still payable in cash. "The flag was lowered," as Mr. Withers has it: "for the first time since the Restoration," Mr. Lawson says, "the collection of current debts was interfered with." The general moratorium was undoubtedly the most unfortunate of our emergency measures, and in all probability we shall not be allowed to forget it.[1] In comparison with it, the suspension of cash payments by the Bank in 1797 seems a comparatively modest precaution. It may, of course, have been necessary: but the necessity is not apparent to observers who have only the ordinary means of information. Mr. Lawson (on p. 111) states very fairly the arguments for and against the measure. Though he abstains from passing a final judgment, it is pretty clear what his judgment would be.

It can hardly be doubted that the relief measures erred by excess rather than defect. Out of the £225 millions offered to the banks, the banks actually borrowed less than £13 millions, which was soon repaid. Some of the greatest banks made no use of the moratorium. Mr Lawson says: "Without declaring a moratorium the Americans gave themselves the benefit of it. On the other hand, we declared a moratorium, but most of us paid our debts all the same." There is a good deal of truth in this. But why did the New York exchange rise to $7, if Americans were not trying to pay their debts?

But whether the relief measures were or were not excessive the huge scale on which they were granted is some indication of the kind of provision the banks thought necessary for the situation created by a European war. Why had no approach to an adequate provision been made? The war could have been no surprise to bankers. It had long been expected and prepared for in the great European centres; and after the experience of the summer of 1911 our bankers could have been under no illusions. Innumerable warnings had been given: the very date of the declaration of war had been foretold by well-placed observers. By Mr. Lawson, at any rate, war was seen to be inevitable two years before the actual outbreak. Writing in 1912, he said: "It is no longer any secret that we are drifting into a trial of strength with the most powerful of European States."[2] But here a question has been raised which seems to deserve more

[1] *Cf.* Mr. A. D. Noyes's article in the *Yale Review* for October, 1915. He speaks of the "stupendous loss in economic prestige which London has already suffered." The language is somewhat over-coloured, and perhaps reflects the known aspirations New York to displace London as the world's financial centre: but it deserves note.

[2] ***Modern War and War Taxes,*** p. 138.

consideration than has been given to it by either Mr. Lawson or Mr. Withers. Would any reserve provision that could reasonably have been made in advance have appreciably strengthened our position in view of a war crisis? There are some who think it would. They think that reasonable reserve and emergency provision would have made a general moratorium unnecessary. Granting that a bill moratorium was inevitable, they think it open to question whether it would have been necessary to suspend all the usual finance and acceptance business, or even to make a prolonged suspension of the stock market (subject, of course, to the necessary restrictions on trading with the enemy). The question is bound up with another. Did the collapse of the great markets paralyse the action of the banks, or was it the withdrawal of adequate banking accommodation that paralysed the markets?[1] The absolute suspension of the markets was a heavy blow, not only to the banks, but to the general business of the country. Might they not have been kept alive, though with their functions restricted, if due and timely preparation had been made? It is a difficult question on which no one could be anxious to dogmatise. One thing may fairly be said. The object was so vitally important that it was worth while to have made a determined effort to secure it. No such effort was made.

Mr. Lawson's book throws valuable light on these matters. The position of the great bill and stock markets during the crisis, and under the emergency measures, is very fully treated by him. His book is much wider in scope and more fully documented than Mr. Withers's sketch, and brings the history down to a later date. What that date is does not always clearly appear. The impression one gets is that the book is to some extent a collection of articles written at different times. But the whole is well arranged and forms by far the most important contribution to the critical history of the war crisis which is at present available. The bill market is not so prominent in his pages as in those of Mr. Withers: but Mr. Lawson gives a useful account of the estimates that have been made of the bills in circulation at various times. Both writers accept the general opinion that at the time of the crisis something like £350 millions of bills were current in the London market. Both writers, again, find that the value of the earlier forms of relief granted was over-rated. Mr. Withers en-

[1] A competent observer, Mr. Spalding, says, "The consensus of opinion, outside banking circles, seems to be that the action by the banks, in calling up all their loans from the discount brokers and other similar borrowers, to some extent precipitated the crisis."—*Foreign Exchanges*, p. 98.

