CHAPTER II

CENTRAL BANKING

BEFORE we can discuss the functions of a Bank of Issue, and more particularly of a Central Bank, it is necessary to look briefly at the nature of the currency of a country; for it is with the creation and regulation of this that Banks of Issue and Central Banks are in the first place concerned.

In the general economic system which has grown up in modern Europe and America one of the most important factors is the use of currency as a machinery for the exchange of goods and services, in place of the primitive system of barter. For this purpose it is usual to employ the precious metals; within the last century gold has taken an almost exclusive place, silver, which at one time was a serious competitor, being now relegated, where it is used at all, to the inferior position of a material for token coins.

But gold, though it has many advantages,

has drawbacks as currency. It is expensive, and as a great deal has to be kept in hand as a reserve beyond what is actually working at any time in effecting sales and purchases, it involves loss of interest as well as cost of storage. It is, moreover, limited in amount, and is not easily transferred from place to place.

Now the need for currency in actual use varies from time to time; more is needed when transactions are frequent and when prices are high. Both prices and activity of transactions vary largely from time to time; there is notably a large seasonal variation. The time of harvest is a period when much currency is required. The staple food for a whole year has to be gathered and marketed in the space of a few months of autumn and early winter. Hence the autumn has always been, by the laws of nature, a time when more currency is needed to finance sales and purchases than at other times of the year.

It was found out long ago that this period of stringency could be easily passed through, if people in general were prepared to take, in place of coin, promises to pay coin made by men reputed to be wealthy and honourable, and who might therefore be relied upon to

fulfil their promises to pay when called upon to do so. In other words, credit could be created and used to supply the place of currency. The farmer who had to pay his workmen for their labour and keep during the harvest would go to the man of means in his neighbourhood—we may at once call him the banker—and borrow from him promises to pay coin on demand, which would be accepted by his men because they could use them with the shopkeepers. They in their turn would pass them on in exchange for goods, and so they would go from hand to hand. In course of time the farmer would have sent his wheat to market, where it would be sold and perhaps after some months he would receive payment for it in "notes" of the banker from whom he had borrowed or some other banker. These he would pay back to his lending banker; the credit given him would be duly cancelled, and the notes, if issued by the lender himself, retired, or, if issued by another banker passed on to be cancelled by him in exchange for cash.

But this system of a credit currency, though admirably simple and economical in its working in normal times, had a great drawback. In all progressive and commercially enterprising communities there come from time to

time periods of speculation, when everyone is convinced that he can easily make a fortune in a little time, if he can only get command of a little capital to start with. At such times it is fatally easy, and most tempting, for the banker to supply the capital by the creation of more credit; for no one troubles much about the interest he has to pay when sudden wealth is in view. Thus bank notes are multiplied beyond all the bounds of legitimate trade. Everyone seems well off, prices rise, and goods are imported on the inflated credit. But creditors abroad will not accept in payment the promises of local bankers here; they want coin, and the foreign exchanges go against us; there is a heavy draft on the nation's stock of gold. Then comes the reaction; some shock to credit, some failure in the schemes of over-sanguine and often fraudulent speculators, breaks down the general spirit of confidence. The reaction reaches a point where people begin to wonder whether the bankers are in a position to meet their promises to pay their notes in gold. After all, in the long run, everyone wants the real coin, not the piece of paper; and if the amount of gold in the country is diminishing, one begins to wonder if one will get one's

share unless one makes haste. There begins a "run" on the banks. The banker has reckoned, from his experience of normal years, that a certain large percentage of his notes will always be outstanding, and keeps coin in hand only sufficient to cover a "reasonable" proportion of his liabilities. But he suddenly finds that no one is "reasonable"; panic is universal, and his reserves are being rapidly exhausted. He sends off post-haste to his correspondent in the capital, and requests an immediate loan in coin, for which he can deposit undoubted security. The correspondent replies that he does not doubt the security, but that he can with difficulty get enough coin to supply his own needs, and can certainly not find any for the country, as the stock of gold in the Bank is getting dangerously low. The result is that the country banker, though he may be in the long run perfectly solvent, has to announce that he is unable to meet his notes in coin—he "suspends payment." The further result is that his customers who hold his notes are reduced to desperation, and immediate, and perhaps final, poverty. This is the tragedy which has been played over and over again, not only in England, but in every country which has

reached a certain point of economic development. The circle of events seems so certain, and its culmination so disastrous, that every country has been forced to take steps to control it. The problem everywhere has been the same—to obtain the benefits of a "fiduciary" currency, that is, a currency based upon the credit of the issuer, while avoiding its great danger. The benefits of a paper currency are first a great economy, namely, the use of a very cheap machine of paper in place of a very expensive one of gold; and secondly, an immense elasticity; a fiduciary currency can be expanded at will to meet the needs of commerce and industry. The great danger of it is the ease with which it can be used for artificial inflation, that is, an increase of credit beyond what is needed for the normal conduct of business. The increase shows itself in a general rise of prices, for more money is used to effect the same amount of sales. But as gold is still the nominal measure of prices, this means that gold has fallen in value compared to other commodities; and therefore foreign countries prefer to take gold, the price of which has not risen, rather than other goods in payment of debts due to them. Thus the over-cheapness, or depreciation of paper

currency, shows itself in the form of a drain of gold to foreign countries. So long as gold is freely purchasable by currency, and its export is freely permitted, a cheapness of gold as expressed in the price quoted for it by other countries, *i.e.* in the course of the foreign exchanges, is an infallible index of inflation.

When Governments, therefore, set themselves seriously to retain the advantages of a paper currency while controlling the evils of undue inflation arising from an excessive issue of paper money, or undue extension of credit in other directions, they have turned to the institution of some central body which could be entrusted with the task of watching the general stock of gold, and empowered to take steps to repress any undue expansion of credit, while holding power to increase the supply of currency when the legitimate demands of trade require it. As a corollary to the establishment of such an institution, the issue of currency by other bodies has been either wholly abolished or severely restricted. Such are the main functions of a "Central Bank" as now conceived. A Central Bank may also exercise other functions, such as keeping the Government accounts, issuing public loans, and the like; but these are not

essential to its character as a Central Bank, and are shared with it to some extent by other banks.

With these considerations in view we will now proceed to examine some of the most important Central Banking systems; and we will begin with the oldest and largest of all, the Bank of England.

The Bank of England is indeed the pivot of the English banking system. But there are contained in it two banks. By Sir Robert Peel's Bank Act of 1844, which still regulates the constitution of the Bank of England, there are created two Departments of the Bank, the Issue Department and the Banking Department. These are kept rigidly distinct, and make separate returns of their position every week.

