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5 THE ECONOMIC CONSEQUENCES OF MR CHURCHILL (1925)

The Economic Consequences of Mr Churchill originated as a series of three articles on England's return to the gold standard which appeared in the *Evening Standard*, 22, 23 and 24 July 1925, under the heading 'Unemployment and Monetary Policy'. Keynes expanded these into the pamphlet which was published the same month by the Hogarth Press of Leonard and Virginia Woolf, chapters I, III and V corresponding to the *Evening Standard* articles. In the United States the pamphlet was published as *The Economic Consequences of Sterling Parity*. For *Essays in Persuasion* Keynes condensed the material of the whole pamphlet.

§I WHY UNEMPLOYMENT IS WORSE

World trade and home consumption are both moderately good—running on a level keel, midway between slump and boom. The United States has had a year of abundant prosperity; India and the Dominions are doing fairly well; in France and Italy unemployment is non-existent or negligible; and in Germany during the last six months the numbers receiving the dole have decreased rapidly, by more than half, to 4·5 per cent against our 10 per cent. The aggregate of world production is probably greater than at any time since 1914. Therefore our troubles are not due either to world-wide depression or to reduced consumption at home. And it is obvious what does cause them. It is a question of *relative price* here and abroad. The prices of our exports in the international market are too high. About this there is no difference of opinion.

Why are they too high? The orthodox answer is to blame it on the working man for working too little and getting too much. In some industries and some grades of labour, particularly the unskilled, this is true; and other industries, for example the railways, are over-staffed. But there is no more truth in it than there was a year ago. Moreover, it is not true in those export industries where unemployment is greatest.

On the contrary, the explanation can be found for certain in another direction. For we know as a fact that the value of sterling money abroad has been raised by 10 per cent, whilst its purchasing power over British labour is unchanged. This alteration in the external value of sterling money has been the deliberate act of the government and the Chancellor of the Exchequer, and the present troubles of our export industries are the inevitable and predictable consequence of it.§

The[1] policy of improving the foreign-exchange value of sterling up to its pre-war value in gold from being about 10 per cent below it, means that, whenever we sell anything abroad, either the foreign buyer has to pay 10 per cent *more in his money* or we have to accept 10 per cent *less in our money*. That is to say, we have to reduce our sterling prices, for coal or iron or shipping freights or whatever it may be, by 10 per cent in order to be on a competitive level, unless prices rise elsewhere. Thus the policy of improving the exchange by 10 per cent involves a reduction of 10 per cent in the sterling receipts of our export industries.

Now, if these industries found that their expenses for wages and for transport and for rates and for everything else were falling 10 per cent at the same time, they could afford to cut their prices and would be no worse off than before. But of course, this does not happen. Since they use, and their employees consume, all kinds of articles produced at home, it is impossible for them to cut their prices 10 per cent, unless wages and expenses in home industries generally have fallen 10 per cent. Meanwhile, the weaker export industries are reduced to a bankrupt condition. Failing a fall in the value of gold itself, nothing can retrieve their position except a general fall of all internal prices and wages. Thus Mr Churchill's policy of improving the exchange by 10 per cent was, sooner or later, a policy of reducing everyone's wages by 2*s* in the £. He who

[1] In the original *Essays in Persuasion*, the section beginning here was entitled 'The Misleading of Mr Churchill'—Ed.

wills the end wills the means. What now faces the Government is the ticklish task of carrying out their own dangerous and unnecessary decision.

§The statistics bear out this reasoning. The following table is, by itself, an adequate explanation of the difficulties of our export industries compared with a year ago:

	United States Cost of living	Great Britain Cost of living		Great Britain Wages	
	Gold	Gold	Sterling	Gold	Sterling
	(Pre-war = 100)				
March 1924	156	157	178	155	176
June	154	150	169	157	178
October	157	162	176	164	178
December	158	174	181	172	179
March 1925	158	176	179	177	181
April	158	172	175	178	181
May	158[1]	172	173	180	181
June	158[1]	172	172	181	181
July	158[1]	173	173	180	180

[1] Provisional.

This table shows that a year ago the cost of living and the level of wages in this country, expressed in terms of gold (i.e. reduced from their sterling value in proportion to the depreciation of the sterling exchange), were in conformity with the dollar cost of living in the United States. Since then the sterling exchange has been raised by 10 per cent, whilst there has been no appreciable change in the sterling cost of living and the sterling level of wages in this country compared with the dollar cost of living in the United States. It follows, of necessity, that our money wages and cost of living are now about 10 per cent too high. The government's policy has secured that we receive 10 per cent less sterling for our exports; yet our industrialists have to pay out in wages just as much as before, and their employees have to expend just as much as before to maintain their standard of life.§ The movement away from equilibrium began in October last and has proceeded, step