The main purpose of a banking reserve is to make such pressure unnecessary.

dorses the very general view that the banks might have "shown greater readiness to assist in the task of reorganising exchange" (p. 74). Mr. Lawson is less inclined to criticise the banks, but justly lays stress on the supreme services rendered by the Bank of England. It was, as he truly says, the mainspring of all the emergency measures. "Without it there could have been no heroic bill-discounting, no conjuring with Treasury guarantees for all sorts of financial and commercial debtors. The Bank of England furnished the talisman, and the Chancellor of the Exchequer applied it" (p. 13).

The services rendered by the Bank were certainly remarkable. The White Paper recently issued shows that in the five days ending July 1st the Bank had made general advances to the amount of £27 millions; while its total advances to bill-brokers are estimated at £30 millions. In the week ending August 5th its gold reserve declined £17 millions, notwithstanding a receipt of £5¼ millions, leaving the amount as low as £11 millions. The proportion dropped in a fortnight from 52 per cent. to 15 per cent. The Bank state that they had refused no legitimate applications for assistance. The whole mass of liability on account of relief measures, nominally assumed by Government, of course fell in the first instance on the Bank. Some idea of the amount of this liability may be gathered from the statement in the Revenue returns that £160 millions has already been repaid. It is clear that the Bank Directors showed their usual courage and did all that could possibly have been expected of them.

Passing to the Stock Exchange position, we find Mr. Lawson here at his best. He is not satisfied that this market need have been closed. Securities had been depreciating for a long time before the war, and in the ten days before the House closed there was a further fall of no less than £188 millions (or 6 per cent.) in the representative securities scheduled by the *Bankers' Magazine*. The open account, too, was small. So Mr. Withers (p. 121): "It was generally agreed by most active stock-brokers in the middle of July that they had never seen the Stock Exchange account so small." Subsequent returns showed it to be about £80 millions for London and £12 millions for the country; hardly one-quarter of the liability in the bill-market. Mr. Lawson thinks that the banks had much more at stake than the members of the Exchange,[1] and that they exerted their influence in favour of closing, a step which he does not believe the Committee would

[1] "It is estimated that the banks had lent £250 millions to their customer against stock exchange securities as collateral."—*Withers*, p. 122.

have taken on their own responsibility. But he admits that direct pressure was put upon the Committee by a section of the members. "The Stock Exchange was made the scapegoat of more powerful and higher-placed offenders. . . . After hours on July 30th, forty large firms are said to have notified the Committee that if the House re-opened they would have to hammer themselves" (p. 54). There we must leave the matter. Of the provisions made for immediate relief to the Exchange, and for facilitating the postponed settlement of November 18th, Mr. Lawson seems to approve. The undertaking of the "banks to which currency facilities are open" not to press for repayment of loans until after the war seems, as he says, to have been of the nature of a *quid pro quo*. But he is very critical of the arrangements made on the re-opening of the Exchange. Chapters IX. and XII., in which he deals with these matters, are among the best in the book. Incidentally he shows that our habit of fortnightly settlement and the contango methods, though extremely convenient in many ways, have their disadvantages, as Americans have always contended, and certainly proved awkward in this war crisis (pp. 128–9). It is a point that deserves careful consideration; though we are hardly likely to change our practice. But there will be much sympathy with Mr. Lawson's general view as to the restrictions. He complains that from first to last the Stock Exchange was treated as though it were a national danger, instead of an essential piece of the nation's economic machinery. The re-opening regulations were unnecessarily drastic. The prohibition of new issues except by special license (sometimes, as a recent case has shown, most arbitrarily withheld) played directly into the hands of Wall Street. In a later passage, written after three months' experience of the new rules, he says that, as he had anticipated, "their effect in stimulating American competition has been very remarkable" (p. 244). So in regard to the minimum price rules. He thinks the fear of German liquidation exaggerated. "First, the bulk of it was done before the war commenced; second, the completion of it was effected chiefly through Amsterdam and New York. . . . Treasury regulations of any kind would have been futile, and those actually issued were far more embarrassing to our market than to Berlin." The C.P.R. method of refusing to transfer shares out of enemy names was an infinitely more effective check than any Treasury restrictions could be (p. 187). The provincial Exchanges seem to have been allowed more freedom. Mr. Lawson says "they faced the crisis more boldly and wisely than the metropolitan one was allowed to do. They also offered a stronger resistance to the encroachments of the Treasury" (p. 58). It is hard to avoid the conclusion that the restrictions were excessive, and that not merely the Exchange, but the country, has suffered in consequence. It is obviously desirable, for instance, to encourage the sale from this side of anything marketable on Wall Street. Yet the enforcement of Leeman's Act and the obstacles to arbitrage have so impeded free dealing as greatly to obstruct such sales. You cannot cramp one of the vital organs of an economic community without impairing its general economic strength.

