CHAPTER VI

THE CO-OPERATIVE USE OF MONEY

THE ACCUMULATION OF SAVINGS

BEFORE proceeding to the consideration of the Money Market, it is necessary to examine two organisations that are in fact departments of it. The first of these is the modern organisation of the Joint Stock system, which embodies the use of collected or subscribed money as the financial "capital" whereby economic activities are carried on.

As will be seen, the financial considerations attaching to joint-stock companies are of Titanic dimensions, and, since these huge subscriptions are in theory provided by the accumulation of "savings" from the money incomes of the individual members, a real understanding of the principle involved, and a close examination of the actual facts concerning the system, becomes of great importance to the student of financial economics.

THE JOINT-STOCK SYSTEM

A business is established usually for the supply of a particular commodity or service for which the promoter considers that there is a demand, and in the hope that ultimately the operation of supplying that

demand will result in a surplus or profit to him as the proprietor of the business.

But with the growth of the present industrial system arose the demand for organisations of a strength and stability beyond the capacity of an individual. The individual in the early days could not provide the "capital" to carry on such undertakings; that is to say, he had not sufficient money to support the activities of those engaged in carrying out the plans of the enterprise.

Therefore arose a new economic function, the supply of capital by means of subscriptions from many individuals, which, being accumulated into a joint stock or fund, became the capital for production or service.

THE INCORPORATED COMPANY

The enormous development of productive power during the last century resulted in a corresponding demand for capital to finance the various undertakings and has resulted in the present organisation of the Joint-Stock Company.

A Company, in the general meaning of the word, is an association of a number of persons who subscribe money to a joint stock, or common fund, for the purpose of employing it in a particular business, and with the intention of sharing amongst themselves the profit (or bearing proportionate shares of the loss) arising from the conduct of the enterprise.

A Company means one that is incorporated under the Statutes affecting such organisations at the time of their formation. The practice of company-formation has become so general and the importance of company interests and activities so gigantic, that the necessary laws for their regulation and control are to-day very stringent, imposing onerous obligations upon the executives who handle the subscribed capital. Every group of more than ten persons who associate for carrying on the business of banking, and every association of more than twenty persons for carrying on any other business, having for its object the acquisition of gain, must be formed under the proper regulations, and registered with the proper State authority; because, if not so formed and registered it will be in effect an illegal association, and—

(1) It cannot enter into any kind of contract;

(2) Therefore no action at law can be brought by it or against it.

LIMITED LIABILITY

An ordinary trading company is to-day incorporated by registration under the Company Acts, 1908 to 1917; and in the great majority of cases the liability of the members or subscribers is limited to the nominal or face value of their shares. Therefore, when such nominal value has been paid, (i.e., when shares are fully paid up), no further liability attaches to the subscriber, and if the enterprise meets with failure, however disastrous, he is at no further loss.

This obviously is a great inducement to the holder of capital, who has responded to the inducement in no uncertain fashion, as shown by the undernoted statistics.

Investment is further induced by the regulations attached to all companies that invite subscriptions from the public, while for the privilege of the limitation of liability companies in general must perform certain acts and conform to a discipline contained in the governing Statutes. Thus the rights of individuals within the company are stated, and at the

same time the interests are protected of all who may deal with it in the course of business.

The distinctive feature of an incorporated company is the well-known fact of its possession of a "legal personality" in addition to and entirely apart from the legal personalities of its individual members.

PROGRESS OF THE JOINT STOCK SYSTEM

At a lecture before the Secretaries Association in November, 1923, Mr. Herbert W. Jordan gave some authoritative statistics and information, and the following notes are based on his observations,—and thereby on the best available authority on the subject.

It was just over sixty years ago, in November, 1862, that the incorporation with limited liability of companies on the basis known to-day was definitely established, by the passing into law of The Companies Act, 1862.

Since that date the law governing limited companies has been developed by successive statutes, by decided cases in the lawcourts, and (although probably not finally) generally consolidated in the Act of 1908.

In the early days registration of a company was regarded as an event worthy of note. From the amounts of the capital with which the bulk of them were registered it may be inferred that the companies were of a substantial character. In 1863/65, for instance, the number of registrations totalled 2,630, and the aggregate nominal capital was £569,179,991. For 1923, the total registrations exceeded 8,000 but the aggregate capital totalled only about £107,000,000. It will be seen that eight or nine companies are now registered for each one registered sixty years ago, but that the average capital has shrunk from £216,415 to £13,107. The decline is caused on the one hand by the development of the private company, (the granting of incorporation with limited liability to small groups or families, engaged in business), and on the other hand by the increase of duty payable on the registered capital; nothing being payable in 1863 against £1 per cent. in 1920.

The progressively increasing popularity of the Joint Stock system is indicated by the following record of the number of companies registered (with the aggregate capital), in 1863 and in the last year of each succeeding decade:—

Year.	Companies Registered.	Aggregate Capital.
1863	789	£137,912,149
1873	1129	£144,869,295
1883	1588	£144,077,257
1893	2382	£84,720,628
1903	3692	£115,657,864
1913	6871	£146,752,558
1923	8005	£106,968,215

The "record" was reached in 1920, when 10,078 companies were registered in England, with a total nominal capital of £559,299,697.