by step, with the improvement of the exchange—brought about first by the anticipation, and then by the fact, of the restoration of gold, and not by an improvement in the intrinsic value of sterling.[1] The President of the Board of Trade has asserted in the House of Commons that the effect of the restoration of the gold standard upon our export trade has been 'all to the good'. The Chancellor of the Exchequer has expressed the opinion that the return to the gold standard is no more responsible for the condition of affairs in the coal industry than is the Gulf Stream. These statements are of the feather-brained order. It is open to ministers to argue that the restoration of gold is worth the sacrifice and that the sacrifice is temporary. They can also say, with truth, that the industries which are feeling the wind most have private troubles of their own. When a *general* cause operates, those which are weak for other reasons are toppled over. But because an epidemic of influenza carries off only those who have weak hearts, it is not permissible to say that the influenza is 'all to the good', or that it has no more to do with the mortality than the Gulf Stream has.

The effect has been the more severe because we were not free from trouble a year ago. Whilst, at that date, sterling wages and sterling cost of living were in conformity with values in the United States, they were already too high compared with those in some European countries. It was also probable that certain of our export industries were over-stocked both with plant and with labour, and that some transference of capital and of men into home industries was desirable and, in the long run, even inevitable. Thus we already had an awkward problem; and one of the arguments against raising the international value of sterling was the fact that it greatly aggravated, instead of mitigating, an existing disparity between internal and

[1] This view was shared by the Treasury Committee on the Currency who reported that the exchange improvement of last autumn and spring could not be maintained if we did not restore the gold standard; in other words, the improvement in the exchange prior to the restoration of gold was due to a speculative anticipation of this event and to a movement of capital, and not to an intrinsic improvement in sterling itself.

external values, and that, by committing us to a period of deflation, it necessarily postponed active measures of capital expansion at home, such as might facilitate the transference of labour into the home trades. British wages, measured in gold, are now 15 per cent higher than they were a year ago. The gold cost of living in England is now so high compared with what it is in Belgium, France, Italy, and Germany that the workers in those countries can accept a gold wage 30 per cent lower than what our workers receive without suffering at all in the amount of their real wages. What wonder that our export trades are in trouble!

Our export industries are suffering because they are the *first* to be asked to accept the 10 per cent reduction. If *every one* was accepting a similar reduction at the same time, the cost of living would fall, so that the lower money wage would represent nearly the same real wage as before. But, in fact, there is no machinery for effecting a simultaneous reduction. Deliberately to raise the value of sterling money in England means, therefore, engaging in a struggle with each separate group in turn, with no prospect that the final result will be fair, and no guarantee that the stronger groups will not gain at the expense of the weaker.

The working classes cannot be expected to understand, better than Cabinet Ministers, what is happening. Those who are attacked first are faced with a depression of their standard of life, because the cost of living will not fall until all the others have been successfully attacked too; and, therefore, they are justified in defending themselves. Nor can the classes, which are first subjected to a reduction of money wages, be guaranteed that this will be compensated later by a corresponding fall in the cost of living, and will not accrue to the benefit of some other class. Therefore they are bound to resist so long as they can; and it must be war, until those who are economically weakest are beaten to the ground.

This state of affairs is not an inevitable consequence of a

decreased capacity to produce wealth. I see no reason why, with good management, real wages need be reduced on the average. It is the consequence of a misguided monetary policy.

II WHAT MISLED MR CHURCHILL[1]

The arguments of chapter 1[2] are not arguments against the gold standard as such. That is a separate discussion which I shall not touch here. They are arguments against having restored gold in conditions which required a substantial re-adjustment of all our money values. If Mr Churchill had restored gold by fixing the parity lower than the pre-war figure, or if he had waited until our money values were adjusted to the pre-war parity, then these particular arguments would have no force. But in doing what he did in the actual circumstances of last spring, he was just asking for trouble. For he was committing himself to force down money wages and all money values, without any idea how it was to be done. Why did he do such a silly thing?

Partly, perhaps, because he has no instinctive judgement to prevent him from making mistakes; partly because, lacking this instinctive judgement, he was deafened by the clamorous voices of conventional finance; and, most of all, because he was gravely misled by his experts.

His experts made, I think, two serious mistakes. In the first place I suspect that they miscalculated the degree of the mal-adjustment of money values, which would result from restoring sterling to its pre-war gold parity, because they attended to index numbers of prices which were irrelevant or inappropriate to the matter in hand. If you want to know whether sterling values are adjusting themselves to an improvement in the exchange, it is useless to consider, for example, the price of raw cotton in Liverpool. This *must* adjust itself to a movement

[1] The title for chapter II and the division into chapters at this point did not occur in the original *Essays in Persuasion* version—Ed.

