Fabian Tract No. 164.

GOLD AND STATE BANKING

A Study in the Economics of Monopoly.

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PREFATORY NOTE ON CURRENCY CRANKS.

Currency cranks are the most foolish of theorists, and their schemes the most futile of Utopias.

The following pages, read as a lecture to the Fabian Society in April, 1911, contain some speculations about the place of gold in the machinery of commerce which the writer puts forward with diffidence, precisely because of his distrust of the company he is keeping.

His speculations lead up to a remarkable conclusion, which, however, is not necessarily dependent on them. And the reader is particularly requested to note that what is here outlined is not a scheme, but a forecast. Neither the Government nor any individual is asked to adopt any proposals or to follow any advice. The writer invites them only to accept Mr. Asquith's well-known policy—"Wait and see." In his view, the almost inevitable effect of economic causes will be that our banks will continue to amalgamate: when there is only one bank, or virtually one, its power will be too enormous for private persons to wield; hence it must be controlled by the State.

The remarkable consequences of this monopoly are briefly indicated in the following pages, which to some extent are based on ideas set forth in Fabian Tract No. 147, "Capital and Compensation."

The connection between Socialism and currency is ancient and respectable.

Labor Notes.

Robert Owen, the father of Socialism, devised the simple expedient of labor notes, which, like a will-o'-the-wisp, if such a thing exist, has ever since lured Socialist theorists to destruction.

He established a series of stores, one, the most famous, in Gray's Inn Road, at which commodities, chiefly boots and clothes, were received and were paid for in hour notes on a valuation in money, an hour being reckoned at sixpence. The introduction of time was therefore purely nominal and for purposes of edification. The time value of an article had no necessary relation to the time spent in its production, except in so far as it has at present, that is, in so far as it regulates the cost of production.

Money.
Ref. from Banks and banking.

Nothing which Owen devised in Utopian reconstruction seems to have lasted longer than a few months, or at most a year or two, and his labor exchanges all promptly failed, though exactly why does not appear. All one can learn from Frank Podmore's exhaustive biography is that they began with apparent success and sprang up in crowds, but in a year or two had all faded away.

In his labor notes, as in his co-operative communities, Owen got hold of a right idea, but he tried to do by private enterprise what can only be properly and completely accomplished by the State, and therefore he failed.

The idea of labor notes is simple enough. It is that labor, added to raw materials, creates wealth. Trade is simply barter. All that is wanted is some authorized indication that the laborer by his labor has created wealth. Constitute an authority with power to apprise the value embodied in the article and to grant certificates therefor, and you have at once a currency which is based on actual wealth and which cannot exceed it in amount.

Where the Theory Fails.

But there is one big flaw in this theory. The mere addition of labor to raw material does not necessarily create wealth. The product must be such as to satisfy some human desire. Moreover, the amount of the labor is no measure of the amount of wealth. And the human desire must be a desire for the product *here and now*, in exactly the right form and quantity. Without this correspondence no amount of labor produces wealth. Finally, not only does desire fluctuate and change, but also it has the very awkward feature that it automatically and inevitably diminishes in intensity as the quantity of the product increases. Thus it is impossible to measure wealth in terms of labor.

Moreover, where do services come in? The work of tramwaymen and busmen and cabmen is moving about people. It may be argued that I am of more value to the community when by the labor of numerous railway servants I am removed each day from the Surrey village in which I live to my office in London, but their labor embodied in me has no exchange value, and it may be said to be cancelled by more labor on the part of the railway servants in conveying me home again at night.

A moment's reflection will show that only some labor is so embodied in commodities as to have a more or less permanent exchange value. Therefore the theory breaks down. The Marxian law stipulates that the labor which creates value shall be socially valuable, but the difficulty is that this can only be ascertained long after the labor has been expended. The labor embodied in commodities cannot be valued with any certainty because the value of the commodity fluctuates, whilst the value of the labor note, if it is to be useful as currency, must be rigidly fixed. The labor note, in fact, comes to be merely an attractive name for a paper currency; the idea that its amount will be automatically regulated by the available wealth of the community vanishes. The notion that it has some special security in the object created by the labor it pays for is unsound because the object created has itself no certain value.

It may be thought that the labor note project is as dead as the wages fund theorem, and it is waste of time to demonstrate its fallacies. This is not so. A recent book, entitled "Twentieth Century Socialism,"* by the late Edmond Kelly, an American lawyer, and a most capable and intelligent man, describes a mixed system of currency, according to which gold will be used for export purposes and labor notes for internal trade, and this project is set out in all seriousness as the most up to date device for settling currency problems.

But any ardent advocate of labor notes who reads this is no doubt already burning to point out that the advantage of labor notes would be that, unlike gold, they cost virtually nothing to produce, and unlike some other forms of currency, they earn no interest, whilst bills and mortgage bonds and overdrafts all carry interest, a charge on industry for the benefit of the capitalists.

The Guernsey Market Notes.

Socialists who take up finance have at intervals since Socialism began, discovered the Guernsey Market House, and they tell us with glee how the States of Guernsey, being short of the needful, resolved to build a market and to pay the workpeople, not in gold but in labor notes, which were to be legally current till the profits of the market enabled them to be redeemed. Why should not our municipalities build their markets, lay their tramlines, construct their waterworks by the same method, and thus escape the necessity of paying ransom to the monopolists of gold or, in simpler words, interest on the capital borrowed.