Up till 1844 the Bank of England, as we have seen, had by practice, though not by law, a monopoly of the issue of notes in London and its neighbourhood. These notes were not, however, legal tender till 1833; though up to that time they enjoyed the privilege of being accepted in payment of taxes and other Government dues, and thus had a prestige which greatly favoured their circulation. When in 1833 they were made

legal tender, their convertibility was to all intents and purposes guaranteed by the nation, and it was logically only a question of time when the issue of them was formally controlled by law. By the Bank Charter Act of 1844 the whole question of the issue of bank notes was so settled as to bring it gradually under complete legal control. Till then, as we have seen, any private bank with not more than six partners could issue, in England, an unlimited amount of its own notes. In periods of " boom," of rising prices and speculation, the temptation of easy profits thus offered was irresistible; and the over-issue of notes by unregulated inflation was followed as a matter of course by times of panic when the issuing banks had their notes returned to them for redemption in cash in masses with which they could not deal, and wholesale suspensions followed. In the political difficulties of 1797, when national inflation began owing to the war then being waged with France, there was a run on the Bank of England, and specie payments had to be suspended by Parliament, not to be resumed till 1821, six years after the ending of the war—about as long, it may be noticed, as the interval between the end of the Great

War and the return to the gold standard in 1925. But before the resumption of cash payments there had been successive crises in country banking in 1814 to 1816; during those three years 240 country banks stopped payment, and 89 went into bankruptcy. There was another outburst of speculation in 1824–5, followed by the inevitable collapse; in six weeks in 1825 above seventy banks went down. This crisis was the cause of the first legislation directed to control the currency. The Act of 1826 in the first place removed the restriction on the number of partners in banks, and permitted the establishment of joint-stock banks outside London; and in the second, forbade the issue of bank notes of a less denomination than £5. This, of course, was done in the hope that the risks of the poorer members of the community might be minimised. But the restriction was futile. The new joint-stock banks which were established in the country under the Act took advantage of the power given them to issue £5 notes, and hastened to bring them into circulation; a new period of inflation was thus brought about, followed by a collapse in 1836 and 1837, when a panic was barely averted. The Bank of England failed to protect its reserves, and in September 1839

had to seek help from the Bank of France. It became evident that the whole banking system of the country had broken down, and a radical reform was needed.

The plan adopted was as follows. In the first place, the control of the issue of bank notes was taken out of the direction of the Bank of England, and rendered automatic. The fiduciary issue, that made on the credit of the Bank, and supported by the standing debt of the Government to the Bank, was fixed at £14,000,000. Any issue of notes in excess of this amount could only be made against a deposit of an equal amount of gold. At the same time the issue of notes by country banks was restricted to those banks who already had the right of issue; and the amount issued was in no case to exceed the average amount of notes in circulation during twelve weeks preceding 27th April, 1844. Moreover, not only could no bank not previously possessing the right issue notes in future, but if any issuing bank joined a joint-stock bank, or by amalgamation increased the number of its partners beyond six, the issue was lost altogether. But, on the other hand, in such a case the Bank of England was allowed to increase its fiduciary issue by two-thirds of

the amount of the cancelled country issue. Thus in the course of time the total amount of the fiduciary issues of the country was to be actually diminished by one-third of the amount of the country issues, and the whole was to be concentrated into the hands of the Bank of England. It may be mentioned here that this process has in practice been very slow, much slower than the supporters of the measure expected; and it was only in 1920 that the last country note issue was cancelled. The fiduciary issue of the Bank of England has now been raised by about two-thirds of the issues cancelled to its present figure of £19,750,000.

The Bank was thus made responsible for the management of the currency of the country indirectly. It could not increase its circulation except by increasing its stock of gold. And it could influence its stock of gold only through its Banking Department. By raising its rate of discount it could attract gold from abroad by the prospect of investment at a better rate of interest; and at the same time it could discourage speculation based on an expected rise in prices by making it less worth while to borrow for such speculation, and by encouraging holders of speculative stocks of

all sorts to sell rather than hold for the rise. On the other hand, when prices were falling and business was dull, it could make it easier for producers to borrow money by reducing the rate at which it was prepared to lend. The main sign for its action was the state of the foreign exchanges. If the stock of gold here was unduly large, the rates of exchange were in favour of England; and as soon as they reached the point at which it would pay to import more gold, the bank rate would be lowered, and the import of gold discouraged. On the other hand, when gold reserves were low, the exchange would be against this country and the signal was given for a rise in the bank rate.

On the whole the new system may be said to have worked fairly well till the outbreak of the Great War. But it had one great fault: it was too inelastic to meet extreme cases of panic. It was, in fact, too slow in action. It used to be an old saying in the City that "7 per cent. will bring gold from the moon"; but it takes time to bring it even from Paris. There have been moments when sudden runs upon the stock of gold have taken place to an extent which have exceeded the Bank's power of maintaining it. At such times the Bank

has had to issue notes beyond the legal amount. This has been done on the written authority of the Prime Minister and the Chancellor of the Exchequer, who undertake to apply to Parliament for legal sanction if necessary. It is a fundamental axiom that in times of panic the one remedy is to lend freely, and to let it be known that loans on approved security will be granted with exceptional liberality. The action of the Government in "suspending the Bank Act" has always produced a speedy restoration of confidence; the mere announcement that cash is available has always stopped a run.

During the last century the power to exceed the legal limit of the fiduciary issue was given on three occasions, 1847, 1857 and 1866. The last occasion when the power was sought was on the outbreak of war in August 1914. It will be instructive if we turn to this and trace the public record of the events of that eventful time. For this purpose it will be well to set out the weekly return which, under the Act of 1844, the Bank has to make, and to trace the significance of the various items there set out. The weekly return is still a most valuable guide to the money market; before the war it was yet more valuable. The

figures which follow are the last of the old régime; though they are still published weekly in the same form they now give a less complete picture of the financial position. We begin then with the weekly return which immediately preceded the crisis.

BANK OF ENGLAND

Accounts pursuant to the Act 7 and 8 Victoria, Cap. 32, for the week ended on Wednesday the 29th day of July, 1914.

Issue Department.

Notes issued	£55,127,405	Government Debt . .	£11,015,100
		Other Securities . .	7,434,900
		Gold Coin and Bullion .	36,671,405
		Silver Bullion . . .	—
	£55,121,405		£55,121,405

Banking Department.