[2] In the original *Essays in Persuasion* version, the words up to here were replaced by the words 'These arguments'—Ed.

of the exchange, because, in the case of an imported raw material, the parity of international values is necessarily maintained almost hour by hour. But it is not sensible to argue from this that the money wages of dockers or of charwomen and the cost of postage or of travelling by train also adjust themselves hour by hour in accordance with the foreign exchanges. Yet this, I fancy, is what the Treasury did. They compared the usual wholesale index numbers here and in America, and—since these are made up to the extent of at least two-thirds from the raw materials of international commerce, the prices of which necessarily adjust themselves to the exchanges—the true dis-parity of internal prices was watered down to a fraction of its true value. This led them to think that the gap to be bridged was perhaps 2 or 3 per cent, instead of the true figure of 10 or 12 per cent, which was the indication given by the index numbers of the cost of living, of the level of wages, and of the prices of our manufactured exports—which indexes are a much better rough-and-ready guide for this purpose, par-ticularly if they agree with one another, than are the index numbers of wholesale prices.

But I think that Mr Churchill's experts also misunderstood and underrated the technical difficulty of bringing about a general reduction of internal money values. When we raise the value of sterling by 10 per cent, we transfer about £1,000 million into the pockets of the rentiers out of the pockets of the rest of us, and we increase the real burden of the national debt by some £750 million (thus wiping out the benefit of all our laborious contributions to the Sinking Fund since the war). This, which is bad enough, is inevitable. But there would be no other bad consequences, if only there was some way of bringing about a simultaneous reduction of 10 per cent in all other money payments; when the process was complete, we should each of us have nearly the same real income as before. I think that the minds of his advisers still dwelt in the imaginery academic world, peopled by City editors, members of Cunliffe

and Currency Committees *et hoc genus omne*, where the necessary adjustments follow 'automatically' from a 'sound' policy by the Bank of England.

The theory is that depression in the export industries, which are admittedly hit first, coupled if necessary with dear money and credit restriction, *diffuse* themselves evenly and fairly rapidly throughout the whole community. But the professors of this theory do not tell us in plain language how the diffusion takes place.

Mr Churchill asked the Treasury Committee on the Currency to advise him on these matters. He declared in his budget speech that their report 'contains a reasoned marshalling of the arguments which have convinced His Majesty's Government'. Their arguments—if their vague and jejune meditations can be called such—are there for anyone to read. What they ought to have said, but did not say, can be expressed as follows:

Money wages, the cost of living, and the prices which we are asking for our exports have not adjusted themselves to the improvement in the exchange, which the expectation of your restoring the gold standard, in accordance with your repeated declarations, has already brought about. They are about 10 per cent too high. If, therefore, you fix the exchange at this gold parity, you must either gamble on a rise in gold prices abroad, which will induce foreigners to pay a higher gold price for our exports, or you are committing yourself to a policy of forcing down money wages and the cost of living to the necessary extent.

We must warn you that this latter policy is not easy. It is certain to involve unemployment and industrial disputes. If, as some people think, real wages were already too high a year ago, that is all the worse, because the amount of the necessary wage reductions in terms of money will be all the greater.

The gamble on a rise in gold prices abroad may quite likely succeed. But it is by no means certain, and you must be prepared for the other contingency. If you think that the advantages of the gold standard are so significant and so urgent that you are prepared to risk great unpopularity and to take stern administrative action in order to secure them, the course of events will probably be as follows.

To begin with, there will be great depression in the export industries. This, in itself, will be helpful, since it will produce an atmosphere favourable

to the reduction of wages. The cost of living will fall somewhat. This will be helpful too, because it will give you a good argument in favour of reducing wages. Nevertheless, the cost of living will not fall sufficiently and, consequently, the export industries will not be able to reduce their prices sufficiently, until wages have fallen in the sheltered industries. Now, wages will not fall in the sheltered industries, merely because there is unemployment in the unsheltered industries. Therefore, you will have to see to it that there is unemployment in the sheltered industries also. The way to do this will be by credit restriction. By means of the restriction of credit by the Bank of England, you can deliberately intensify unemployment to any required degree, until wages *do* fall. When the process is complete the cost of living will have fallen too; and we shall then be, with luck, just where we were before we started.

We ought to warn you, though perhaps this is going a little outside our proper sphere, that it will not be safe politically to admit that you are intensifying unemployment deliberately in order to reduce wages. Thus you will have to ascribe what is happening to every conceivable cause except the true one. We estimate that about two years may elapse before it will be safe for you to utter in public one single word of truth. By that time you will either be out of office, or the adjustment, somehow or other, will have been carried through.