Mr. Theodore Harris, a member of our Society, not exactly orthodox in his opinions or, indeed, practice, in the matter of currency, has rendered a great service by investigating this famous transaction in the archives of the island; † and alas, the bright illusion vanishes! The labor notes were not, so far as evidence goes, given in exchange for labor, but were put out as currency, just as Argentina or Honduras, or Venezuela does to-day. They were not secured on a market in building, but on an excise of spirits, just as any borrowing State with bad credit hypothecates its customs or its railway receipts as special security for its loan. In fact, the notes have not been repaid yet, and these same notes, though the Market House was built in 1820, still circulate in the island.

What the States of Guernsey actually did was to issue paper money, in small amounts, intended to be redeemed after short periods; and the scheme came to an end apparently, precisely as the economists predict. Guernsey found the facile descent into paper currency as attractive as all States find it. It set its printing

* Longmans; 1910. 7s. 6d. net.

† "An Example of Communal Currency: the Facts About the Guernsey Market House." Compiled . . . by J. Theodore Harris. P. S. King & Son. 1911.

press humming till its paper notes amounted to £55,000. Then the bankers kicked. The account of their difficulties is obscurely worded, and the editor makes no attempt to elucidate it. But it seems clear that foreign commerce and finance could not go on with a currency incapable of export. The market notes were driving out the gold, because gold alone was valuable for sending abroad. So the bankers persuaded the States to retrace their steps. The £55,000 was reduced to £41,000, and at this figure it has remained ever since.

It is obvious that any Government by the issue of paper money, can make once for all, a profit to the amount of the gold replaced by the paper which has no appreciable cost. To that extent it is always possible for a Government to obtain a supply of capital free of cost. It can only do it once. In the United Kingdom the value of our gold coins in circulation is £113,000,000.* Theoretically we could let the foreigner take these, and replace them by inconvertible paper. Practically every nation which can afford it uses gold in preference to inconvertible paper, because experience shows that a currency of, or based on, gold is worth as an instrument of exchange far more than its cost. Inconvertible paper is only used by nations who have blundered financially and have failed hitherto to recover their losses.

The Stability of Gold.

Gold, then, is universally regarded as the best basis for currency, because it is the most stable. But it is said by some that the alleged stability of gold as a measure of value is not a fact. Other things, it is said, exchange with gold in proportion to its quantity. An increase in the supply of gold means a rise in prices, because there is more gold available to exchange against products in general. It is pointed out that the gold production of the world has increased enormously, from £22,000,000 in 1885 to £95,000,000 in 1911, and in fact the rise in commodity prices in most countries of the world, and recently England, is a marked feature of present day politics.

Let us consider what actually happens. Every month the Transvaal mines produce some 800,000 ozs. of gold, worth roughly £3,400,000. The greater part of that gold is shipped to London. When £1,000,000 of gold is landed from South Africa, let us suppose that it is taken, as much or most of it is, by the Bank of England. When in the Bank it is actual or potential money, and is available as currency or floating capital. Its immediate effect is to increase the supply of loanable capital, to decrease the rate of interest on such capital by increasing the supply, and also by increasing the gold reserve. (It must be remembered that the Bank rate is largely determined by the amount of gold reserve ; the rate is put up when gold is scarce, in order to attract floating capital to England, and therefore to check the outflow of gold and sometimes to bring gold.)

* Report of the Deputy Master of the Mint, 1911. Of this sum £44,214,173 was held by bankers, including the Bank of England, on June 30th, 1910. Gold bullion to the value of £20,000,000 also in the Bank is not included in the above.

But low rates of interest mean cheap trading and low prices. So the first effect of more gold is not to raise but to lower, even if only a little, the range of prices.*

Now has it any other effect? Does anybody who has a bank account, in the savings bank or any other bank, ever fail to get gold when he asks for it? Obviously not. Whether the Bank of England has much gold or little, it always pays in gold any person who has a claim upon it. Even if ten or twenty millions in gold were brought into the Bank, no person would use another sovereign than he uses now.†

It therefore seems to be clear that for currency purposes we have in England, and have had for fifty years past, every ounce of gold we want to use. Whether the Transvaal or Mysore or Westralia or the Jungle produce from their mines ounces of gold by the million or no ounces at all, we in England do not use one half sovereign more or less of currency. If I owned a private mine, and took its proceeds, 100,000 ounces, to the Mint, and got it coined into sovereigns, I could only pay these into a bank; in a few hours they would be in the coffers of the Bank of England, and the currency would be at exactly the same level as before.‡

The inference is that the quantity of gold in use in England as currency is not determined by the quantity of gold produced in the mines, because currency in England is the first claim on the world supply of gold, and is relatively a small claim. A mere fraction of the ninety-five millions in value produced annually (the figure is for 1911) is all that is required to supply the wear and tear, and to meet the demands (if there are any) of our growing population, and increasing commerce and industry. If half a million or one million is all we need annually for our currency, it is immaterial whether the total production is fifty or seventy-five or one hundred millions.

What becomes of the rest? Large amounts are used in the arts, for jewelry and watches and gold leaf. For the rest, it seems probable that other countries are not, as we are, full up with gold. Twenty years ago, when I was in the United States, I saw a gold coin in the Eastern and Middle States in the course of three months only once or twice. There was no gold in circulation, and I believe there is very little even now.§ Only a few years ago, in 1907, America

* Some economists argue that a low rate of discount encourages loans for the purchase of commodities and so raises prices. But the new loans may also be applied to the production of more commodities and so lower prices. In fact during the present century, with its unparalleled gold production, the Bank rate has on the average been markedly higher than it was at the end of the last century. From 1892-7 it varied between 2 per cent. and 3 per cent. (average 2·46); from 1898-1911 it varied between 3 per cent. and almost 5 per cent. (average 3·61). The recent effect of the great output of gold on prices through its tendency to lower the Bank rate has therefore been at the utmost only negative.