Proprietors' Capital . .	£14,553,000	Government Securities .	£11,005,126
Rest	3,491,756	Other Securities . .	47,307,530
Public Deposits (including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	12,713,217	Notes.	25,415,055
Other Deposits . . .	54,418,908	Gold and Silver Coin .	1,460,139
Seven-day and other Bills	10,969		
	£85,187,850		£85,187,850

The meaning of the return of the Issue Department is evident. The total amount of bank notes issued at that date was £55,121,405, against which was held in gold £36,671,405. Though it is legal for the Bank to hold a certain small proportion in silver, in practice this

is never done, and the line for silver bullion is always blank. The other two lines, "Government Debt" £11,015,100, and "Other Securities" £7,434,900, together make the "fiduciary issue," which the Bank can legally put out against advances made to the Government, and against securities transferred from the Banking Department. The amount of the fiduciary issue was thus at the date of the above return £18,450,000. It was raised on the 13th February, 1923, by £1,300,000 to the sum of £19,750,000, at which it now stands. In 1844 the fiduciary issue was fixed at £14,000,000, and the provincial issues were £8,631,647. These having gradually lapsed, the Bank has exercised its claim to add two-thirds of the amount to its fiduciary issue, and the final limit under the present Charter has been reached.

The items in the Banking return need more explanation. The Proprietors' Capital has been fixed from time to time at renewals of the Charter, and now stands at £14,553,000. The "Rest" is undivided profit. This is never allowed to fall below £3,000,000, and in each half-year the surplus beyond that amount furnishes sufficient for the half-year's dividend. Naturally the profits added to the Rest are

those which the Bank sees fit to declare, after making provision for inner reserves.

"Public Deposits" represent, as set out, the balances standing to the credit of various Government departments. So far as the City is concerned, they are an element of mystery; why they increase or diminish from time to time and how far they may be set off by the Government Securities on the other side of the account is a matter of guess-work. It is, however, possible to note the increase in the balances in February and March, when the great ingathering of taxation takes place, and the temporary drops when heavy interest payments on Government stocks are made. The item in the Government accounts which most affects the money market, namely, the Government overdraft known as "Ways and Means Advances," is the subject of a special statement.

The most important item on this side of the account is that of "Other Deposits," which includes the deposits on current account of (*a*) the customers of the Bank in its ordinary banking business, and (*b*) the balances kept by other banks. What the proportion of these two may be is not known; before the war it was, according to the usual guess, about half

and half. But it is certain, from the experience of other banks, that the ordinary customers' deposits vary only slowly, and any marked variation in this item from week to week must be due to changes in the bankers' balances. In the return before us there had been a great and sudden increase from £42,185,297, the week before, on July 22, to over £54,000,000 on July 29. This means that in the anticipation of imminent trouble the banks were strengthening their balances at the Bank of England in preparation for the calls which were certain to come should war break out.

The last item, " Seven-day and other Bills," refers to the " Bank post Bills," which are issued by the Bank of England itself for seven days' usance only, the practice of issuing sixty days' bills having been discontinued twenty years ago. The Bank issues them to its own customers free of stamp duty and commission. They appear to be used principally for convenience when travelling abroad, as they can be readily cashed. The amount varies, but the total is always negligible.

Passing to the other side of the account, the first item, "Government Securities," is, like " Public Deposits," too much involved in the

mysteries of inter-departmental book-keeping to give much information to the outside world. The second line, however, is of great interest to the market. The "Other Securities" represent the amount of borrowing from the Bank both by its regular customers and by the money market. It includes both loans against securities and bills discounted. We have seen how in this particular week the banks had increased their balances with the Bank of England by some £12,000,000. This line shows how it was done. The banks had not indeed borrowed direct from the Bank of England, nor discounted bills with the Bank; they make it a rule not to do that. But they had been calling in their short loans from the money market. As we shall see when we come to deal with the money market, this "put the market in the Bank"; the discount houses and others with whom the short loans are placed could only repay the banks by borrowing at the Bank of England, which they had done either by discounting bills or borrowing upon bills and gilt-edged securities. Thus the total of "Other Securities" rose from £33,632,762, on July 22, to £47,307,530 on the 29th. This increase of nearly £14,000,000 roughly corresponds to the increase in "Other

Deposits," showing where the money had gone.

The two next lines "Notes" and "Gold and Silver Coin" constitute what is called the "Reserve," the amount of cash which the Bank keeps in hand for the purpose of the till, that is, in order to meet the calls which may be made upon it for payments, whether by way of loan or for withdrawals. The percentage which the Reserve bears to the liabilities to the public (*i.e.* other than to its shareholders for Capital and Rest) is known as the "proportion," and is an index to the strength of the Bank's position. In this case the two lines together amount to £26,875,194, and the "proportion" to the "Public" and "Other" deposits, £67,132,125, is almost exactly 40%. This was not, in the days before the war, a particularly low figure for the "proportion"; it was generally held that the minimum which was safe was 30%, and when that was approached a rise in the bank rate was confidently looked for. But the proportion of 40% on July 29 was a marked falling-off from the preceding week, when it had been over 52%, and the drop was significant. Since the war, indeed, it has been the custom to work with a much smaller proportion,

and the ratio may fall to 15% without exciting any alarm. It is generally round about 20%. In 1914, however, things were different, and the position as shown by the next return, which we will now consider, plainly shows the severity of the crisis which the country had been through. It will be remembered that in August 1914 the regular Bank Holiday fell on Monday the 3rd. But by Saturday the 1st it was clear that war was coming. The first week in August is always a time for large withdrawals of cash for holiday purposes. But this year there was something of a panic, and on the Friday and Saturday the banks were besieged by customers calling for gold. The pressure grew so great that on the Saturday the bank rate was raised to 10%, the Governor of the Bank obtained from the Prime Minister and the Chancellor of the Exchequer the letter authorising a suspension of the Bank Charter Act, and an order was issued extending the Monday Bank Holiday to Tuesday, Wednesday and Thursday. So it was that the next Bank return was made for the evening not of Wednesday the 5th, but of Friday the 7th. A return on Wednesday would have been equivalent to Saturday the 1st, the last banking day, and would have

shown if the Bank Act had actually been violated—that is, whether in the return of the Issue Department, while the "Government Debt" remained unchanged, the "Other Securities" had exceeded the legal limit of £7,434,900. But if that did happen it had been put right by the Friday. Even so the Friday's return is eloquent enough.

BANK OF ENGLAND

An account . . . for the week ended on Friday the 7th day of August, 1914.

Issue Department.

Notes Issued . . .	£44,491,070	Government Debt . .	£11,015,100
		Other Securities . .	7,434,900
		Gold Coin and Bullion .	26,041,070
		Silver Bullion .	—
	£44,491,070		£44,491,070

Banking Department.