III THE POLICY OF THE BANK OF ENGLAND[1]

The effect of a high exchange is to diminish the sterling prices both of imports and of exports. §The fall in the price of imported food tends to reduce the cost of living. It is surprising, perhaps, that it has not had more influence in this direction. Probably the explanation is to be found partly in the world-wide rise of food prices, partly in a time-lag (in which case we may look forward to some further fall in the cost of living in the near future), and partly in the fact that by the time a commodity, even an imported commodity, reaches the consumer, its cost has been considerably affected by the various home services performed on it. Nevertheless, the table printed in the first chapter shows that some reduction of money wages on this score is, in fact, already justifiable—though not, for that reason,

[1] In the original *Essays in Persuasion* version this section was entitled 'The Balance of Trade and the Bank of England'—Ed.

much the easier to accomplish. Since the higher exchange does not help us to *afford* a higher real wage, it only grants this boon to the workers in order that it may be snatched away again as soon as possible. Meanwhile, the apparent cheapness of foreign products causes us to buy more of them. At the same time, the fall in the sterling price of exports reduces the business of the export industries.§

The result is both to encourage imports and to discourage exports, thus turning the balance of trade against us. It is at this stage that the Bank of England becomes interested; for if nothing was done we should have to pay the adverse balance in gold. The Bank of England has applied, accordingly, two effective remedies. The first remedy is to put obstacles in the way of our usual lending abroad by means of an embargo on foreign loans and, recently, on colonial loans also; and the second remedy is to encourage the United States to lend us money by maintaining the unprecedented situation of a bill rate 1 per cent higher in London than in New York.

The efficacy of these two methods for balancing our account is beyond doubt—I believe that they might remain efficacious for a considerable length of time. For we start with a wide margin of strength. Before the war our capacity to lend abroad was, according to the Board of Trade, about £181 million, equivalent to £280 million at the present price level; and even in 1923 the Board of Trade estimated our net surplus at £102 million. Since new foreign investments bring in no immediate return, it follows that we can reduce our exports by £100 million a year, without any risk of insolvency, provided we reduce our foreign investments by the same amount. So far as the maintenance of the gold standard is concerned, it is a matter of indifference whether we have £100 million worth of foreign investment or £100 million worth of unemployment. If those who used to produce exports lose their job, nevertheless, our financial equilibrium remains perfect, and the Governor of the Bank of England runs no risk of losing gold, provided that the

loans, which were formerly paid over in the shape of those exports, are curtailed to an equal extent. Moreover, our credit as a borrower is still very good. By paying a sufficiently high rate of interest, we can not only meet any deficit but the governor can borrow, in addition, whatever quantity of gold it may amuse him to publish in his weekly return.

The President of the Board of Trade calculates that, during the year ended last May, it is probable that there was no actual deficit on our trade account, which was about square. If this is correct, there must be a substantial deficit now. In addition, the embargo on foreign investment is only partially successful. It cannot hold back all types of foreign issues and it cannot prevent British investors from purchasing securities direct from New York. It is here, therefore, that the Bank of England's other remedy comes in. By maintaining discount rates in London at a sufficient margin above discount rates in New York, it can induce the New York money market to lend a sufficient sum[1] to the London money market to balance both our trade deficit and the foreign investments which British investors are still buying in spite of the embargo. Besides, when once we have offered high rates of interest to attract funds from the New York short-loan market, we have to continue them, even though we have no need to increase our borrowings, in order to retain what we have already borrowed.

Nevertheless the policy of maintaining money rates in London at a level which will attract and retain loans from New York does not really differ in any important respect from the French policy, which we have so much contemned, of supporting the exchange with the help of loans from Messrs J. P. Morgan. Our policy would only differ from the French policy if the high rate of discount was not only intended to attract American money, but was also part of a policy for restricting credit at home. This is the aspect to which we must now attend.

[1] §The Harvard Economic Service estimates that in recent months American banks have advanced to the London money market between $200 million and $300 million§.

To pay for unemployment by changing over from being a lending country to being a borrowing country is admittedly a disastrous course, and I do not doubt that the authorities of the Bank of England share this view. They dislike the embargo on foreign issues, and they dislike having to attract short-loan money from New York. They may do these things to gain a breathing space; but, if they are to live up to their own principles, they must use the breathing space to effect what are euphemistically called 'the fundamental adjustments'. With this object in view there is only one step which lies within their power—namely, to restrict credit. This, in the circumstances, is the orthodox policy of the gold party; the adverse trade balance indicates that our prices are too high, and the way to bring them down is by dear money and the restriction of credit. When this medicine has done its work, there will no longer be any need to restrict foreign loans or to borrow abroad.

Now what does this mean in plain language? Our problem is to reduce money wages and, through them, the cost of living, with the idea that, when the circle is complete, real wages will be as high, or nearly as high, as before. By what *modus operandi* does credit restriction attain this result?

In no other way than by the deliberate intensification of unemployment. The object of credit restriction, in such a case, is to withdraw from employers the financial means to employ labour at the existing level of prices and wages. The policy can only attain its end by intensifying unemployment without limit, until the workers are ready to accept the necessary reduction of money wages under the pressure of hard facts.

