

CHAPTER IV

CAUSES AND CONDITIONS OF THE MONETARY BOOM

EXPANSIONS of money income, which are the dominant characteristic of monetary booms, can only, except in very peculiar circumstances, be started and developed if the controllers of industry — in war principally the Government, in peace business leaders — have a keen desire to use — not to hold — purchasing power. In times of peace, with which alone we are here concerned, that desire is generated and developed by expectations of good money returns, no matter whether these expectations are well or ill founded. Unless such expectations exist, or can be created, mere readiness on the part of banks to provide money, even to provide it at very cheap rates, cannot, as our experience in the early 'thirties has shown, bring a boom to birth. Nobody wants to borrow money for use unless he can see ways of using it to get a good return ; and, if money is forced upon him, say, by the purchase from him of securities, he will simply hold it as an idle savings deposit in his bank : or, if we prefer other language, an increase in the quantity of bank money will be offset by a corresponding decrease in its income velocity.

After a brief period of hesitancy and uncertainty following the Armistice the business world came rapidly to the conclusion that prospects were bright. It might perhaps have been expected that a brake would be imposed by the existence of substantial Government stocks of certain commodities : for example, motors, scientific apparatus, machine-tools and chemicals. Both the Government and the business world were, however, concerned

that the disposal of these stocks should be undertaken at an early date, the latter because their existence represented a significant element of uncertainty and hence a drag on the market. The Minister of National Service and Reconstruction assured the House of Commons that "the policy which the Government is following with regard to the disposal of the stocks of materials which it holds" was to "get down the price of raw material to a level not higher than the anticipated post-war prices of that material". Generally disposal was undertaken through ordinary trade channels, so as to compete as little as possible with existing merchants and manufacturers. Glycerine manufacturers, for example, sold Government stocks *pari passu* with their own production. Non-ferrous metals were marketed through recognised merchants and brokers on a commission basis; and mechanical transport was mostly sold through the ordinary dealers in the trade. In a few cases, indeed, a conflict of interest appeared between the Government and private producers; the former being interested in slower disposal at a higher price, the latter (provided they were producers and sellers and not buyers of it) in a temporary lowering of price and rapid disposal. For example, as late as eighteen months after the Armistice the world's stocks of lead about equalled Europe's pre-war annual import. The Government showed a desire to maintain the existing price in order to unload its stocks without loss; whereas Australian producers pressed for a lower price to stimulate consumption in the future, when they would have the market more nearly to themselves. In general, however, the Government's stocks were disposed of smoothly; their existence did not in any serious degree damp down the optimism of the business world.

The development of this optimism is illustrated by the fact that the prices of speculative securities were rising from the beginning of 1919. The eight securities in this

group listed by the London and Cambridge Economic Service rose by 12 per cent between January and April, and by 20 per cent between January and May. In the same period the yield on their four fixed-interest securities had already begun to fall slightly. The general attitude of the business world is well illustrated by the following extracts from the usually sober columns of the *Economist*. In the issue of 18th October we read: "With a comparatively small volume of American competition, which is bound to get smaller, with Germany, Belgium, Russia and other pre-war rivals practically out of the race, and with the world's hunger for steel to satisfy, the trading opportunities for British steel are golden".¹ On the same date we read again: "The prospects of spinners and manufacturers in Lancashire were never brighter than at the moment. Large profits continue to be made and big dividends declared. Although since the beginning of the year an extensive business had been done, there are no indications of markets abroad being over-supplied. . . . It is believed that all cloth made in Lancashire during the next two or three years will be needed."² A week later a Sheffield correspondent, in an article on the iron and steel trade in the same paper, wrote: "When it becomes possible to observe the economic effects of the recent war in true perspective it will probably be found that the most outstanding result is a new lease of life for British trade" — largely because of the damage to German competition.³ By way of entertainment I cannot resist comparing these paeans with the following extract from the same admirable paper's issue of 25th December 1920: "Seldom have the outstanding features of our economic position been more unfavourable at this season of goodwill and festivity than they are this year. With unemployment rife, short time

¹ 18th October 1919, p. 609.² *Economist*, p. 610.³ *Ibid.* 25th October 1919, p. 759.

general, demoralised stock markets, stocks of goods difficult to sell — or even unsaleable — when offered below cost of production, and a consequently uncomfortable feeling on the part of all who own them or have lent money against them, we have a most depressing setting for the festival, which in pagan times welcomed the turning of the sun towards longer days and a more genial warmth, and under the Christian era bids us think of peace and hope and friendliness.”¹ Even journalists are not omniscient!