The Treasury issue of Currency Notes, which was one of the earliest emergency measures, has been the subject of so much, and such divergent, criticism that it seems to call for special remark here, all the more as neither Mr. Lawson nor Mr. Withers seems quite satisfactory in his handling of the matter. We have an influential Committee of the British Association recommending that the issue should be withdrawn, and that if paper money is required to replace sovereigns and half-sovereigns it should be provided by Bank of England notes of these denominations. It is a curious recommendation because, as everyone knows, the Bank of England issue is practically made by the Bank as the mere instrument of the Treasury. The Directors of the Bank have no control or discretion whatever in regard to the issue, which is purely mechanical. Sir Richard Cooper, on the other hand, demands in the House of Commons that the Government should take over the present Bank issue. Now there is, of course, one important distinction between the two issues as now conducted. Neither issue is a bank issue in the ordinary sense of that term. But the Bank of England issue is made under conditions which are defined by statute, and which in practice limit its uncovered element. Even here, however, it must be observed that the Treasury may be and has been invested by Government with power to suspend the statutory conditions. But the new Currency Note issue is at present absolutely undefined. So far as the Act is concerned, "Currency Notes may be issued to such persons and in such manner as the Treasury direct." This may be a reasonable arrangement at a time of crisis, but, as Mr. Withers objects, is hardly defensible as a permanent arrangement. Definite statutory regulation, however, could easily be provided. What is still more objectionable than the absence of regulation is that the actual method of issue is concealed, and the whole weekly return "quite incomprehensible except to those who have privileged access to an understanding of its mysteries" (Withers, p. 113). This is one of the many examples of the policy of secrecy and mystification which has done so much to undermine public confidence during the war. It makes useful criticism almost impossible. As Mr. Lawson says, "The first condition of thorough and effective inquiry is a relaxation of the severe reticence which characterises most of our banking returns" (p. 51). But one point should be clear enough. The Currency Notes are certainly payable in gold on demand. Why then does Mr. Lawson speak of "the fiction of their being gold notes"? They are as clearly convertible, under Section 3 of the Act of August 6th, as the regular issues of the Bank are. Indeed, as Mr. Withers properly observes, this Act imposes a new liability on the Bank not recognised in its weekly account (p. 117). It is not so clear whether the Bank has any control over the gold reserve of £28½ millions now held against the notes. This, again, is not shown in the Bank return.

But what is, or should be, the purpose of an issue of this kind? Some definite conclusion on this point is surely essential before we can pronounce on the expediency of the issue. It does not seem to have been duly considered by the critics, and this may explain their very various utterances. Perhaps the difficulty partly arises from the extreme ambiguity of the term "note." This name is given to a variety of documents which have little in common but their physical character and their currency. Some are issued by Governments, some by private persons: some are legal tender money, some merely forms of bank credit, like the cheque or the credit against which the cheque is drawn. Some, like the gold and silver certificates of the United States, are really convenient substitutes for coinage, backed by their face value in metal. Our Bank of England notes come near to this type. Others, again, are issued as auxiliary to existing metallic currency, whether of standard coin or small change. Again, the occasions of the issue may be quite different: the notes may be issued to meet quite different economic purposes. Mr. Conant insists upon three of these as primary.[1] Notes may be used to meet (*a*) a seasonal demand for currency, (*b*) a crisis or emergency demand, (*c*) a demand for the concentration of the stock of gold. To this one might add that notes may also be used (*d*) as the simplest form of bank advances (*cf.* the early Scottish banks), or (*e*) as a cheap form of till-money, an instrument of banking economy; and lastly they have too often been used, especially if inconvertible, (*f*) as a last resource for financing Governments, a kind of forced loan. Perhaps we may assume that there has been no question,

[1] *Banker's Magazine (New York)*, Sept. 1915.—"The Modern Field for the Bank Note: its Service in Emergencies and in the present War."

so far, of using currency notes in this last fashion; and they clearly cannot serve uses (*d*) and (*e*). Coming back, then, to Mr. Conant's three primary uses, the currency notes were neither intended nor required to serve as seasonal currency, after the manner of the monthly and quarterly issues of the Reichsbank. We rely on Bank of England credits to discharge this function in England.