This is the so-called 'sound' policy, which is demanded as a result of the rash act of pegging sterling at a gold value, which it did not—measured in its purchasing power over British labour—possess as yet. It is a policy, nevertheless, from which any humane or judicious person must shrink. So far as I can judge, the Governor of the Bank of England shrinks from it. But what is he to do, swimming, with his boat burnt, between

the devil and the deep sea? At present, it appears, he compromises. He applies the 'sound' policy half-heartedly; he avoids calling things by their right names; and he hopes—this is his best chance—that something will turn up.

The Bank of England works with so much secrecy and so much concealment of important statistics that it is never easy to state with precision what it is doing. The credit restriction already in force has been effected in several ways which are partly interdependent. First, there is the embargo on new issues which probably retards the normal rate of the circulation of money; then in March the bank rate was raised; more recently market rate was worked up nearer to bank rate; lastly —and far the most important of all—the Bank has manœuvred its assets and liabilities in such a way as to reduce the amount of cash available to the clearing banks as a basis for credit. This last is the essential instrument of credit restriction. Failing direct information, the best reflection of the amount of this restriction is to be found in the deposits of the clearing banks. The tendency of these to fall indicates some significant degree of restriction. Owing, however, to seasonal fluctuations and to the artificial character of the end-June returns, it is not yet possible to estimate with accuracy how much restriction has taken place in the last three months. So far as one can judge, the amount of direct restriction is not yet considerable. But no one can say how much more restriction may become necessary if we continue on our present lines.

Nevertheless, even these limited measures are responsible, in my opinion, for an important part of the recent intensification of unemployment. Credit restriction is an incredibly powerful instrument, and even a little of it goes a long way—especially in circumstances where the opposite course is called for. The policy of deliberately intensifying unemployment with a view to forcing wage reductions is already partly in force, and the tragedy of our situation lies in the fact that, from the misguided standpoint which has been officially adopted, this course is

theoretically justifiable. No section of labour will readily accept lower wages merely in response to sentimental speeches, however genuine, by Mr Baldwin. We are depending for the reduction of wages on the pressure of unemployment and of strikes and lockouts; and in order to make sure of this result we are deliberately intensifying the unemployment.

The Bank of England is *compelled* to curtail credit by all the rules of the gold standard game. It is acting conscientiously and 'soundly' in doing so. But this does not alter the fact that to keep a tight hold on credit—and no one will deny that the Bank is doing that—necessarily involves intensifying unemployment in the present circumstances of this country. What we need to restore prosperity today is an easy credit policy. We want to encourage business men to enter on new enterprises, not, as we are doing, to discourage them. Deflation does not reduce wages 'automatically'. It reduces them by causing unemployment. The proper object of dear money is to check an incipient boom. Woe to those whose faith leads them to use it to aggravate a depression!

§IV THE CASE OF THE COAL INDUSTRY

I will illustrate my argument by applying it to the case of the coal industry. This industry has been in bad order ever since the war, apart from a temporary spurt whilst the Ruhr was out of action. Its troubles are due, therefore, to other causes besides the return to gold. By dwelling on these Mr Churchill may endeavour to make out a plausible case for the conclusion that the exchange has no more to do with the difficulties of the coal industry than the Gulf Stream has. It is, therefore, a good example to select, because it is *prima facie* unfavourable to my conclusions.

(1) In the *Economist* (27 June 1925), a correspondent writes: 'In Brazil, American coal at time of writing was quoted at \$8.85, against 39*s* (\$9.32) for the British product, while the

freight rates from the United States were around \$4, and from the United Kingdom \$3.76 (15*s* 9*d*).'

When this correspondent wrote the exchange was about 4.78. At today's exchange the price of the coal (39*s*) would be \$9.48 and the freight \$3.83. At the exchange of last June (4.31) the price of coal would have been \$8.40, and of the freight \$3.40.

Thus, last June we could quote 45 cents a ton less than American coal; now American coal can be quoted 63 cents less than ours, *merely on account of the improvement of the exchange*. In Canada and throughout South America, the effect of 10 per cent on the exchange makes the difference between our coal being on a competitive level with coal from the United States, or too dear. The same thing is true in Europe, for the effect of the return to gold has been to raise our exchanges by at least 10 per cent in terms of the currencies of France, Belgium, and Germany above what they would be otherwise.[1]

If our collieries lower their prices, as they are compelled to do, so as to be on as good a competitive level with foreign countries as they were a year ago, they have to lower their sterling prices by something like 1*s* 9*d* a ton.[2]

Has a price reduction of 1*s* 9*d* a ton no more to do with the troubles of the coal industry than the Gulf Stream? In terms of miners' wages this is a large proportion of the total reduction asked for by the mine owners. It is sufficient to turn a net profit of 6*d* a ton, which was what the coal industry earned in the first quarter of this year, into a loss of 1*s* 3*d* a ton.

(2) Apart from pit-props the coal industry consumes very few foreign goods. Moreover, the wages bill makes up a very high proportion of the total costs of raising coal. Thus, more than any other industry, the coal industry has to sell at the foreign value of sterling and to buy at the home value of sterling. A measure which raises the former without raising the latter

[1] The rise in the case of France and Belgium has been more than this.