For this optimistic outlook there was, as the above quotations themselves show, some solid ground. Throughout the world, and here not less than elsewhere, there was a great banked-up desire for all sorts of goods and services, the supply of which during the war had been cut off or, at all events, greatly curtailed. Much equipment too had been allowed to run down and was in urgent need of renovation or repair. There was thus plenty of work needing to be done, and, with proper organisation, the various civilian industries, all expanding, might have been expected to provide markets for one another's output, thus converting desire into demand. There was every reason to anticipate good employment and production all round, unless some violently restrictive action was taken by the monetary authorities. Nothing of that sort was done and, by the summer of 1919, employment all round *was* good. Moreover, the expectation of high returns, in many industries at all events, was in fact realised. This was notoriously so in the textile industries and in the ship-building industry. Thus conditions leading to prosperity were in fact present, though, as after-events were to show, business optimism outran the facts.

The emergence of this optimistic attitude into action would have been greatly hampered if the Government's restrictions upon new company issues imposed during the

¹ *Economist*, 25th December 1920, p. 1121.

war had been continued far into the peace. In their report published in November 1918 the Committee on Financial Facilities wrote : " Commercial issues of new capital having been largely in abeyance since the commencement of the war, it is reasonable to expect a very large number of appeals for new capital ". Moreover, " the increased Cost of Living and high taxation will induce many people to seek a high return on their capital with less consideration for safety, and will consequently encourage the issue of enterprises of a speculative, or unessential, character ". Hence, " whilst we are in favour of an early removal of all measures of state control of finance and industry alike, at the same time we are of opinion that it will be advisable to maintain after the war some control over new issues, at any rate until such time as state borrowing in connection with the war is completed ".¹ Thus the risk of a strong post-war boom with serious after-effects was clearly forecast. None the less, the Government in March 1919 freed from control all new issues whose proceeds were to be applied inside the United Kingdom ;² and in November the Treasury granted a general licence for new issues whose proceeds were to be used abroad, thus freeing all kinds of new issues.

Subsequent happenings are described in the *Economist* of 3rd January 1920 as follows : " After the removal of the ban on domestic issues, company prospectuses began to appear more frequently, but the June issue of the funding loan called a halt, and, when the new issue campaign was again beginning to gather force, the holiday season intervened. Then came the railway strike (27th September-5th October), but, with that trouble safely out of the way,

¹ Par. 37 : printed in Kirkaldy. *British Finance, 1914-21*, p. 434.

² *Economist*, 29th March 1919, p. 514. This was a long step in advance of the preliminary and cautious policy adopted three months earlier, when it was officially announced that the Local Government Board in conjunction with the Treasury were ready to consider applications from local authorities to raise loans for urgent schemes of public utility, but could only in very special circumstances make advances from the local loans fund (*Ibid.* 7th December 1918, p. 771).

the prospectus rush began in earnest and continued unabated until Christmas week. In the last quarter of 1919 about £105 millions were raised by borrowers, other than the British Government, as compared with about £106 millions in the whole preceding nine months."¹ Large new issues continued to be made during the first quarter of 1920. They then fell off with the summer and the Yorkshire coal strike of 16th July–14th August, but were still substantial at the end of 1920, when the Boom, in most of its manifestations, had dwindled away.² Statistics for new issues, "excluding Government loans, etc.", are reported by the Midland Bank and printed in the London and Cambridge Economic Service Bulletins. From these it appears that, while the monthly figures vary in a very erratic way, the quarterly figures show a steady rise from the first quarter of 1919 till the first quarter of 1920. In the former of these two quarters they were some £35 millions, in the latter £127 millions;³ in both quarters much the greater part of the money raised being for use in this country. It may well be that the action of the Government in removing restrictions in this field was premature and too sweeping, that it made feasible and encouraged a number of mistaken speculative ventures, thus opening a road for the spirit of optimism to emerge into action, and so being in part responsible, when the crash came, for the rapid retreat that followed.

It has been argued that, besides opening a road for it, the Government also played a direct part in stimulating, first, business optimism and, later, business pessimism, by its tax policy. Thus Mr. Henry Clay writes: "The optimistic finance of Mr. Bonar Law and Mr. Chamberlain, or perhaps it would be fairer to say of the Coalition Government, has a good deal to answer for. The country was

¹ *Economist*, 3rd January 1920, p. 10.

² *Ibid.* January 1921, p. 5.