Proprietors' Capital . .	£14,553,000	Government Securities .	£11,041,152
Rest	3,647,083	Other Securities . .	65,351,658
Public Deposits . . .	11,499,452	Notes.	8,385,650
Other Deposits . . .	56,749,610	Gold and Silver Coin .	1,580,999
Seven-day and other Bills	10,312		
	£86,359,457		£86,359,457

In this return we notice at once the great change in the Issue Department; Notes Issued have fallen by over ten and a half millions. The amount of the fiduciary issue is not exceeded, so there has been just the same drop in the item of Gold Coin and Bullion. On

Friday and Saturday the banks had been busy in supplying their customers' demands for gold, often handing them bank notes, which were taken to the Issue Department to be changed for gold. Thus £10,630,335 had been presented in notes and withdrawn in gold, the notes being thereby cancelled. And the return of the Banking Department shows where the notes had come from. The Gold and Silver Coin in the Reserve has hardly been touched; but the Notes have shrunk by no less than seventeen millions, to £8,385,650. The Bank has been busy in paying them out by way of loans and discounts, and the Other Securities have been swollen by eighteen millions, from £47,307,530 to £65,351,656. And the "proportion" has fallen from 40% to 14·6%. The ten millions in reserve would have been exhausted by two more such days as the Friday and Saturday, and the Bank could not have met the calls upon it.

But in the same week a change had been made which deprived the Bank Return of its significance. The Currency and Bank Notes Act had been passed on August 6th, and the provision of cash had been taken over by the Treasury, acting through the Bank, and there was no further need to be anxious about

obtaining currency. In fact from this time, owing to the method of accountancy adopted by the Bank and the Government, the Bank Return became more and more unintelligible, and bankers ceased to pay any attention to it during the war. I may perhaps be allowed a personal anecdote: I was discussing the Bank Return with the Governor of the Bank during the war, and mentioned that there was only one line of it which I thought I understood; and that was the line "Gold Coin and Bullion." The Governor, with a twinkle in his eye, replied, "Mr. Leaf, I do not think you understand even that."

The control of the currency has gone through three complete revolutions since the outbreak of the war, and another is impending. It will be well at this point to recapitulate the different systems.

(1) From 1844 to 1914 the Bank Charter Act, moderated by three "suspensions," was the controlling authority. Under this Act the issue of notes for currency purposes was strictly limited to the fiduciary powers of the Bank of England, the gradually diminishing fiduciary powers of the country banks, and to the gold which had to be deposited, earmarked £ for £ against any further issue. During the period

1894–1913 the Bank held gold varying normally from about £33,000,000 to £38,000,000. The amount held was returned week by week, and carefully watched in the market. It was generally understood that in normal times if the former figure was approached the bank rate was likely to be raised; if the latter, a reduction might be expected. In addition to the Bank of England's stock of gold, large amounts were held in reserve also by the banks, and a still larger amount was in circulation in the country. What these sums came to, either separately or in the aggregate, was not known; though various estimates were made from time to time, no authoritative confirmation was possible.

(2) On the outbreak of the war a new fiduciary currency was established by the issue of notes through a department of the Treasury. The amount and manner of the issue was left to the absolute discretion of the Treasury. This was essentially a War Loan free of interest, for an unlimited period, and as such was a highly profitable expedient from the point of view of the Government. The effects of it were, however, modified by the fact that practically the whole of the gold in circulation was called in, not by any legal enactment,

but by moral suasion, and most of it was passed on to the Bank of England. In so far as the issue of Treasury notes was merely a substitution of £1 and 10*s.* notes for sovereigns and half-sovereigns it was not a measure of inflation at all, but merely a change in the form of the currency such as obtains in many countries as the normal form of currency—in the United States, for instance, no coin larger than a dollar circulates in a metallic form, and even the metallic dollar is rarely seen except in the West. Throughout the war both bank notes and Treasury notes were theoretically convertible into gold. But the export of gold was, though not forbidden, closely controlled under the Defence of the Realm Act, and not permitted to any private person. A certain amount of gold was allowed to manufacturers—dentists needed it, for instance, and there was a large demand for wedding rings. The only other purpose for which it could be worth the while of anyone to change notes into gold was for the illegal object of melting down the coin of the realm; and on this ground the demanding of gold in exchange for notes was a highly suspicious operation and subjected anyone who attempted it to a surveillance which amounted in practice to a

prohibition. The banks continued to hold reserves of gold of their own, but the greater part of what they received from the public was paid in from time to time to the Bank of England. Although an export of gold continued under Government supervision, no returns were made public, and it was supposed, though never publicly stated, that a very considerable part of the stock of gold which appeared in the Bank returns was in fact not in the vaults of the Bank at all, but was held for them in Ottawa, Cape Town, Melbourne, and even in New York.

Through the whole of this period (1st January, 1916–21st March, 1919) the American exchange was "pegged," that is, it was kept steady at \$4·76½ to the £, rather below the parity of exchange, but sufficiently high to prevent any profit on the export of gold, a process which during war-time was abnormally costly. This pegging was made possible only by large loans in the United States and very large sales of American securities held by British nationals (some £950 millions), which for the time took the place of exports of gold. But this resource had its limits; it was impossible to continue borrowing indefinitely, and the load of debt was already heavy

enough. It was accordingly decided, in 1919, that the American exchange must be left to find its own level, and that the fact of a serious depreciation in sterling must be faced.

(3) Thus came about another change in fiscal policy. Hitherto the gold standard had been maintained in theory, but had already gone by the board as an effective policy. It was certain that, as soon as the American exchange was unpegged, there would be a serious fall, which would bring about at once disastrous exports of gold, unless restrictive measures were adopted. The first step was to forbid by legislation the export of gold, except under special licence. This regularised the practical prohibition which had grown up during the war; it was the actual abandonment of the gold standard. For no person could bring notes to the Bank and turn them into gold with which to pay a debt owing by him outside the kingdom. And even within the kingdom the restriction on the use of gold was made closer, inasmuch as by agreement, though not by legislation, the joint-stock banks handed over to the keeping of the Bank of England for the Treasury all the gold which they had in their vaults. The

Bank therefore obtained for the first time a complete control of the whole gold reserves of the country.