† For confirmation of this view see de Launay, "The World's Gold," quoted by W. W. Carlile, "Monetary Economics" (Arnold, 1912), p. 6.

‡ Gold in circulation is currency; gold in the Bank is floating capital.

§ The United States Currency Department has taken a great deal of gold in recent years and held early in 1912 £247,000,000.

ran out of currency and had to borrow gold and anything else as quickly as possible from all the world over. India, again, is on a gold basis, but has no gold currency. It is said that the gold coinage melts away into hoards. Here too it is probable you could not get gold anywhere and everywhere, if you want it and have negotiable currency to give for it.

I am not prepared to say whether the rise of prices* in India, which is enormous, or in the United States, which is notorious, or in Germany, where it is affecting the fortunes of political parties, is or is not due to the increased supplies of gold or to what extent it is due to this cause among others in each case, because I am not familiar with the banking and currency system of those countries. They may in the past have had available less gold than they could use, and the increase of the world supply may be having some effect on their prices.

In England the only possible effect † of increased output of gold seems to me to be to lower prices, and that perhaps is why England has largely escaped that great rise in the cost of living of which so many other nations are complaining.

In foreign countries, it may be that the gold reservoir, so to speak, is not yet full, and its gradual filling from the produce of the mines may be affecting the level of prices. In England our reservoir has been full for the past half century at least, the level varies slightly from month to month or from year to year, but that is a matter of internal and external trade, and bears no sort of relation to the gold supply of the world.

The Local Value of Gold.

What, then, determines the value of gold? Why does half an ounce of gold (say £2) exchange, roughly, for a ton of iron, or a quarter of wheat? Why is it reckoned a bare living wage for a fortnight in London? Why in all these cases is the weight of gold half an ounce, and not a quarter of an ounce or two ounces?

* The increase of prices abroad must affect the prices of imported goods and raw materials in England.

† One accepted explanation of the effect of increased gold production on prices attributes the rise to the increased demand for commodities caused by the wealth of the mineowners. But in this connection gold is in no way different from any other commodity, except in so far as a bountiful harvest or a big cotton crop tend to depress the prices of wheat and cotton; and the increase of wealth in terms of gold is not necessarily proportionate to the increase of commodities. According to this theory, the settlement of new countries (as in Canada or South America) should affect prices quite as much as the discovery of new gold fields. Stanley Jevons made an investigation of prices in the years 1845-62 and calculated, by taking "unweighted" prices (i.e., considering a rise of 10 per cent. in the price of corn as practically equivalent to a fall of 10 per cent. in the price of black pepper), that prices on the average had risen 9⅓ per cent. coincidently with an increase in the production of gold. All his forecasts based on this induction have proved wrong, and he made no attempt to check his conclusion by ascertaining that no such alteration of prices had occurred in previous decades when there had been no change in gold production. Moreover he did not attempt to show *how* the increased output of gold had affected prices. ("A Serious Fall in the Value of Gold," by W. Stanley Jevons; Stanford, 1863. This is said to be still the classical authority for the generally accepted doctrine.)

Well, the first thing to notice is that the value of gold not only varies from century to century—that is well known, and economists write books about it—but from place to place.

By one of those odd blindnesses common amongst economists, the fact that the exchange value of gold varies from place to place is commonly disregarded: the professors are aware of the phenomenon but it does not fit into their theories, and so they only speak of it as a variation in real wages, or the cost of living. But if the value of commodities varies in terms of gold, it is necessarily and equally true that the value of gold varies in terms of commodities.

I read recently that in the remote interior of China a European missionary can live in comfort on 12s. 6d. a month. That is an extreme case. Wages in Belgium are, according to Seebohm Rowntree,* about half those in England. In America, according to a recent Board of Trade Report,† wages are more than twice our rate, and it is commonly said that a dollar is the equivalent of a shilling. Now I do not see that it can be disputed that this means that the value of gold in terms of commodities and services varies. Impossible, it is sometimes said: merchants would buy where commodities are cheap, people with fixed incomes would rush to live where their gold purchases much. Well, they would and they do. The coast towns of France swarm with our half-pay officers, who live there precisely because their gold has a higher value in France than in England. And as for the merchants, their business in the main does consist in buying where many commodities are given for little gold, and selling where more gold is given for the same commodities. Would eggs be brought from Denmark and Siberia and Ireland to sell, not in London only, but throughout England, in towns and villages and farms, if eggs and gold interchanged on equal terms in Siberia and in Surrey?

Now the prices of certain articles, of corn and cotton, of iron and copper and tin, are more or less international. Apart from tariffs, corn and iron must fetch practically the same prices in London and Hamburg, in Marseilles and in Constantinople, because cargoes can be sent to one or the other at practically the same cost; they are one market for international produce, and goods in one market can have but one price.

But for land and houses and labor, and innumerable other things, the effective market is measured by half-miles, and for the great bulk of things it is bounded by a frontier. Our home trade, as all the world knows, is enormously greater than our foreign trade and enormously more valuable. Only a mere fraction of the people can select their places of residence in accordance with the purchasing power of their incomes, because most incomes are earned. Only a tiny fraction will exercise this choice, because most people are bound

* In some trades; in others the difference is less. "Land and Labor: Lessons from Belgium" (Macmillan, 1910), p. 561, etc.