³ Special Quarterly Issue, July 1923, p. 15.

under-taxed when it was prosperous ; the Government preferred to increase the floating debt and to remit taxation in 1919, although it was realising hundreds of millions by the sale of war stores. The result was, first, an undesirable inflation of credit and prices ; second, the necessity of raising the Excess Profits Duty a year later, at the moment when its effect in assisting depression would be greatest ; and third, the very heavy pressure of taxation during the depression. The Government's financial policy served first to exaggerate the Boom and then to intensify the depression."¹ The facts are as follows.

In the 1919 Budget the Excess Profits Duty was, indeed, reduced from 80 to 40 per cent ; but taxes were increased on beer and spirits and estate duties on estates of over £15,000 ; the net result of these changes being estimated at an increase of £41 millions of revenue in the current year, and £108·9 millions in a full year. In fact, during the fiscal year, 1st April 1919 to 31st March 1920, tax revenue amounted to £999 millions, as against £784 millions in 1918-19. In the Budget of 1920, introduced when industry was still very active, further additions to taxation were made, estimated to yield £76½ millions in the current year and £198 millions in a full year ; the Excess Profits Duty being raised again, this time to 60 per cent. The standard rate of income tax was still left intact, but the super-tax level was lowered from £2500 to £2000, while various adjustments were made which were estimated to reduce the net yield by £1 million in the current year and £16 millions in a full year. In fact, aggregate tax revenue in 1920-21 was £1031 millions. In the Budget introduced in April 1921, when depression was in full swing, the Excess Profits Duty was abolished and the duty on spirits and sparkling wines was reduced.

This record does not support Mr. Clay's thesis. In the

¹ *The Post-War Unemployment Problem*, p. 21.

first years of peace, to increase taxation, instead of, as many people might have expected, substantially reducing it, was not the act of a financial profligate feeding fuel to a boom. Of course, it may still be argued that in April 1921, when the depression had become deep, the Government ought deliberately to have budgeted for a large deficit to be financed by the creation of bank money in the hope of helping industry towards recovery.

The emergence of optimism into action was also probably stimulated in some degree by the rapid removal of war controls. Had the Government kept its powers, and had it possessed the will and courage to exercise them in defiance of what would certainly have been powerful pressure, it might, by restricting the uses to which important materials could be put, have checked activity, and so also business optimism, the motive force behind the monetary expansion of the Boom period. Moreover, a less evident eagerness to get rid of rationing and all kinds of price restrictions might have helped to hold in check the psychological rebound of the whole community from war-time restrictions, and so have contributed to the same end. As it was, we may fairly say that the driver, by throwing loose the reins on a horse already restive, made it more restive still.

Business optimism, however generated and whether warranted or unwarranted, led to a much more rapid turnover of balances than usual. This is shown by the fact that Metropolitan, Country and Provincial Clearings increased substantially, relatively alike to the deposits and to the current accounts of the London clearing banks. Messrs. Phelps-Brown and Shackle have made careful calculations of what they call the velocity of the total cheque-paid non-financial circulation — roughly non-financial clearings divided by current accounts — for every month from January 1919 to 1937. According to them this

velocity worked out at 10·63 in April 1919 (10·30 in March), at 13·60 in April 1920, and at 13·70 in June 1920 — its maximum level apart from a freak figure in March 1920. This represents an increase between the two Apriks of 28 per cent, implying that, had deposits or current accounts not increased at all, non-financial clearings would have increased by some such percentage, as against the 50 per cent by which they did in fact increase. As was explained in Chapter II, it is unlikely that in this period money income grew in as high a proportion as non-financial clearings; so we must not say that the public's more active use of their balances was responsible for an increase in money income as large as 28 per cent. Still, it was undoubtedly responsible for a substantial increase. Mr. Henry Clay, when he speaks of "the inflated bank credits, which sent prices soaring in the Boom of those years" (1919-20),¹ as though what the banks did was responsible for everything, is leaving out of account this very important fact.