The real question, then, is between Mr. Conant's other two uses. Are we to regard the currency notes as an emergency issue or as a means of concentrating our stock of gold? At the outset, no doubt, these notes were used and intended purely as an emergency issue. The primary object was to allay the bankers' panic and to prevent the development of panic in the general public. Later, too, it may have been used in somewhat similar fashion to lessen the strain on the banks caused by the subscriptions to the enormous war loans. But if this were the real ground for the issue, it ought long ago to have been withdrawn from circulation. It certainly was not the purpose for which such an issue had long been planned. The normal function of the currency notes was to serve as a means of increasing our financial strength by the concentration of all our available gold at the centre. Germany had largely effected this before the war by the issue of smaller Reichsbank notes; and since the outbreak of war, first Germany, and then France, have increased their central holding of gold in a quite remarkable way. For more than a generation past, some of the ablest Governors of the Bank of England had steadily held in view the adoption of a similar policy in this country. They regarded our gold currency as our first line of defence in a serious war. Hence they were opposed to a £1 note issue in peace; because if such an issue had been made on the ordinary lines, a large part of the coin replaced would never have been held in reserve, but would have left the country. But in a war issue, Government can control the terms of issue, and might so have arranged it that by this time some £100 millions of gold would have found their way from the circulation to the central reserve. A costly gold circulation is one of the first luxuries we should economise in time of war. But the concentration of gold is not merely an economy in expense. It is an immense increase of our economic resources. £1 in the central reserve, Lord Goschen used to say, is worth £5 in the pockets of the people.

From this point of view the Treasury issue has been very largely a failure. We do not know how much additional circulation is required by the heavy military expenditure and the rise of wages. The currency notes may have done good service in preventing withdrawals of gold from the Bank for this purpose. But while in Germany the gold reserve has increased by some £55 millions since the last pre-war return, and the French reserve by some £40 millions in the last four months, there is no evidence that any appreciable amount of gold has reached the Bank of England.[1] Between July 29th, 1914, and July 28th, 1915, the Bank lost £22 millions to the general circulation. Some £15 millions of this may have come back since; but the Bank has been wholly dependent for any increase in its resources on purchases of imported gold. Meanwhile the Treasury issue, though it has failed to discharge the only purpose which could justify its continuance now that the time of emergency has passed, shows a steady increase, and has now reached an amount of £90 millions odd, having doubled in five months. Where is the gold which this large issue must have superseded, and would, if rightly managed, have brought into the national reserves? With the exception of the £28,500,000, which has long been set apart as currency note reserve, we are forced to the conclusion that most of the gold is being hoarded by the banks, or by some of them. It was in the power of the banks to make the issue a great success. They might perhaps have been compelled to do so if suitable conditions had been imposed when assistance was first given them by the Government. The public behaved well. They gave the currency notes a good reception, and often voluntarily brought in gold to the banks. It is not their fault if the issue has so far failed. Of course, the failure is not complete. If the gold is not yet where it should be, in the central reserves, large quantities, at any rate, have been withdrawn from the hands of the public. This is a step in the right direction. To recall the Treasury notes, as some advise, would only be a retrograde movement, even if it were practicable. What is wanted is to complete the concentration of gold which the notes make possible.

The question of Ways and Means does not enter into the scope of Mr. Withers's book. Mr. Lawson deals with it energetically and at some length. His chapter on "Our Intricate and Perplexing Taxes" is full of useful suggestion. What strikes him, and so many other observers, is the remarkable disregard of administrative difficulties and indirect consequences so often shown. A recent illustration of this was the proposal to make

[1] "So far gold has not been added to the Bank from internal circulation, but rather the reverse."—*Bankers' Magazine*, October, 1915, p. 485.

bankers collect income tax on deposits, and, again, the scheme for levying income tax on wage receivers by quarterly instalments. Mr. Lawson considers that it is the lower middle class who are most heavily penalised by current taxation.[1] He strongly disapproves of the Vote of Credit system. All expenditure under this system is made on dummy estimates and withdrawn from Parliamentary Control. The procedure was condemned by the Treasury Minute of February 14th, 1880, which he quotes on p. 313. Mr. Lawson foresees "the doom of the One-Man Budget"; and apparently looks forward to the institution of a Standing Committee on Finance, such as exists in France. His general criticism may be summed up in a single sentence: "The two most essential elements of sound finance have been very little heard of, namely, business management and administrative economy."