† The precise ratio is as 100 to 232. "The Cost of Living in American Towns." Cd. 5609, 1911.

by stronger attractions than a high purchasing power of gold. Finally, only a few of the things which are bought and sold can be transferred from one country to another.

Since, then, gold has different values according to locality, it is clear in the first place that its value is not determined by any cause connected with gold itself. For gold is indisputably international and flows with hardly a trace of resistance from one country to another, across oceans and mountains from Arctic beaches and Australian deserts, to the strong rooms in London and Paris and Berlin.

Hence we are forced to the apparently absurd conclusion that the value of gold in any given locality is not determined by any general cause at all, but depends on local custom. In other words, agricultural labor is paid 10s. a week in Dorset and 20s. a week in Northumberland largely because it was paid, let us say, 9s. a week in Dorset and 18s. a week in Northumberland ten years ago, and the laborers have managed to get a rise of 1s. and 2s. respectively in the interval. If you ask why wages are not 18s. a week in Dorset also, there is no reason in the nature of things. It is custom.* Northumbrians have been able to raise their wages because of the neighboring coal mines. Dorset men have not. But it is misleading to use special illustrations. A dozen explanations can be given why wages vary in different countries. But it is not so easy by any means to explain why the general level of prices varies so enormously from Belgium or Russia to New York or Pittsburg.

Take Belgium again. According to Mr. Rowntree wages are low because house rents are low.† Rents are low because building is cheap. Building is cheap because wages are low. A complete circle! In other words wages are low in Belgium because wages are low. That in my opinion is the correct explanation. In terms of gold it is equivalent to saying that the value of gold in relation to commodities is high in Belgium. In fact, labor is not, as used to be said, the source of all wealth, but a factor in all wealth of overwhelming importance. The cost of labor largely determines the range of prices. Wherever labor is or has been scarce and that scarcity has forced wages up and prices with them : or wherever labor is organized and intelligent, and demands high wages, prices also are high, and gold is relatively cheap. On the other hand where labor is ignorant or degraded, or remote from the world market, wages are low, prices are low, and gold is dear.

* By custom I mean that which exists owing to the habits of thought of the people of a district. The value of gold in terms of labor, for example, is fixed locally because people have been and are in the habit of offering and accepting certain rates of wages, certain rents for cottages and, to some extent, for farms, and even prices for commodities. Within the limits of these customs, rates are kept relatively stable by competition. No man can obtain much more than the customary rate because of the competition of his neighbors.

† This is not intended as a criticism of Mr. Rowntree, and in fact he does *not* explicitly include low rents amongst the causes of low wages in Belgium, though it is implied on pp. 72 and 529. See also pp. 445, 527 and 528 of "Land and Labor."

But remember, labor benefits by high wages even if accompanied by high prices, because the world market controls the prices of world commodities, such as corn and meat, and therefore, notwithstanding high prices, the American and Australian and English workmen are better off than the Belgian and Italian, the Hindu and the Chinee.

Is Gold a Monopoly?

Socialists sometimes object to gold as a basis of currency, because they say that the bankers and financiers have a monopoly of gold, and by that monopoly make great wealth for themselves.

Now the idea that in England bankers and financiers have a monopoly of gold, or desire a monopoly of it, is singularly perverse. In fact, it is the one commodity of which by law there is, and can be, no monopoly. Our whole monetary system is based on free gold, and it is this free gold which makes London the financial clearing-house of the world. By law, every bank or other debtor must make payment in Bank of England notes or in gold, and every holder of Bank of England notes can by law get gold for his notes at the Bank. A monopoly of gold, if it means anything, means a monopoly, not against the poor, but against the rich. De Beers have a virtual monopoly of diamonds because they control the sales to the rich, who are able and willing to buy. There is no monopoly in motor cars, though comparatively few are wealthy enough to be buyers.

There is, by law, no monopoly of gold, because any man who can command three pounds' worth of saleable property, or can do three pounds' worth of saleable services, and therefore has a claim on the world, can demand payment in gold, and, in fact as well as law, can get it in gold.

But there is another consideration. The odd thing is that gold, supposed to be desired by all men, is in fact the one thing bankers dislike and detest.

A banker keeps a large part of his assets in investments of various sorts, stocks, bills and loans, and a small part in gold. The stocks and bills and loans all yield interest, and it is from them that he pays the interest on his deposits, and makes his working expenses, and his dividends. His gold yields no return whatever, and requires safe custody, for which he has to pay. Every additional £1,000 in gold is so much interest lost, and so much extra coin to be cared for. Every thousand sovereigns he pays away reduces his dead capital. That is why there is a constant rumble of complaint going on that the bankers do not keep a sufficient reserve of coin, and trust too much to the Bank of England. The financial critics, always half a century out of date, as I shall subsequently show, are full of the terrible risks the banks run in keeping their stocks of gold so low. Why this perversity if their "monopoly" of gold is so precious? On the contrary, what is precious to them is to get rid of every sovereign they can possibly spare, and to foist on to the Bank of England, a semi-public body, the duty of keeping for the country the enormous stock of idle and useless gold, which from generation to generation reposes in its vaults, as a fetish for the City to worship, a sort of golden ark of the covenant, kept in the holy of holies of Threadneedle Street, never to be seen or touched by the ordinary mortal, but in some mysterious way essential to the stability and endurance of the mighty fabric of our commerce and industry.