It was under this system that the country passed through the great crisis, the tremendous fall in prices of 1921–2. This fall was not due to any policy of deflation; it was a world-wide phenomenon, which, in fact, began not here but in Japan. It was due to a sudden realisation of the fact that the world, in the frenzied outburst of speculative production which followed the end of the war, had increased its output of goods of every sort far beyond the power of the impoverished nations of Europe to purchase. The fall in prices brought with it a great deflation of the currency; as prices fell, the amount of currency needed to buy and sell the goods became less, and the issue of Treasury notes fell off. At the same time the nation was rapidly paying off debt, and thus cancelling the excess of credit which had been created during the war. The deflation of prices and reduction of currency went hand in hand. The general index-number for wholesale prices for Great Britain according to the *Economist* fell between January 1921 and December 1922 from 255·8 to 193·8, and in the same period the total

amount of Treasury notes current fell from £367,626,000 to £301,336,000.

At the same time the American exchange, as had been foreseen, began to go against us; and the number of dollars which were equivalent of £1 fell from the "pegged" figure of 4·76½ to a minimum of 3·21¾. As the process of deflation came to an end in England, the dollar exchange began slowly to rise. The regularity of the rise was interrupted by a false alarm of fresh inflation towards the end of 1923; but throughout the early part of 1924 a steady improvement set in, and by July 1924 a return to the gold standard began to be a matter of practical politics.

(4) The decisive step was taken on April 28, 1925, when the Chancellor of the Exchequer, as a preface to his Budget speech, announced that the embargo on the export of gold, which had been legally enacted for the period up to December 31st, would not be renewed on that date, and that in the meantime licences for the export of gold would be freely given. This placed the country on the gold standard, so far as international trade was concerned. But it was decided that, for the protection of the gold reserves held by the Bank of England, it was necessary that the circulation of gold

coin should not be resumed. The obligation of the Bank to pay both Treasury Notes and its own bank notes in gold coin, £ for £, had been nominally maintained, as provided by the law, since the outbreak of the war. This obligation was now abolished; the Bank was given the option to pay notes in gold coin if it wished to do so, but was no longer compelled. On the other hand, it undertook to sell gold in bars of not less than 400 oz. fine at the Mint price of £3 17*s*. 10½*d*. per oz. standard, so that anyone wishing to export gold could obtain bullion but not specie. The right of the holder of bullion to have it coined at the Mint was withdrawn. It may be mentioned that this plan, proposed by the eminent economist Ricardo, was adopted in 1819, when the Government, after the long suspension of payments during the Napoleonic wars, was proposing to return to gold.

It has been pointed out that, under the Currency and Bank Notes Act of 1914, there was no limit whatever to the discretion of the Treasury; notes might be issued to any amount that the Chancellor of the Exchequer of the day thought fit, and no provision whatever was made for any gold backing. But a certain amount of gold, and subsequently some

silver, was set aside as a partial cover. The percentage of gold to the total issue was entirely arbitrary, but as gold coin returned from circulation when displaced by notes, the total amount placed to reserve against the Treasury notes rose to £27,000,000. This was subsequently transferred to the Bank of England, and bank notes were taken against it. The state of the Treasury Notes issue for the week ended 26th May, 1926, was as follows:

Treasury Notes Outstanding:			
		Government Securities	£249,604,425
		Bank of England Notes	56,250,000
£1 Notes	£237,239,340	Silver Coin	6,550,000
10s. Notes	42,964,446	Balance at Bank of England	126,594
Certificates	18,760,000	Investments Reserve a/c	£12,261,852
Total	£298,963,786		

(which includes £1,304,381 notes called in but not yet cancelled).

Fiduciary Issue, £242,713,786—this being the total of the Treasury Notes outstanding—£298,963,786—less the total of Bank of England Notes held, namely, £56,250,000.

The Treasury, however, by a Minute issued on the 15th December, 1919, declared its policy to be a gradual reduction in the total issue of Treasury notes, and to this end announced that the total amount of notes uncovered by gold or Bank of England notes at any time in any year would be limited to the maximum amount attained in the previous year. Thus the total fiduciary amount might be reduced, but could never be in-

creased. The limit was thus reduced year by year as follows:

	£
1920 :	320,600,000
1921 :	317,555,200
1922 :	309,988,400
1923 :	270,183,800
1924 :	248,190,900
1925 :	248,145,400
1926 :	247,902,500

It will be seen that the limit has now reached a point below which it is not likely to fall, so long as conditions remain much as they are at present; so long, that is, as the general level of prices does not greatly vary from the present point, and there is no great boom in trade such as will call for a large addition to the volume of currency. In fact the limit is already too low to allow for the temporary expansion of currency which normally takes place in the holiday seasons at Christmas and the beginning of August, when there is a general demand for cash. Thus at Christmas 1924, and again at the beginning of August 1925, the demand for Treasury notes increased till the fiduciary issue, the amount not covered by gold or Bank of England notes,

exceeded, or threatened to exceed, the maximum of the year preceding. The Bank of England was therefore called upon to deposit notes to cover the deficiency. This was, of course, equivalent to an export of gold from the Bank.

Under the present system, therefore, the absolute control of the currency is vested in the Treasury, that is, in the hands of the Chancellor of the Exchequer for the time being. It is within his power to inflate the currency to any extent that he may think fit; he may make Government loans to an unlimited amount by directing the Treasury to issue currency notes and place them at the disposal of any person or body whom he may wish to favour. He is entirely free from any control, whether of the House of Commons or of his own colleagues in the Government, so long as he can keep his transactions out of the annual Budget. He can, of course, after the deed is done, be expelled from office; but what he thinks fit to do is within the limits of the law in any case, and cannot be rescinded by his punishment.

So far the Treasury, as we have seen, has voluntarily limited its issues by Minute; but the Minute is no more than a declaration of

policy, and may be cancelled without notice. It has only been maintained in existence as long as it has by the help provided by the Bank of England. If at any time there should be a financial panic necessitating an expansion of the issue, it would no longer be necessary for the Bank to apply for a suspension of the Act; all that would be needed would be an order for the issue of so many Treasury notes on the fiduciary basis.

Hitherto this abandonment by Parliament of all control, logically only justifiable as an emergency measure to meet the stress of war, this legal establishment of an absolute financial dictatorship, has been satisfactory in its application. The Governor of the Bank of England has been taken into a sort of informal partnership with the Chancellor, and all their steps have been guided by an enlightened regard for the national credit. But conditions may change, and it can hardly be held that the present position is anything but temporary. The only other Government, so far as I am aware, which has been placed in a similar position is that of the Czecho-Slovakian State. Here the stabilisation of the currency, involving a large measure of deflation, was placed in the hands of the Ministry of Finance, aided by a

consultative Committee. But when stabilisation was attained, the issue of currency was handed over to a State bank legally established and provided with means to maintain the value of its notes.