[2] The Secretary of the Mining Association, giving evidence before the Coal Inquiry, estimated the figure at 1*s*; but he did not mention what dates he was comparing.

proportionately is, therefore, certain to prove particularly injurious to the coal industry.

(3) Apart from the direct effect on the exports of coal, the same causes which depress the trade in coal operate to depress the trade in the industry which is the biggest user of coal, namely, iron and steel.

(4) One of the worst troubles of the coal industry, peculiar to itself, is that in the present conditions of demand for coal there are far too many coal miners. The urgent need of the industry is to reduce its numbers. Yet, largely as the result of a change in the localisation of the industry (S. Yorkshire prospering at the expense of S. Wales and Northumberland), the industry is actually taking in much new labour. There are several explanations of this state of affairs. But the remedy can only come from the absorption of labour out of this industry into others. The necessary condition of this, however, is that other industries should be booming. It is in this sort of way—by keeping down the expansion of other industries—that credit restriction reacts on coal.

So far, therefore, from the troubles in the coal industry being due to other causes, §I should pick out coal as being above all others a victim of our monetary policy. On the other hand, it is certainly true that the reason why the coal industry presents so dismal a picture to the eye is because it has other troubles which have weakened its power of resistance and have left it no margin of strength with which to support a new misfortune.

In these circumstances the colliery owners propose that the gap should be bridged by a reduction of wages, irrespective of a reduction in the cost of living—that is to say, by a lowering in the standard of life of the miners. They are to make this sacrifice to meet circumstances for which they are in no way responsible and over which they have no control.

It is a grave criticism of our way of managing our economic affairs, that this should seem to anyone to be a reasonable proposal; though it is equally unreasonable that the colliery

owner should suffer the loss, except on the principle that it is the capitalist who bears the risk. If miners were free to transfer themselves to other industries, if a collier out of work or underpaid could offer himself as a baker, a bricklayer, or a railway porter at a lower wage than is now current in these industries, it would be another matter. But notoriously they are not so free. Like other victims of economic transition in past times, the miners are to be offered the choice between starvation and submission, the fruits of their submission to accrue to the benefit of other classes. But in view of the disappearance of an effective mobility of labour and of a competitive wage level between different industries, I am not sure that they are not worse placed in some ways than their grandfathers were.

Why should coal miners suffer a lower standard of life than other classes of labour? They may be lazy, good-for-nothing fellows who do not work so hard or so long as they should. But is there any evidence that they are more lazy or more good-for-nothing than other people?

On grounds of social justice no case can be made out for reducing the wages of the miners. They are the victims of the economic juggernaut. They represent in the flesh the 'fundamental adjustments' engineered by the Treasury and the Bank of England to satisfy the impatience of the City fathers to bridge the 'moderate gap' between \$4.40 and \$4.86. *They* (and others to follow) are the 'moderate sacrifice' still necessary to ensure the stability of the gold standard. The plight of the coal miners is the first, but not—unless we are very lucky—the last, of the economic consequences of Mr Churchill.

The truth is that we stand midway between two theories of economic society. The one theory maintains that wages should be fixed by reference to what is 'fair' and 'reasonable' as between classes. The other theory—the theory of the economic juggernaut—is that wages should be settled by economic pressure, otherwise called 'hard facts', and that our vast machine should crash along, with regard only to its equilibrium as a whole, and

without attention to the chance consequences of the journey to individual groups.

The gold standard, with its dependence on pure chance, its faith in 'automatic adjustments', and its general regardlessness of social detail, is an essential emblem and idol of those who sit in the top tier of the machine. I think that they are immensely rash in their regardlessness, in their vague optimism and comfortable belief that nothing really serious ever happens. Nine times out of ten, nothing really serious does happen—merely a little distress to individuals or to groups. But we run a risk of the tenth time (and are stupid into the bargain), if we continue to apply the principles of an economics, which was worked out on the hypotheses of *laissez-faire* and free competition, to a society which is rapidly abandoning these hypotheses.

V IS THERE A REMEDY?

The monetary policy, announced in the budget, being the real source of our industrial troubles, it is impossible to recommend any truly satisfactory course except its reversal. Nevertheless, amongst the alternatives still open to this government, some courses are better than others.

One course is to pursue the so-called 'sound' policy vigorously, with the object of bringing about 'the fundamental adjustments' in the orthodox way by further restricting credit and raising the bank rate in the autumn if necessary, thus intensifying unemployment and using every other weapon in our hands to force down money wages, trusting in the belief that when the process is finally complete the cost of living will have fallen also, thus restoring average real wages to their former level. If this policy can be carried through it will be, in a sense, successful, though it will leave much injustice behind it on account of the inequality of the changes it will effect, the stronger groups gaining at the expense of the weaker. For the method of economic pressure, since it bears most hardly on the weaker industries where wages

are already relatively low, tends to increase the existing disparities between the wages of different industrial groups.