During the past twenty years there has never been less than 20 millions sterling of gold in the Bank, rusting, so to speak, idly in its strong rooms. During the last forty years there has never been less than 17¾ millions. Even in 1866, the year of the great panic, when half the banks were toppling and credit was shaken to its core, the Bank never had less than 11¾ millions, and this was only about a million under the average of several previous years.

Our Banks too Big to Fail.

The fact, which surely everybody knows and hardly anybody ventures to state, is that the stability of our great banks—and all our banking system which now matters a tittle consists of great banks—is based not on the supply of gold in their vaults, nor on the reserve in the Bank of England, but on the fact that they are too big to fail, too big commercially and far too big politically. If Lloyds, or the London County, or the National Provincial stopped payment, the consequences would far exceed a San Francisco earthquake, a Chicago fire, or any other catastrophe within the memory of man. The Chancellor of the Exchequer with a word could avert the catastrophe as Richard Seddon did in New Zealand,* and so saved his country from the panic which desolated Australia ; or as an alternative, a dozen bank managers in conclave could save the situation, as they saved it when reckless speculation in Argentine loans wrecked the fortunes of the house of Barings.

Is it credible that both the Ministry and the banking community would stand aside in face of an impending calamity certain to bring them irretrievable misfortunes ?

Even in America at the financial crisis of a few years ago the banks, when they had time to think about it, refused to resign when defeated by the scarcity of currency, considering it wiser simply to decline to honor cheques till the clouds rolled by, rather than follow the traditionally correct course of closing their doors and winding up in bankruptcy because they happened to have run short of gold or paper currency.

The ultimate security of our banks is, then, dependent not on a stock of gold, but on the political and commercial common sense of our country. The economists still talk about commercial crises because they read Mill and Ricardo—who wrote about what they saw around them—instead of observing what happens now. All the first class finance of the empire is and has for years been centred in London, and there has been no bank failure in London of the traditional sort since the failure of Overend, Gurney & Co. in 1866,

* By an Act passed in one day, June 30th, 1894, the Government lent the Bank of New Zealand £2,000,000 in return for a share of control. A further loan was made in 1895.—"Newest England," by H. D. Lloyd. (New York), Doubleday. 1900. Page 276.

an event which but few bankers nowadays will be old enough to recollect. *Industrial* crises—periods of declining trade—we still have, and shall have no doubt for years to come. *Financial* crises are matters of ancient history, which are described in the classical economists, who, I understand, are chiefly studied by the occupants of bank parlors.

Bankers, old fashioned people who follow tradition with great reverence, still believe that their five per cent. or ten per cent. of gold is their sole salvation. They compare their banks to a mighty pyramid of credit standing upside down, poised on its tiny apex of gold ; they flatter themselves that it is their extraordinary caution, their admirable system, their almost superhuman dexterity, which alone accomplish this perennial miracle.

The Basis of Currency.

In fact it is all a delusion, because the security of the credit system does not depend on gold, but on public good sense ; and gold is to the system merely the small change, as silver and copper are to the individual. The only proper explanation of our system of currency with which I am acquainted is to be found in John A. Hobson's important book, "The Industrial System," although it is in my opinion marred by a curious error of some £15,000,000,000 sterling! The great bulk of our currency consists of bankers' credit, but it does not seem to be commonly recognized that the potential substance of bank credit is the total tangible wealth of the country, which is estimated at something between fifteen and twenty thousand millions sterling.*

The realized property of the nation consists of all sorts of things —land, houses, machinery, products, raw or manufactured, all the miscellaneous property summed up in the case of individuals only at their death for the beneficent operation of the death duties.

Our banking system is an enormous federated pawnshop. Those who have things—traders with goods bought on credit, or in warehouses, or on the high seas, or in process of manufacture, landowners requiring money to build or improve, householders desiring to buy a house and pay by instalments, all who want to use and control property which they cannot at the moment fully pay for, deposit the documents representing that property, deeds, bills, bonds, etc., at a bank as security for loans. On the other side is the class who keep their spare money at the bank, current accounts or deposit accounts. What the banker borrows he lends. What the depositors possess is really and ultimately the goods which the borrowers have pledged.

Our currency consists in the main of crossed cheques, that is, orders on the bankers to transfer claims on the goods in pawn from

* He considers the effect on prices of a given increase of the output of gold in relation to the national income (£2,000,000,000). My view is that gold, except for use in the arts, is of the character of capital and not income, since it is necessarily saved, and cannot be spent. Hence the increased output has relation to the national capital, which is fifteen to twenty thousand millions. See Chapter xvi.

one account in a bank to another account in the same or another bank. As I have said before, the whole of the realized and saleable wealth of the country or, to speak more accurately, the whole less the margin of safety which the prudent banker would deduct, is potentially available to be thus turned into currency ; and under a perfect system, a monopoly, it would actually be available.

One State Bank.

Our banking system can, however, never be perfect till it is not merely a series of trusts, but an actual monopoly, which of course must be under the State.

If all banking were done at one bank, the problem would be infinitely simplified, and people would realize that our paper currency, bank notes, cheques and bills are not, in truth, based on gold alone, but on all other forms of realized wealth. Moreover, they would further perceive that the real limitation of a banker's operations is not the amount of his deposits, but the amount of his loans.