The most recent parts of Mr. Lawson's book do not seem to be later in date than May, 1915; and he does not go into detail as to the methods, outside taxation, by which money has been raised. But the outstanding feature of our finance has been the remarkable success of the Treasury Bill. This applies more especially to the system of continuous issue at fixed rates: which has the great merit of suiting the convenience of the money market, and at the same time giving the central authority an effective control over the market rate of discount. These bills have been current to an amount of £275 millions without any of that disturbance which a loan of the same amount would cause. It is clearly impossible to meet the enormous demands of the war without recourse to longer-dated obligations; but when we consider that the greater part of the money borrowed is being constantly returned by war expenditure, the presumption seems to be in favour of continuous, rather than catastrophic, loans. Mr. Drummond Fraser and Mr. Gibson have advocated the continuous issue of War Bonds of various amounts and dates, down even to the value of £5, and period of one year; and their arguments seem to be well worthy of consideration. It has often been asked, too, why the lowest denomination of Treasury Bill should be £1,000. This excludes a great mass of possible private investors in these bills. Here we touch closely on another issue which has come very much to the front in the war finance of all the great countries. Is it better that Governments should be directly financed by the public, or mainly by banks using the

[1] In his Income Tax Table, p. 298, there is an obvious slip of shillings for pence in the rates.

money of the public? Neither Mr. Withers nor Mr. Lawson touches on this point. Mr. Gibson has more than once expressed decided views in favour of direct subscription; but some of his arguments are not convincing. Each method seems to have its own advantages, and it is hardly possible to dogmatise on the question. We can all agree in accepting Mr. Gibson's general account of the problem of war finance. "The whole art of loan raising is to substitute scrip for goods with as little financial disturbance as possible."

But so far, to use a phrase of Mr. Lawson's, "we have only been shuffling the cards for the real game which is to come." We have simply been dealing with matters of account, with the machinery of finance. If we were, as Germany now practically is, a self-sufficient country, the problem of finance would be fairly simple, though it must necessarily run into alarming figures. If the production and consumption of the nation were so adjusted as to leave a margin above the civil consumption sufficient to furnish the extra supplies of food, munitions, &c., required to carry on the war—then the question of arranging for the postponement of payment for the cost of the war consumption could be settled without any great difficulty. It might even prove, as Mr. Gibson thinks, that the war could be financed at 4 per cent.,[1] for, as he says, the success of war loans is more dependent on the right mobilisation of the national industry than on the rate of interest. But here we come to the real crux of the situation. The real problem concerns the economic conditions which lie behind the Chancellor's figures of account, viz., the balance of national production and consumption. What is absolutely essential, and after more than a year of war we have hardly begun upon it, is the reorganisation of our whole economic life, consumption as well as production, upon a war basis. Production must be increased, or non-military consumption cut down, until there is a sufficient balance to meet the military consumption. When we consider that the extra consumption due to war (including advances to Allies) is estimated for the next financial year at £1,625 millions, as against a normal annual consumption of little over £2,000 millions, we can see how very serious the position is.

The necessary reorganisation ought to have been put in train at the outset. It *must* have been, if, like Germany, we had been a nearly closed State. But our sea-power enabled us to obtain temporary assistance from outside. This was a doubtful boon.

[1] *Bankers' Magazine*, August, 1915, p. 147.

The assistance disguised the real position, without providing any permanent amelioration of it. If it had been given on terms of long-dated loan, it would still have increased the weight of debt the country has to carry; but it might have been worth our while to incur this inconvenience rather than to put severe restrictions on national consumption. But the neutrals in this war are all borrowing, not lending nations. Hence our purchases were made on ordinary commercial "cash" terms, that is, by short bills (sometimes, we are told, actually by cash in advance). The result is that we now find ourselves faced with an exchange problem of a much more urgent character than any question of loan liability. The consequences of failure to meet cash liabilities are well understood. They stand on a quite different plane from the difficulties imposed by borrowing for long terms. A great business may prosper on borrowed capital; but inability to meet its bills is fatal. What the present amount of our adverse balance on exchange is can only be roughly guessed. We have no definite figures as to our earnings on freights, as to expenditure of foreigners in England, as to remittances to relations from abroad, as to the value of our financial and commercial services to foreigners, nor as to the interest on our foreign investments. We may be certain that the war has disturbed all normal estimates for these items. Nor do we know the exact figures of our advances to our Allies,[1] nor the amount of imports on Government account: both items of first-rate importance. But six months ago estimates were made which put the adverse exchange balance for the year at £500 millions. We must take this as a minimum figure. Of course, this adverse balance has been largely set off by special operations. Apart from the normal adjustments of exports and imports, whether of goods or services, there are four main methods by which exchange can be rectified, and we have used them all. We have exported gold, we have sold securities, our banks have made private finance arrangements, and, finally, we have raised a dollar loan in New York, jointly with France, for £100 millions. We have also cut down rigorously our foreign investments. How far all these operations have gone towards reducing the adverse balance can only be matter of conjecture. What is certain is that all the chief neutral exchanges are against us, by percentages ranging from about $1\frac{1}{2}$ per cent. to 9 per cent.; the New York exchange, most important of all, having dropped at one time to $7\frac{1}{2}$ per cent. discount, and standing now at about 5 per cent.