The question is how far public opinion will allow such a policy to go. It would be politically impossible for the Government to admit that it was deliberately intensifying unemployment, even though the members of the Currency Committee were to supply them with an argument for it. On the other hand, it is possible for deflation to produce its effects without being recognised. Deflation, once started ever so little, is cumulative in its progress. If pessimism becomes generally prevalent in the business world, the slower circulation of money resulting from this can carry deflation a long way further, without the Bank having either to raise the bank rate or to reduce its deposits. And since the public always understands particular causes better than general causes, the depression will be attributed to the industrial disputes which will accompany it, to the Dawes Scheme, to China, to the inevitable consequences of the Great War, to tariffs, to high taxation, to anything in the world except the general monetary policy which has set the whole thing going.

Moreover, this course need not be pursued in a clear-cut way. A furtive restriction of credit by the Bank of England can be coupled with vague cogitations on the part of Mr Baldwin (who has succeeded to the position in our affections formerly occupied by Queen Victoria) as to whether social benevolence does not require him to neutralise the effects of this by a series of illogical subsidies. Queen Baldwin's good heart will enable us to keep our tempers, whilst the serious work goes on behind the scenes. The budgetary position will render it impossible for the subsidies to be big enough to make any real difference. And in the end, unless there is a social upheaval, 'the fundamental adjustments' will duly take place.

Some people may contemplate this forecast with equanimity. I do not. It involves a great loss of social income, whilst it is going on, and will leave behind much social injustice when it is finished. The best, indeed the only, hope lies in the possibility

that in this world, where so little can be foreseen, something may turn up—which leads me to my alternative suggestions. Could we not *help* something to turn up?

There are just two features of the situation which are capable of being turned to our advantage. The first is financial—if the value of gold would fall in the outside world, that would render unnecessary any important change in the level of wages here. The second is industrial—if the cost of living would fall *first*, our consciences would be clear in asking labour to accept a lower money wage, since it would then be evident that the reduction was not part of a plot to reduce real wages.

When the return to the gold standard was first announced, many authorities agreed that we were gambling on rising prices in the United States. The rise has not taken place, so far.[1] Moreover, the policy of the Bank of England has been calculated to steady prices in the United States rather than to raise them. The fact that American banks can lend their funds in London at a high rate of interest tends to keep money rates in New York higher than they would be otherwise, and to draw to London, instead of to New York, the oddments of surplus gold in the world markets. Thus our policy has been to relieve New York of the pressure of cheap money and additional gold which would tend otherwise to force their prices upwards. The abnormal difference between money rates in London and New York is preventing the gold standard from working even according to its own principles. According to orthodox doctrine, when prices are too high in *A* as compared with *B*, gold flows out from *A* and into *B*, thus lowering prices in *A* and *raising them in B*, so that an upward movement in *B*'s prices meets halfway the downward movement in *A*'s.

At present the policy of the Bank of England prevents this from happening. I suggest, therefore, that they should reverse

[1] In my opinion, we need not yet abandon the hope that it will take place. The tendency of American prices is upwards, rather than downwards, and it only requires a match to set alight the dormant possibilities of inflation in the United States. This possibility is the one real ground for not being too pessimistic.

this policy. Let them reduce the bank rate, and cease to restrict credit. If, as a result of this, the 'bad' American money, which is now a menace to the London money market, begins to flow back again, let us pay it off in gold or, if necessary, by using the dollar credits which the Treasury and the Bank of England have arranged in New York. It would be better to pay in gold, because it would be cheaper and because the flow of actual gold would have more effect on the American price level. If we modified the rules, which now render useless three-quarters of our stock of gold,[1] we could see with equanimity a loss of £60 million or £70 million in gold—which would make a great difference to conditions elsewhere. There is no object in paying 4½ per cent interest on floating American balances which can leave us at any moment, in order to use these balances to buy and hold idle and immobilised gold.

Gold could not flow out on this scale, unless at the same time the Bank of England was abandoning the restriction of credit and was replacing the gold by some other asset, e.g. Treasury bills. That is to say, the Bank would have to abandon the attempt to bring about the fundamental adjustments by the methods of economic pressure and the deliberate intensification of unemployment. Therefore, taken by itself, this policy might be open to the criticism that it was staking too much on the expectation of higher prices in America.

To meet this, I suggest that Mr Baldwin should face the facts frankly and sincerely, in collaboration with the trade union leaders, on the following lines.

So long as members of the Cabinet continue to pretend that the present movement to reduce wages has nothing to do with the value of money, it is natural that the working classes should take it as a concerted attack on real wages. If the Chancellor of the Exchequer is right in his view that his monetary policy has had no more to do with the case than the Gulf Stream, then it follows that the present agitations to lower wages are

[1] See the Note on our gold reserves at the end of this chapter.

simply a campaign against the standard of life of the working classes. It is only when the government have admitted the truth of the diagnosis set forth in these chapters that they are in a position to invite the collaboration of the trade union leaders on fair and reasonable terms.