The assets of the bank are the goods pawned with it. Whilst we have a number of independent banks, each one can only lend in proportion to its deposits, because one bank might hold the property, and another bank might hold the credits or currency secured on it. If we had but one bank, and all cheques were drawn on it, and had to be paid back again into it, banking, so far as internal commerce was concerned, would be reduced to book-keeping. A supply of gold would have to be kept for small change, but beyond that, for the purposes of internal transactions, no gold basis would be dreamt of ; no banking panic could be feared, because what was withdrawn with one hand would have to be paid back with the other.

The Uselessness of Deposits.

A universal State bank could convert into currency any property lodged with it, and would not have to consider its deposits of currency, that is, its deposits in the ordinary sense. What good, then, would the deposits be ? Why should the bank accept and pay interest on deposits ? The only possible answer is in the negative. Under a régime of competition, bankers must pay interest on deposits because their loans are limited by their borrowings. Under a monopoly conditions are wholly altered. The "laws" of political economy and the rules of commerce, elaborately worked out in theory as well as in practice on the assumption of competition vanish into nothing as soon as a monopoly supervenes.

The economics of monopoly have not yet been even sketched, but at first glance one can see surprising results.

With a strict banking monopoly all crossed cheques would be drawn on and paid into the same bank. Therefore, all cheque transactions would be book transfers from one customer to another.

Under the competitive banking system, if I have £1,000 at my credit in Parr's Bank, the bank will pay me £20 or £30 a year to leave that deposit there, because if I spent it, I should pay it away to persons who had accounts in other banks. But if there was only one bank, I could only pay it away to other customers of that bank; the £1,000 could only be transferred from one customer to another. That, obviously, would make no sort of difference to the bank. Therefore, the bank would not pay me £30 a year for refraining from transferring my £1,000 to other accounts in the bank's ledgers.

It is easy to explain why, under competitive banking, a banker's loans are limited by his deposits, and under a unified banking system there would be no such limit. When a bank accepts, say, warrants for goods in dock warehouses as security for a loan, it in effect promises to pay gold, if demanded, to the agreed amount. For most purposes this promise does not take effect, because transactions are in cheques balanced against one another.

But at the end of the day each banker squares up through the Clearing House, and if in any case the amount due *to* other banks exceeds the amount due *from* other banks, the bank which owes actually does pay in gold or in notes or drafts on the Bank of England, which are equivalent to gold.

Deposits in a bank are made in gold or cheques on other banks. The bank which receives £1,000 in deposits, can lend that sum, because its payments out will equal its payments in. But it cannot lend in excess of its deposits to any large extent, because it would have to pay away the difference in gold or its equivalent, at the end of the day.

But if there were only one bank there would be no settling up in the evening; no other bank would exist to demand a balance in gold. All the elaborate Clearing House business, which is in effect, a balancing up in order to arrange that each particular bank shall have at the end of the day the proper amount of assets to balance its liabilities would cease, because the claims on the goods would always be in the possession of clients of the bank which held the goods. The bank, it is true, would undertake to pay gold against goods as before, but gold for internal circulation—and for the moment I exclude foreign trade—varies in amount slowly and between well-ascertained limits; and on the average, if one borrower took his loan in gold, other depositors would bring in gold to the equivalent amount.

Remarkable Consequences Thereof.

I confess this proposition is simply staggering. There are our enormous bank deposits, the pride of the City, fifteen hundred millions in all. Banks are amalgamating every day. There are only some sixty or seventy left which do home business in the United Kingdom. If those amalgamate, the need for these enormous deposits suddenly, so to speak, vanishes. The universal banker drops a note to each depositor: "Dear Sir or Madam, The National London Midland County Capital Joint Stock Bank of England has resolved to amalgamate with Messrs. Lloyds, Parr, Barclay, British Linen Co., its remaining competitor, as from the 25th inst., and I beg to inform you that we shall no longer be able to pay interest on your deposit. You may take it somewhere else *if you can*. Your obedient servant, General Manager."

But this suggests a misconception. The interest-bearing value of deposits ceases, not by the fiat of a monopolist, but in actual fact. Bank deposits are only a shadow, so to speak, of wealth. Take a case. If I possess £1,000 of Great Western Railway five per cent. debentures (that is a part of the land, stations, engines, etc., of a railway company) any bank will lend me, say, £1,000 on them at, say, four per cent. If I choose to be so foolish, I can deposit that £1,000 in the same bank and the bank will pay me, say, two and a half per cent. on it.

We have then

(a) Certain tangible things, railway lines, and buildings and engines,
(b) Debenture stock representing them at five per cent.,
(c) A loan from the bank on them at four per cent.,
(d) A deposit at the bank of the loan at two and a half per cent.,

all three latter based on the railway, and consisting of nothing else than the railway. The action of the bank in lending £1,000 on the debentures is to make the railway, to the extent of £1,000, available for currency. For the time it is as much currency as gold or notes.

Now the point I want to make clear—and it is not very simple—is that deposits in banks are based on things like railways or bales of cotton, have no value apart from those things, have no power apart from those things of earning interest, and are not in themselves of any value, but merely represent claims of one set of people on wealth apparently held by another set.

It is all a system of double entry. Every item appears at least twice. So long as we have competing banks this system must be kept up, and a bank must make its claims on the general stock of wealth, that is, its deposits, balance its loans, that is the claims it gives to others, on the particular wealth pawned with itself.

But as soon as it becomes the universal pawnshop, the sole creator of bankers' currency, it cannot be called upon (as any one bank can at present) to pay against property lodged in another bank. Therefore the value of deposits ceases.

Effect on the Rate of Interest.