It can hardly be long before some fresh arrangement is made by which the sole power of note issue will be given back to the Bank of England. The whole system of currency regulation will then have to be reopened. The choice will be between a return to the strictly limited and mechanical system of the Bank Charter Act, with largely extended powers of fiduciary issue, as it is impossible now to abolish at once the whole excess issue of Treasury notes; or, on the other hand, some sort of arrangement as that which, in one form or another, exists in most foreign countries—an arrangement under which the Central Bank is allowed to issue a certain proportion of currency against the discount of approved commercial paper and/or Government securities, in place of the deposit of actual gold which our present system demands. This plan has the great advantage of elasticity. In a time of pressure and panic it gives all banks the power of helping their customers by lending freely either upon securities or by

the discount of their bills, with the knowledge that they can always depend upon obtaining the necessary funds from the Central Bank by re-pledging the securities or re-discounting the bills.

It is, in fact, the means adopted by the United States in the reform of their issue system which took place just before the war; and it is necessary that for the sake of comparison a short account should be given of this. This is the more important because recent events have drawn the two systems into close contact, and the course of business in England has largely depended upon co-operation between London and New York. The Federal Reserve Board's policy, as reflected in the Reserve Banks' discount rates, particularly in New York, has had a great influence on the bank rate in London.

American banking had a bad start; it was from the first a victim of the politicians. When the Republic was first founded a bitter contest arose between the school of Alexander Hamilton, who wished to see a strong central authority, and that of Jefferson, who was a supporter of State rights as against those of the central Federal Government. It was natural that Hamilton should favour a central

bank and that Jefferson should oppose it. It is needless to dwell on the chequered and unhappy career of the Bank of the United States, first formed under Hamilton's auspices, and finally, after it had been a leading political issue in the Presidential election of 1832, virtually destroyed by executive action, though its charter had not yet expired, in 1833. From that time American banking became purely provincial. Banks established under State law held the field; no general legislation existed, and under this system the issue of notes was practically unlimited. The amount of notes issued, which in 1830 was estimated at something over $66,000,000, had in 1837 risen to $149,000,000. In the latter year the crash, the natural offspring of rapid inflation, came, and it is believed that every bank in the United States, without exception, suspended payment. This brought about action in most of the States to restrain the evils of uncontrolled issue. In the State of New York, for instance, "incorporated" banks under State law were required to contribute one half per cent. of their capital annually to a security fund, devoted to payment of the notes of defaulting banks. This, however, was practially a dead letter, as it

acted directly to encourage rash banking; the speculative banker knew that his risks were to a certain extent at least covered by the funds of more cautious establishments, and lost any sense of responsibility. In addition to the "incorporated" banks there was a system of "free" banks; all individuals or associations who chose to deposit securities with a minimum of $100,000 were allowed to issue an equal amount of notes. This permission was largely used; but it had the obvious objection that it made no provision for the immediate payment of notes; in time of panic the securities became unsaleable, and notes were repaid only after a long period of liquidation, and rarely if ever in full, as the securities in such periods could only be sold at less than the price at which they had been pledged.

This did not stop panics; another occurred in 1857, and once more, it is said, every bank in the United States stopped payment. But before any further reform in the banking system had been effected the Civil War came in 1861, and altered the whole position. The Federal Government took upon itself the issue of notes which were inconvertible and legal tender. The Government thus obtained a

forced loan not bearing interest, coin was driven out of circulation, and gold went to a large premium. By the Banking Law of 1863 the whole banking system of the country was altered. A Currency Bureau with a Controller of Currency was set up in Washington, with power to authorise banking associations of not less than five persons to be established, with a minimum capital of $100,000. Any such bank must transfer to the Treasurer of the United States any United States interest-bearing bonds, not less than one-third of the capital stock, and should thereupon receive from the Controller of Currency circulating notes of different denominations equal in amount to 90% of the current market value of the bonds, but not exceeding their par value. Under this law large numbers of existing banks were transformed into "national" banks, and their existing notes were withdrawn in exchange for the new national bank issue, which soon obtained currency throughout the United States, regardless of the bank issuing, as they were all backed by adequate security in the United States Treasury.

The new system, though in the long run it secured the safety of the notes, did not

prevent banking crises. It had the grave defect of erring on the side of rigidity as much as the old erred on the side of laxity. America is a land which has always been eminently dependent upon harvests. The great grain and cotton crops which form the staple of its exports are all harvested in the autumn, and sent at once to the various ports, mostly on the east coast, for export. The sums required for the gathering and moving of the crops are very large, and the call for currency in the last four months largely exceeds the needs of the rest of the year. There was no organised provision for meeting this call and spreading it over twelve months.

In 1912 there were some 30,000 banks scattered through the United States. All were individual units, with no coherence or "team-work." They had substantial reserves supposed to be available in an emergency; but these largely consisted of sums placed on deposit with other banks, which in their turn deposited their reserves with yet other banks; and by this system of "pyramiding" no bank could call up its so-called "first-line" reserves without causing a disturbance through a long line of banks, probably ending

in New York. There was no central institution like the Bank of England or the Bank of France which could keep a watch over a general reserve fund, and transmit it almost automatically to the point where it was needed. The currency system was notably inelastic. The securities which were almost exclusively used as a basis for note issue were United States 2% bonds of 1930. These were always in demand for this purpose, and consequently always more or less at a premium. The banks got but little return upon them as an investment, and they looked rather to the price at which they could be bought than to the necessities of the country for currency. "In other words, the expansion and contraction of the bank-note circulation was not, as it should have been, in response to variations in trade demands, but in response to variations in the price of the Government debt" (Kemmerer). Moreover, the purchase and deposit of the bonds involved a great deal of red-tape and delay before the supply of fresh notes could be obtained from Washington. Then, again, rigid requirements for the reserve to be held against all loans made it difficult for the banks to increase their book credits when trade was expanding. Nor could banks

lend their credit by accepting bills, as is done in Europe on a large scale; for the courts had decided that acceptance of bills by banks was illegal. The evil results of the American system are thus summed up by Dr. Kemmerer.

"To this defect of credit inelasticity coupled with that of decentralisation were to be attributed largely the frequent and wide fluctuations in the interest rates on call and short-time loans, for which American money markets were notorious, the alternation of periods of excessive speculation stimulated by redundancy of currency and credit with periods of stringency and liquidation brought on by scarcity. For this rigidity of our credit system the business men and the farmers paid the price of higher interest rates; the farmer suffered through the necessity of selling his staple crops largely in the fall when a tight money market was depressing prices, and of buying his supplies largely in the early spring when easy money conditions tended to make prices abnormally high; the banker was compelled to keep large reserves and to tie up an excessive amount of his commercial deposits in capital investments, such as the purchase of bonds and the making of call loans on stock exchange collateral;

while upon all classes in the community an uncertain and unstable money market, which was wont to collapse frequently in panics, imposed the burden of great financial anxiety." The system with these defects naturally operated to the great disadvantage of the foreign trade of the United States. This was mostly financed through London by the system of bank acceptances. For instance, an exporter of coffee from South America to New York would be reimbursed by a sterling draft on London which the New York importer had to arrange with a London bank, who took the commission payable on the transaction.