[1] Lately estimated by Mr. McKenna at £423 millions for the year 1915–16.

The remedial measures were carried out in a way that is certainly open to criticism. There are two sides to every exchange question, just as there are to the question of high prices. There are obvious objections to low exchange, which makes payment for imports costly. But on the other hand, it is all in favour of exports of goods and of the sale of securities. Hence it is eminently desirable that the various operations for rectifying exchange should be carried out by some concerted arrangement, if not by one authority. Our resources in the way of securities marketable on Wall Street are limited, and it is desirable to sell them to best advantage, *i.e.*, on a low exchange. If the bulk of them could be sold by a committee of experts, much as Barings' securities were realised after 1890, then gold exports, bank finance, and loan operations might be so arranged as not to clash with the sale of securities.[1] The American loan itself was only a qualified success, as might have been expected. Up to the war the United States had been a great borrower from Europe. In spite of the stimulus which the war has given to her trade she cannot suddenly become a lender upon a large scale. What she was able and willing to lend might probably have been obtained with less fuss if special subscriptions to the regular war loans had been opened in New York, with interest payable in dollars, not subject to British income tax. If the amount obtained in this way proved inadequate, it would then be possible to supplement it by private finance arrangements of the familiar type, but perhaps for longer terms. The plan adopted of raising a special loan seems to have created some political difficulty, and hardly improved the national credit.

In any case, our resources for rectifying an adverse exchange balance are strictly limited. None of the four expedients to which we have resorted can be continuously available to any considerable extent. The exchange difficulty is only the symptom of a more radical mischief. The real significance of the adverse exchange is that our national economic life is very far from being organised on a sound war basis. The margin between the output of our industries and the consumption of our civil population is not sufficient to furnish the military supplies which we have undertaken, and are obliged, to provide. This is the fundamental issue, and we ought to have faced it long ago. Our credit is excellent and our financial methods sound. But the best finance in the world cannot enable a nation, situated as we now

[1] After these lines were written, we learn from the Press that arrangements of the kind suggested may be made: a year too late.

are, to go on continuously consuming greatly in excess of its production.

Our papers are never tired of dwelling on the weakness and artificiality of German war finance. Too much can easily be made of this. It will prove awkward for Germany when the final settlement comes. But till then, what is important is not so much the machinery of finance as the national organisation behind it. If Germany, after supplying her population with bare necessaries, is still able to produce what is required to keep her armies in the field, then, however artificial her finance may be, it will not prevent the carrying on of the war. There is a passage in the rather flamboyant speech of Dr. Helfferich on the Third German Loan which is not without instruction for ourselves. "The wealth," he says, "to which our success is due is not the sum of our savings, but rather our whole economic technical apparatus. It lies, above all, in the living labour power of our people, who, in war, work and create for war. . . . We carry victory within ourselves."

If victory does not lie within us, we certainly cannot find it elsewhere. The modern Englishman is apt to think he can. The popular trade philosophy, which studiously ignores the importance, almost the very existence, of political frontiers, has allowed us to drift into a complacent dependence upon foreign nations. Nothing but our sea supremacy makes the position possible, even in time of peace. But war emphasises the always vital importance of the nation; and in a world-wide war like this, when the only neutrals are borrowers and not lenders, it is clear that the belligerent groups must in the main be self-sufficient. We must rely on our own resources; it is high time we began seriously to organise them. Maximum efficiency, minimum expenditure: these must be our objectives. Fortunately there are wide margins for economy in both directions. But they must be utilised to the utmost.

H. S. FOXWELL