Another consideration arises. If the unified bank has not to pay interest on deposits,* what rate of interest would it charge on loans? On the whole I do not see why it should charge more than enough to earn the necessary working expenses and interest on its working capital, say one and a half per cent. It will really in practice be much less. But let us say one and a half per cent. for the present. Take a simple case. I buy ten acres of land for £5,000 in order to build houses for sale. I deposit that land—in the form of deeds—with the universal bank, which advances me £4,000. That £4,000

* Banks hold large deposits on current account for which they pay no interest. But this is really a concealed "cross entry." The customer pays the bank for keeping his account by letting it have a loan without interest.

is paid away in cheques to timber merchants and brick merchants, and artizans of all sorts, and all the cheques obviously are paid in again to the bank, so that the £4,000 stands in other names than mine. Presently I sell the houses for £10,000 which comes into my account out of some other account all in the one bank. Then I pay off the loan : get my land transferred to the purchasers, and the transaction is closed. I started with £5,000 and end up with £6,000. The bank is out of pocket by the cost of the clerical labor, the valuation of the land and other working expenses, and that is all. These I must pay. Beyond these working expenses, there is no necessary reason why anything should be charged at all.

Further, the effect of this on the rate of interest on borrowed money would be remarkable. If the State bank lent on good security at one and a half per cent. fixed, it would obviously pay me to buy £1,000,000 Consols returning about three per cent., and get the money from the bank at one and a half per cent. The security would be perfect, and the profit £15,000 a year. Everybody would do this. And at once the price of all gilt-edged securities would rise till they returned to an investor only a shade over one and a half per cent. Our two and a half per cent. Consols could be reduced at once to one and a half per cent. Our town and county councils could borrow in future at one and a half per cent. The toll taken by the idle possessors of capital would in future borrowings be only half what it has hitherto been, though existing obligations would continue for a time.

A Bank Monopoly in Sight.

We are already within an easily measurable distance of a banking monopoly. In the Stock Exchange Year Book for 1898 the number of banks recorded which did a home trade, in the United Kingdom and the Isle of Man, is one hundred and twenty. In the volume for 1908 the number is seventy-nine. In ten years forty-one banks have disappeared.

The latest list of joint stock banks,* omitting one or two quite insignificant in size, is sixty-eight, some of them quite small ones. At the present rate of decrease there will be only sixteen in 1924, and only one in 1929 ! It is not the small banks only which disappear. Only recently the London and County and the London and Westminster, both first rank concerns, joined their forces. It is, moreover, inevitable because large banks almost invariably pay a higher rate of interest on their capital than small ones.† It is an advantage to big banks to buy small ones, and to small ones to sell to big. In another ten years everybody will be discussing what the

* "Stock Exchange Year Book," 1912. I have not included the very large number of foreign and colonial banks, which no doubt conduct a little home trade, or the discount houses. The Co-operative Wholesale Bank is not in the list, but I doubt if there are any other omissions.

† The Bank of England is an exception ; it has a relatively low rate of dividend because it keeps so large a part of its capital in gold.

effects of a banking monopoly will be. This, then, is no speculation, such as the familiar puzzle, How will newspapers run under Socialism? This banking monopoly is coming so near that it is actually in sight, and its arrival can be calculated almost as accurately as the next total eclipse of the sun.

Moreover, this monopoly cannot be left in private hands. Finance is the life blood of commerce, of industry, and of politics. Any board of directors which possessed exclusive power to grant or withhold credit would be the virtual dictators of the Government and of the lives of the people. No community could endure such a monopoly for an hour in any other hands than its own representatives. And the control over industry which such a monopoly would give to the State must have far reaching consequences.*

International Banking.

But unfortunately this attractive forecast can scarcely be realized in one country alone. If the United Kingdom no longer gave interest on deposits and America maintained her antiquated system of tiny banks, currency would tend to float over where it would earn interest, and this would mean in the long run a demand by America for our gold. In fact competition between countries is on the same lines as competition between banks in one country.

But there is already in existence a piece of machinery expressly designed to maintain our stock of gold. The Bank rate is put up when there is too big a demand for our gold because a relatively high rate of interest attracts floating capital from other financial centres, Paris, or Berlin, or New York, and the influx of capital means either the influx of gold or the cessation of its efflux.

Under the unified banking system this machinery would necessarily be retained, in order to preserve the balance of gold actually required for our international and internal trade.

But this retention of the Bank rate means that interest would continue to be paid on floating capital, that is, amongst other things, bank deposits; and so it may be said the whole idea of cheap loans vanishes. I think this is not necessarily the case.

Bankers' deposits vary in their depth, so to speak, from day to day money, lent for twenty-four hours only, to loans, mostly taken by bankers trading abroad, for periods up to a year. Now day to day money cannot move far. A lender who may require repayment in a day or even a week will not send his money even as far as Paris. Probably by far the greater part of bankers' deposits is money

* The State already participates in the business of banking through the Post Office Savings Banks and the Postal Order and Money Order business. In Austria, Switzerland (1906), Japan (1906), and Germany (1909) Postal Cheque systems have been in operation for some years which in effect convert every post office into a branch bank for the purpose of the transfer of money. (Report by the Postal Clerks Association, 39 Gainsborough Street, Higher Broughton, Manchester. "The Post Office: the Case for Improvement, Development, and Extension," ? 1911, ? free.) Progress in England on these lines may be anticipated, and ultimately the State will doubtless work the Post Office Banking business and the Unified Bank in co-operation. But it is not possible here to deal with the problem of their amalgamation.

required at very short notice, which would in no case be sent abroad. It is true that the rate of interest paid on deposits varies with the Bank rate, but it always lags one and a half per cent. behind that rate, and that rate itself is quite often below the market rate. It is therefore clear that floating capital is attracted from abroad by the rate of discount on bills, and not by the rate of interest on deposits. When the Bank rate is four per cent. in London and three per cent. in Paris, the London holder of a bill who wishes cash for it discounts it in Paris at three per cent. rather than in London at four per cent. In other words he sells the bill in Paris and gets the money (floating capital) sent over to London for him. But the merchant with more money than he wants for the moment does not as a rule deposit elsewhere than with his own bank, and he takes the two per cent. or three per cent., whatever it is, according as fate determines.