In short the inefficiency of the American banking system had long been a by-word when the great panic of 1907 convinced even the most conservative American banker that something must be done. The reform of the system was hotly debated for several years, and it was not till 1914 that the "Federal Reserve Act" was passed by Congress just in time, as it happened, to assist in the enormous expansion of business involved in the outbreak of the war, and afterwards to finance the huge loans issued by the United States on their entry into the war in 1917.

The new system was in the nature of a compromise. The long tradition of American public opinion, grown almost into a test of patriotism, rejected any real centralisation of banking; it was not possible to set up a real "Bank of the United States" with the authority of the Bank of England or the Bank of France. American banking has always been and remains essentially provincial; the sense of "State Rights" is outraged by the thought of a Federal Bank interfering all over the country, just as by a rigid veto on branch banking, even within the limits of the State (the chief exception being California), an effective limit is set to the growth of individual banks, and the small local banker retains a favoured position from which he is not likely to be ousted. It need hardly be added that this is the exact contrary of the tendency which is to be seen in English banking, which has for the last century been steadily progressing through amalgamation to complete concentration in London.

The United States are, under the Federal Reserve Act, divided up into twelve districts, each with a Federal Reserve Bank of its own;

and the co-operation of these twelve banks is secured by the provision of a Federal Reserve Board sitting at Washington, and possessing considerable powers of control over each of the Federal Reserve Banks.

Each Federal Reserve Bank is formed by banks in the district, who are called " member banks." All National banks must become member banks, and State banks are permitted and encouraged to join. The member banks subscribe the capital in proportion to their own capital; they are entitled to a dividend of not more than 6%, further profits going to the United States Treasury. They appoint three members of the Board, three others are appointed from the business men of the district, and three, of whom one is the chairman, are appointed by the Government.

The main provision for the control of the currency is to be found in the section of the Act which sanctions the creation of Federal Reserve notes. These are obligations of the United States and are receivable in payment of all taxes, customs and other public dues, but are not legal tender. Any Federal Reserve Bank may apply for such notes against collateral security consisting of " notes, drafts,

bills of exchange, bankers' acceptances, or gold or gold certificates." Each Federal Reserve Bank is required to "maintain reserves of gold or lawful money of not less than 40% against its Federal Reserve notes in actual circulation." No Federal Reserve Bank may pay out notes issued by another Federal Reserve Bank; such notes when received in the course of business must either be returned to the issuing bank, or paid direct into the Treasury of the United States in order to be retired.

All member banks are bound to keep with their Federal Reserve Bank their legal reserves, which must bear a specified proportion to their deposits, going up in certain circumstances to 13% of their deposits at not more than thirty days fixed, and 3% on deposits at longer dates. The Federal Reserve Banks themselves must keep 35% of their total deposits in cash; but provision is made for an elasticity of credit by the provision that the Federal Reserve Board may permit a temporary reduction below this limit on payment of an additional and progressive interest on the deficiency, so that it can practically only be used in the case of emer-

gency. This is analogous to the unwritten rule by which the British Chancellor of the Exchequer will only permit a "suspension of the Act" when the Bank Rate has been raised to 10%.

The full working of the Federal Reserve Act depends, it will be seen, largely upon the amount of good commercial paper bearing two names which the member banks can discount with their Reserve Bank in order that it may be put into the Treasury as a basis for the issue of Federal Reserve notes. One of the objects of the Act is to create an open discount market, in which bills can be borrowed upon. The importance of the discount market in London we shall see later on. Hitherto there has been but little dealing in bills in America. Banks were not allowed to accept, and acceptances for trade debts were for the most part only local in character. But earnest efforts are being made to extend this most useful form of negotiable credit, and considerable progress has been made.

Good commercial bills are the most available form by which the general supply of credit can be apportioned among the different

parts of the country according to their respective needs. The Federal Banks are prepared to discount for one another, and can indeed be compelled to do so in case of need by the Reserve Board. Thus it is now easy, when the Middle West requires cash for the movement of the grain crop, or the South for the cotton, for the Federal Reserve Bank at Chicago or Atlanta to send bills to the Reserve Bank at New York with a request that they be discounted. The cash is sent to the country districts, where the member banks use it to help the farmers with their wages or freight for their goods; and when the bills come due and are paid to the Reserve Bank in New York whose duty it is to collect them, the proceeds can be used against the shipment of the goods abroad. Against these goods bills are then drawn on foreign countries, which can be discounted, and so the supply of marketable bills is kept up, and the foreign exchanges are effectively worked.

Generally speaking the Reserve Banks have set up an efficient system of co-operation, and have reformed the distribution of credit and currency in a satisfactory manner. As the discount market grows in width and

elasticity the whole banking system should become more and more worthy of the United States.

But though the system has hitherto worked well, and undoubtedly saved the country from the serious financial crisis which, had it not been just established, must have attended the outbreak of the war and the entry into it of the United States, it does not appear to be wholly popular among the banks. Although the Federal Reserve Banks are the "bankers' banks," and as such do not ostensibly compete with the member banks, yet they have been given powers which do to a considerable extent interfere with the private interests of their constituents.

In the first place, though it was distinctly intended that they should have a large control over the general supply of credit in the country by means of their discount rates, which they could raise when they saw signs of a speculative expansion of loans, yet it was clear that a mere raising of the rate might not be sufficient to give them this control. They might raise the rate, but the member banks, so long as money was plentiful, as it generally is at the beginning of a speculative

boom, might go on lending at lower rates, so long as they were not obliged to borrow from the Reserve Banks. Power was given, therefore, to the Reserve Banks to make their rates effective by going into the market and selling their securities, thus bringing money from the market into their own reserves, and leaving less available for the banks to lend. This they seem to have used with much effect, in pursuance of the policy of the Federal Reserve Board to restrain any great rise in prices by keeping credit in check. Now a rise in prices brings an immediate profit to the speculator and through him to the banker; and it is only too easy to seek this immediate profit, regardless of wider interests. Hence it can be readily understood that the " open market policy " of the Reserve Banks has met with a great deal of unfriendly criticism. It may be noticed that this policy is rendered easy to them by the provision that they shall not pay the member banks, by way of dividend on their capital, more than 6% per annum, any surplus going to the United States Treasury. This is an indication to them that their policy is intended to be national and not sectional;

they need not hesitate to take steps which involve a loss of profit. And the "open market policy" does of course involve a loss of profit; for securities earning interest are sold in order that the proceeds may be locked up and remain idle; for if it were sought to make profit by re-lending, the policy would be stultified. The restriction of credit is not in any case a profitable or popular policy.