As soon as the government admit that the problem is primarily a monetary one, then they can say to labour:

This is not an attack on real wages. We have raised the value of sterling 10 per cent. This means that money wages must fall 10 per cent. But it also means, when the adjustment is complete, that the cost of living will fall about 10 per cent. In this case there will have been no serious fall in real wages. Now there are two alternative ways of bringing about the reduction of money wages. One way is to apply economic pressure and to intensify unemployment by credit restriction, until wages are *forced down*. This is a hateful and disastrous way, because of its unequal effects on the stronger and on the weaker groups, and because of the economic and social waste whilst it is in progress. The other way is to effect a *uniform* reduction of wages by *agreement*, on the understanding that this shall not mean in the long run any fall in average real wages below what they were in the first quarter of this year. The practical difficulty is that money wages and the cost of living are interlocked. The cost of living cannot fall until *after* money wages have fallen. Money wages must fall *first*, in order to allow the cost of living to fall. Can we not agree, therefore, to have a uniform initial reduction of money wages throughout the whole range of employment, including government and municipal employment, of (say) 5 per cent, which reduction shall not hold good unless after an interval it has been compensated by a fall in the cost of living?

If Mr Baldwin were to make this proposal, the trade union leaders would probably ask him at once what he intended to do about money payments other than wages—rents, profits, and interest. As regards rents and profits he can reply that these are not fixed in terms of money and will therefore fall, when measured in money, step by step with prices. The worst of this reply is that rents and profits, like wages, are sticky and may not fall quick enough to help the transition as much as they should. As regards the interest on bonds, however, and particularly the interest on the national debt, he has no answer at

all. For it is of the essence of any policy to lower prices that it benefits the receivers of interest at the expense of the rest of the community; this consequence of deflation is deeply embedded in our system of money contract. On the whole, I do not see how labour's objection can be met except by the rough-and-ready expedient of levying an additional income tax of 1*s* in the £ on all income other than from employments, which should continue until real wages had recovered to their previous level.[1]

If the proposal to effect a voluntary all-round reduction of wages, whilst sound in principle, is felt to be too difficult to achieve in practice, then, for my part, I should be inclined to stake everything on an attempt to raise prices in the outside world—that is on a reversal of the present policy of the Bank of England. This, I understand from their July *Monthly Review*, is also the recommendation of the high authorities of the Midland Bank.

That there should be grave difficulties in all these suggestions is inevitable. Any plan, such as the government has adopted, for deliberately altering the value of money, must, in modern economic conditions, come up against objections of justice and expediency. They are suggestions to mitigate the harsh consequences of a mistake; but they cannot undo the mistake. They will not commend themselves to those pessimists who believe that it is the level of real wages, and not merely of money wages, which is the proper object of attack. I mention them because our present policy of deliberately intensifying unemployment by keeping a tight hold on credit, just when on other grounds it ought to be relaxed, so as to force adjustments by using the weapon of economic necessity against individuals and against particular industries, is a policy which the country would never permit if it knew what was being done.

[1] This will not prevent bondholders from gaining in the long run, if in the long run prices do not rise again. But such profits and losses to bondholders are an inevitable feature of an unstable monetary standard. Since, however, prices generally do rise in the long run, bondholders in the long run are losers, not gainers, from the system.

§A NOTE ON OUR GOLD RESERVES

On 15 July 1925, the Bank of England held nearly £162 million in gold. The active note circulation of bank notes and currency notes amounted to £387 million. Against this note circulation the law provides that £120 million must be held in gold. Thus our free stock of gold, available for export, amounts to £42 million, or about a quarter of the whole. Since we cannot run too near to the legal minimum, the amount actually available in practice is about half this—say £22 million. The £120 million which must be held to satisfy the law is absolutely useless for any other purpose.

A NOTE ON THE INCREASE IN THE VALUE OF STERLING IN TERMS OF FOREIGN MONEY

Since it is often believed that the restoration of gold only, or chiefly, affects our exchange with the United States, I give the following table of the change in the value of sterling since last June in the principal countries:

Percentage increase in the value of sterling (middle of June 1925) since June 1924

	%		%
Italy	31	Sweden	11
France	27	Brazil	9
Germany	13	Holland	5
Japan	13	China	3
United States	12	Switzerland	2
Czechoslovakia	12	India	−6
Belgium	12	Argentine	−10

The movement in the opposite direction in India and the Argentine, though it increases the buying power of these countries as customers, does not help, in this context, because they are neither of them industrial competitors. The above table shows that the exchange movements of the last year have worsened our competitive position with our chief industrial rivals by 12 per cent or more. Thus the figure of 10 per cent which I have used in the text understates the case.§