It is difficult to foresee exactly what would happen under a unified banking system, that is, under conditions very different from our own. But so far as I can judge the continuance of the protection of our gold reserve by means of a varying Bank rate does not involve the maintenance of our present payment for money placed on deposit. It must be remembered that already the bankers hold enormous sums on current account on which they pay no interest at all. Further, at present Colonial and other banks accept deposits for terms of months at substantially higher rates than the London banks pay, and therefore deposits fixed for long periods tend to go abroad. This tendency of deposits would be promoted if our unified bank paid no interest at all, and perhaps payment of interest on deposits for substantial terms might be necessary, at any rate at first, in order to help to keep our gold at home and prevent our Bank rate from maintaining too high a level.

All this is only a special example of the general rule that industrially the world is rapidly becoming a unit. It is practically impossible for one country greatly to outstrip the others in even such rudimentary instalments of Socialism as factory legislation or such elementary approximations to common sense as reduction of armaments.

As I have said before, it is difficult to see precisely how near we can approach to an ideal banking system in England so long as other countries remain as they are. But of one thing we may be sure. Other countries will advance, as we are advancing ; and if the international difficulty is the only one this forecast has to face, it may be regarded with confident equanimity.

Socialist Theorists Justified.

One point in conclusion. The old Utopian Socialists invented labor notes because they dimly saw that currency should be founded on wealth aud not alone on gold. Commerce and finance have spontaneously carried out their idea in a practical form and created the cheque system, which is, in fact, an almost perfect currency, based on wealth, the product of labor.

So, too, these forerunners dimly dreamed that interest was an unnecessary charge on labor and was somehow created by our system of finance. That dream, too, will come true, in so far as the interest is now unnecessarily charged on the simple transaction of making the realized wealth of the country available for our currency.

NOTE.

IT may be worth while to answer in anticipation two criticisms of a general character on the argument advanced in the foregoing paper.

If the quantity of gold produced bears practically no relation to its present value as currency, how, it may be said, can the enormous prices (i.e., the low value of gold) on goldfields be accounted for, and what is the explanation of the changes in the levels of prices in Tudor and other periods?

The answer is that my paper deals with currency in England, now, under a system of universal banking. In Tudor times and indeed at any time up to about half a century ago, there was no such banking system, and prices, in Tudor times at any rate, *were* determined by the quantity of gold or silver available for currency. The currency system I analyze is very modern and very local, and of other times and places I say nothing.

Again, it may be asked why we should not use silver or copper for our currency if the quantity of gold produced bears no relation to its value in currency. Would the discovery of a method of transmuting lead into gold have no effect on the exchange value of the sovereign?

The answer is this. If any one person possessed the secret of turning lead into gold and used it only to supply gold for his own needs as currency, his great wealth, increasing *pro tanto* the demand for commodities, would infinitesimally raise the general level of prices. Gold, for him, would be more easily obtained than commodities, and he would spend it freely. If many or most people obtained gold with relative ease (as was recently the case at Klondyke, or at any other placer goldfield), the general level of prices *is* raised because gold dust is relatively easier to obtain than bottles of whisky: and gold is in fact used rather for primitive barter than as an adjunct to a modern banking system.

If (as might conceivably happen) a cheap method of extracting gold from sea-water were discovered, the company exploiting the secret would for a while earn enormous profits, and those profits would, by increasing the demand for products, raise, perhaps sensibly, the level of prices. But apart from this the currency value of gold in England would not be directly affected *so long as the whole output was freely absorbed*. (Elsewhere, in the absence of a complete banking system, prices might be greatly raised, and this would *indirectly* affect prices here.) But the time would ultimately come when nobody would want gold at the Mint price: the Bank of England would have enough, and all nations would have what they required for currency and for the arts at the fixed price. Then something would begin to happen. The sea-gold company of the hypothesis would get its gold turned into sovereigns at the Mint in accordance with the law, and these, put into circulation by the company, would be paid into banks and ultimately into the Bank of England. The Bank could not get rid of them because other countries, by hypothesis, already had all the gold they wanted. Our financial system would therefore be clogged with surplus gold which locked up the bank capital in a form yielding no interest. At this point, if not before, our system of free coinage of gold would no longer work, and the whole problem of currency would have to be reconsidered.

In other words, our present currency system (and incidentally the reasoning of the foregoing paper) is dependent on the fact that the demand for gold exceeds the supply. The output, however great, is absorbed somehow, and there is always room for more. The moment the demand is satisfied, a new factor, so it seems to me, will appear on the scene, the effects of which are not easily calculable.

Finally, I desire to emphasize that the distinction between capital (actual things which earn interest) and currency created out of this capital by banks (which can be used as capital for some purposes) is vital to my argument, and has been as yet insufficiently recognized by economists. It is the interest now charged on this form of currency which under an altered system could be largely and permanently reduced.

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