In another way the Federal Banks have adopted a policy which has produced serious criticism from the member banks. When cheques had to be collected by banks holding them in another town from that in which they were payable, the holding bank used to send them to their correspondents in the paying town, and a charge was made for collection. This charge was a considerable source of profit to the collecting bank. The charges differed in different districts, and it often was found a profitable practice to send cheques by roundabout routes for payment, in order to avoid some expensive town through which they would naturally have been passed. The Federal Reserve Banks deemed it their duty to bring all districts into proper co-ordination by abolishing these

transit charges, and set up a general clearing system by which all cheques throughout the country could be presented for payment free of cost. The banks, who had profited by the commissions which were now no longer to be had naturally grumbled at this competition, and complaints are still loud. But there is no doubt that the general banking facilities of the continent have been materially increased by the new practice.

It is worth while to compare with the American system a yet later one which has had the most thorough discussion by the highest authorities both of Europe and America, namely, the German banking system set up under the Dawes Commission and subsequently modified by the Conference of London. As this scheme has been thoroughly considered and approved by the British Government and the Bank of England, it would seem that it indicates the lines on which the new Bank Charter for the regulation of our own note issue may be expected to run.

In the original Dawes Report the new German Bank of Issue was bound to keep not less than 33⅓% of gold, or foreign

exchange, against its note issue, the balance being covered by approved commercial bills and other securities. It was also bound to keep a further special reserve in gold or gold securities of 12% of its deposit liabilities—this provision in effect seems to have been designed to correspond to our own division between the Banking and Issue Departments. Any drop below these limits was to be penalised by rapidly increasing rates of interest payable on the amount of the deficiency.

By the London Conference these very severe requirements were somewhat modified, and the new law now provides as follows. The Reichsbank has the right of note issue for fifty years, but the existing rights of the Würtemberg, Bavarian, Saxon and Baden Note Banks are reserved, their collective issues not to exceed 194 million marks—a quite small amount. The Reichsbank may make advances against gold and silver, certain Railway Bonds and Shares, State Certificates of Indebtedness falling due within twelve months, Bills and Commodities. All bills must regularly bear three names, instead of two required under the old system—in other words, purely commercial bills must be

re-discounted with the Reichsbank with the endorsement of a bank or other financial establishment, as the ordinary commercial bill bears only the names of the drawer and acceptor. The requirement of a third signature may be dispensed with in some cases for a limited amount. The amount of the note issue is to be covered by gold or foreign exchange up to 40%, of which three-quarters, or 30%, must be represented by gold. The remaining portion is to be covered by discounted bills and cheques satisfying specific requirements. Only in exceptional cases may the cover sink below 40% on consent being given by the General Council against, at the most, one dissenting vote. In this case the Bank has to pay on the difference arising on the 40% cover a tax as follows:

On a cover of between 37% and 40%	3% per annum,
On a cover of between 35% and 37%	5% per annum,
On a cover of between 33⅓% and 35%	8% per annum,

and a further 1% per annum on every 1% below the cover of 33⅓%. When the cover is below 40% the discount rate must be at least 5%. In case the tax is paid, the discount rate must be increased by at least one-

third of the percentage of the tax plus each increase of the aforementioned rates. That is, it would seem that if the tax of 3% becomes payable between the limits of 37% and 40%, the discount rate must be at least 5%, plus 1%, that is 6%, and increase till when the limit of 35% is passed the rate will be 5% plus $\frac{8}{3}$%, or $7\frac{2}{3}$% at least. This system of combined raising of the interest rate and the tax penalty should be completely efficacious. It may be added that up to the present the Reichsbank has gold in reserve well in excess of the amount required, the percentage on the 7th July, 1926, being 51·6%. The rate of discount, however, has ruled high, having only been reduced from 10% to 9% in February 1925, and from 9% to 7% in March 1926, then to $6\frac{1}{2}$% on 7th June and to 6% on 6th July, at which latter figure it at present stands.

It would seem then that when the time comes for our issue system to be placed on a sound footing, by the transfer of the Treasury note issues to the Bank of England, and the consequent entire remodelling of the Bank Charter Act, it will have to be on lines similar to those which have received such

authoritative approval from all the chief banking experts of the world. That is to say, the Bank will have the sole issue of notes; it will be bound to keep against the notes at least one-third of their amount in gold, with exceptional power to go below this limit on payment of a heavy tax, to be recouped from the borrowers who require the further issue by a still heavier bank rate for discounts. The remaining two-thirds of the issue will be against approved bills and other first-class securities, to be rigidly defined.

It was probably for considerations of this nature that the Treasury authorities, of course with the active support of the Governor of the Bank, decided, in accordance with the original proposal of the Cunliffe Committee, that it would be possible to return to the gold standard—*i.e.* to permit the export of gold, and its sale by the Bank at the standard rate—when the stock of gold amounted to £150 millions, while general conditions at the same time were such as to leave no doubt that the Bank could retain this stock by the normal operation of the bank rate. At the present time the stock is ample for conditions such as those outlined above. Taking at

random a recent date, it appears from the Bank return, and the report of the Treasury notes department, that on August 12, 1925, there were outstanding:

Currency Notes and Certificates . .	£301,216,000
Bank Notes in circulation	145,253,000
Total circulation	446,469,000

The amount of gold required to back this circulation to the extent of one-third would be £148,823,000, or close on the £150,000,000 proposed by the Cunliffe Committee. As a matter of fact, the Bank held at that date:

In the Issue Department	£162,434,000
In the Banking Department (say 50% of £1,822,000)	911,000
Total	£163,345,000

or over £14·5 millions more than the minimum needed. This would permit of the circulation of another £43·5 millions of notes before the limit was reached at which penal rates would come into play. So long as this proportion were maintained, the money market, which watches minutely the Bank's returns of the import and export of gold, would be in no apprehension of "dear money" or a rise in

the bank rate. But if gold began to go out to an extent which suggested an approach to the limit of £150 millions, anxiety would be aroused at once; the prospect of a rise in the bank rate would be brought near; and all those who deal in the discounting of bills would at once begin to raise the market rate in anticipation.