But, in order to carry out their desire for expanded activity, business men, besides turning over their existing balances more rapidly, needed also more balances in the form of accommodation advances from the banks. Such accommodation advances were specially needed in industries which during the war had contracted in scale. Some firms indeed, having made good profits out of their war activities, were strongly placed and in a position to finance themselves. But many others would not have been able, without assistance, to rebuild their stocks and make good the wartime depreciation of their equipment. For these purposes it was in accordance with common practice that they should apply to the banks. Moreover, since all prices were much higher than before the war, they naturally needed finance on a scale considerably higher than they

¹ *The Post-War Unemployment Problem*, p. 61.

did then. "Manufacturers and traders informed the banks, in particular after the Armistice, that, on account of the great rise in prices, they required considerably more credit to run their businesses. This was true."¹

. In normal circumstances, if one set of industrialists seeks to expand, while another set is contracting, the additional finance required by the first is offset by reduced requirements on the part of the other. The transfer of activity that took place after the war was, however, of a very peculiar character. It was not a question of advances so far made to firms that were contracting being repaid and handed over instead to others that were expanding. The contracting firms were represented by the war industries. Their working capital was not reduced by sales, the proceeds of which could be handed over in repayment of bank loans. Rather, in large part the value of their working and fixed capital alike was destroyed by the advent of peace. Moreover, the debtor was the Government, a Government whose Budget was not balanced, but which had, in part, still to finance its expenditure out of loans. This did not, of course, make it impossible for it to repay the banks, for it could do this out of loans raised from the public. None the less, the extent to which banks could get back credit from the Government to transfer to individuals was limited by factors outside their control. How much did they in fact get back ?

The Government's borrowing from the commercial banks was, in part, by way of Treasury bills, and, in part, by way of balances borrowed from the banks by the Bank of England at interest — a system started in 1917 and abandoned in July 1919 — and credited to the Government by the Bank of England in the form of Ways and Means Advances. Between our two Aprils the London clearing bankers' holdings of Treasury bills fell from £197 millions

¹ Memorandum by Mr. Gibson in Kirkaldy's *British Finance, 1914-21*, p. 399.

to £69 millions, *i.e.* by £128 millions. Money at call and short notice lent to the money market by the clearing banks, of which a part may have been indirectly lent to the Government, fell by £63 millions, while bankers' balances at the Bank of England were substantially unchanged. It would thus seem that the loans to the Government for which the clearing banks were directly, or indirectly, responsible fell by not less than £130 and not more than £190 millions. To this extent the clearing banks' loans to industry were in effect credit transferred to industry from the Government. These banks, as already noted, appear to have deposits equal to about three-quarters of those of all the commercial banks of the United Kingdom.¹ Multiplying, therefore, by four-thirds we get, for all the commercial banks together, a transfer of between £170 and £250 millions.

The total credits asked for by industry and provided by the banks amounted, however, to much more than this. Thus, for the London clearing banks, between April 1919 and April 1920, advances, *i.e.* loans and overdrafts, increased from £508 to £862 millions, *i.e.* by £354 millions, a large part of which presumably went directly or indirectly into industry, and commercial bills discounted from £91 to £148 millions, *i.e.* by £57 millions.² Again using our four-thirds multiplier, we may, therefore, guess that from £500 to £550 millions of bank credit altogether was provided for industry between our two Aprils.³ Hence some £300 to £350 millions of credit was newly created by the banks for industry, over and above the transferred credit. This roughly corresponds with a £400 millions increase in the total deposits of the commercial banks — inferred from a recorded increase of £300 millions for the London clearing

¹ Cf. Kirkaldy, *British Finance, 1914-21*, p. 74.

² Macmillan Committee on Finance and Industry, Appendix I, p. 284.

³ The corresponding figure from January 1919 to April 1920 works out at a little less than £600 millions.

banks. The extra deposits represented an increase between our two Aprils of about 19 per cent.¹

It has sometimes been argued that the expansion of Bank deposits during the post-war Boom was made larger than it would otherwise have been by an after-working of the methods of finance adopted by the State during the war. These methods, it is claimed, since they left behind a great mass of floating debt in the form of short-dated Treasury bills — over £1000 millions in January 1919 — opened a road for post-war credit expansion which, had the war been financed without resort to these bills, would have been closed. Now, that large outstanding issues of Treasury bills *might have* served as a basis for the creation of large new bank credits is unquestioned. Banks holding these bills — and the same thing is true of private holders — could, by refusing to renew them, have forced the Government to apply to the Bank of England for Ways

¹ This increase, it will be noticed, was not based on a corresponding proportionate increase in "cash and balances at the Bank of England". That item, on the contrary, decreased from £198 to £181 millions; and the proportion fell from 13.9 to 10.6 per cent. In this context, Keynes' observation (*A Treatise on Money*, vol. ii, p. 68) may be cited: "The relatively low figures (for the proportion) for the first quarter of 1921 are probably to be explained by the fact that this was the beginning of the post-war publication of monthly figures, so that the conventional ratios of the different banks had not yet had time to settle down". During the war itself, figures for the proportion obtained for all the joint-stock banks of the United Kingdom, for successive Decembers — December was, of course, the chief window-dressing month — are:

1913	16.7
1914	19.5
1915	18.0
1916	22.1
1917	18.7
1918	18.2
1919	17.9

In these figures, however, the base is not "cash and balances at the Bank of England", but "cash and balances at the Bank of England, etc." The "etc." represents "balances with and cheques in the course of collection on other banks in the United Kingdom and cheques, drafts, etc. in transit"; items that might be looked on as cash in the course of a few days (Kirkaldy, *British Finance, 1914-21*, p. 85). This accounts for the large proportions in the above table.

and Means Advances. The proceeds of these Advances, when expended, would normally appear in the balances of the commercial banks at the Bank of England. The banks would then be able greatly to expand their loans to the public, without reducing below its normal level their proportion of "cash and balances at the Bank of England" held against their deposit liabilities. It is not, however, a question here of what might have happened, but of what did happen. There is no evidence that refusals to renew Treasury bills did in fact force the Government on to the Bank of England.¹ On the contrary, the average monthly amount of Ways and Means Advances, which had been high during the latter part of the war and by July 1919 had risen to £514 millions, thereafter fell very rapidly to £32 millions in November, and never again rose above £63.1 millions (in December 1920).² Nor is there any apparent connection between the volume of Treasury bills, or of Treasury bills plus Ways and Means Advances, and the state of bank credit during the post-war monetary Boom. Between April 1919 and April 1920 Treasury bills did, indeed, rise from £983 to £1060 millions, but, meanwhile Ways and Means Advances fell from £232 to £45 millions; while in April 1921, when depression was deep, Treasury bills and Ways and Means Advances together were slightly higher than they had been at the peak of the Boom. The Treasury bill position, and equally the state of the floating debt as a whole, cannot, therefore, claim any part in actually facilitating, though, no doubt, there was in it a power to facilitate, the credit expansion of the post-war period.³

¹ In June-July 1919, Ways and Means Advances were, indeed, abnormally high and Treasury bills abnormally low (71st Statistical Abstract, p. 184), in connection with the issue of the Victory loan, but in the following month this abnormality had disappeared.

² Cf. Kirkaldy, *British Finance, 1914-21*, p. 161.

³ Statistical Abstract of the United Kingdom, 71st issue, p. 184. After the end of 1921 Ways and Means Advances were not, in general, resorted to by the

This, however, is a side issue. The fundamental fact is that business optimism about the prospects of industry stimulated an expansion in money income by leading to an increase in the stock of bank money in existence as well as by heightening the frequency of its turnover into income. But this does not exhaust our subject: there remains a further important factor affecting the scale of the Boom and the state of money income. This is monetary policy. Had the Bank of England decreed a very high Bank rate and, by open-market operations, made that rate effective, it could have restricted the amplitude of the Boom — the swing-up of money income — in two ways. First, even if this policy had left business men's expectations of returns from the use of money in industry unaltered — so to speak, left the demand schedule intact — nevertheless, by putting up the price for borrowing money, it would have lessened the amount of money that they chose to borrow and use. But secondly, and more important, the enforcement of a high rate, particularly if it were maintained for some time, would have created an opinion that prices must soon stop rising, or even fall, and so have worsened the prospect of returns from money used in industry and lessened the amount that business men wanted to have at the old price. At the same time it would have lessened their keenness to turn over rapidly such balances as they had; in other language, would have made it less attractive for them to keep resources in the form of goods rather than of money; in yet other language, would have heightened their desire for liquidity. Thus a policy of high Bank rate made effective in the market would have fought against and to some extent restrained the development of the Boom. Now, had the Gold Standard not been abandoned when the New York exchange was unpegged in March 1919, it

would have been very difficult for the Bank of England to keep the discount rate during the summer of 1919 down to the 5 per cent level at which it had stood since 15th April 1917. For British prices were rising a good deal more steeply than American prices, and the New York exchange was falling. Thus the Federal Reserve Board's comparative international price indices showed, between April and September, a rise of 17 per cent for England against 8 per cent for the United States, and the New York exchange fell from 4.65 to 4.18. As things were, however, the Bank rate was not raised till November and then only to 6 per cent, in spite of a continued relative rise in English prices and a continued fall in the exchange. It was the abandonment of the Gold Standard that, as was explained in Chapter I, gave the Treasury and the Bank of England freedom in this matter. That act of policy, coupled with the way in which the freedom conferred by it was used, was thus a very important, if an indirect, factor in promoting and accentuating the scale of the Boom.