COMPANIES NOW ON THE REGISTER

During the past sixty years 193,259 companies have been registered in England, with a total nominal capital of £8,790,114,115. Of these companies some 82,000 are now in active operation, their combined "paid up" (as distinct from their nominal) capital being £3,932,000,000. These figures should be regarded as approximate, though they are the result of careful calculation. More than 110,000 companies, it will be seen, (having a "paid up" capital probably in excess of £1,300,000,000), have succumbed in the

course of these sixty years. In the latter case, however, the whole of the capital cannot be said to have been "lost." A large percentage of it probably represents shares originally issued as "fully paid up," without payment, to the promoter of a company, or the vendor of a business being acquired by a company. Amalgamations, absorptions, and reconstructions also must be responsible for large amounts.

But for the student of finance the "money" concerned is the chief interest, and here it is noted that in the course of sixty years the astounding figure of £5,232,000,000 has been subscribed to a joint or common fund for the purpose of financing industry, and that at the present time individual members of the community hold the ownership of almost £4,000,000,000 which in theory is "money" being used by the joint-stock company system, and ultimately repayable by it.

SHARES AND BONDS

In the case of the joint-stock company just examined the investor buys a "share" in the operations of a commercial undertaking, and in fact the name of Share is applied to the document embodying the legal right attached thereto. And in this case, as in the majority of economic enterprises, the shareholder runs the risk of the loss of his capital. The money is supposed to be used by the company, but to be repayable at a specified date or on demand, yet pressure of circumstances may reduce the value of the undertaking to such a degree that it is impossible for the shareholder to realise his capital. Therefore his share may lose part or all of the value for which he subscribed.

But there are other forms of loan-creations to which the element of risk does not attach, and which may be included generally under the name of "bonds." These are subscriptions by individuals to a common fund raised by a public body and by certain classes of undertakings doing work of a public nature, and by Governments. These loans, which, as we have seen, are supposed to be a transfer of actual "money" from the lender to the borrower, are protected in such a way that their repayment is ensured. The borrower must, at a specified date and on stated terms, produce the "money" and repay it to the lender.

Remembering the credit-creation involved by the banking system, the loaning of large amounts of "money" again creates curious questionings. The British loans on the bond-security, that must ultimately be repaid, probably amount to £1,000,000,000, apart from borrowings of the State, which, by magnitude and importance, overshadow all other borrowings.

THE NATIONAL DEBT

The borrowings of a State are usually included in the description of "The National Debt." The Government of a country is the centralized authority of the individual citizens. The duties of a Government are the regulation of the communal life and the protection of individual and collective rights, and its actions are deemed to be the expression of the collective decision of society. Therefore it is the privilege of a citizen to pay for the benefits of government by subscribing the money necessary to carry on the work of the central authority. He subscribes by taxation; his taxes pay for the intangible benefits embodied in an ordered and disciplined community.

But occasions arise when the Government of a

country cannot obtain by taxation sufficient money to meet its expenditure. Therefore they borrow from their citizens or from foreigners, and, using the money for their present purpose, undertake to repay it after a stated period of time. War, of course, is the principal cause of State borrowings, and the recent disaster to civilization that devastated Europe is its outstanding example. Its remarkable effects are reflected in the undernoted figures.

National Debts

	1919	1918	Increase
United Kingdom	£7,882,000,000	£766,000,000	£7,066,000,000
86 Principal Countries of the World	£45,801,000,000	£6,887,100,000	£89,418,900,000

The current financial literature is inclined to talk of "inflation" and "watered" currencies, when considering the question of National Debt. In the case of Britain, for instance, the Government is blamed for its "interference" with the financial system, and its creation of an excessive amount of "money" by printing representative money in the shape of currency notes, and (under the operation of the money market) by direct borrowings. Hartley Withers, in "Bankers and Credit," seriously contends that the whole of the necessary "money" should have been found by taxation. The mentality that can seriously make such a contention is hard to understand.

But the fact is beyond controversy or recrimination. The Government owes a sum of money amounting to almost £8,000,000,000, which it is bound to repay, and, according to the theoretical conception of money now being gradually re-imposed, it is further expected to repay the sum in gold, or at least under the regulations imposed by the "Gold Standard."

THE MARKET FOR SECURITIES

It is obvious that a purely financial system of the extent of the joint stock system must require specialized organisation, and the necessity has in fact evolved a particular financial function.

In the case of a trading company there is the necessity of floatation, and collection of the required capital, and in the case of public borrowings the necessary "issue" of the loan and collection of the money. Again, remembering that joint stock companies have legal personalities apart from individual members, and that the undertaking must continue irrespective of the needs of any persons, it is obvious that a shareholder desiring to recover the money lent could not ask the company to make a refund. And even more particularly the subscriber to a public loan could not claim repayment other than in the terms stated on his bond. Therefore the investor is forced to find some other person willing to invest money and unwilling to wait until a new issue is made. The share or bond is then sold for its proper value.

These various considerations have created the company promoter, the loan-issuer, and the stock-broker, as the financial operators of securities based on subscribed money, (loans). The "market" for securities is, specifically, the Stock Exchange operated by the Stock-brokers; though, subject to special provisions, securities can be bought and sold in prescribed manner without the aid of brokers.

It has been seen, however, that industry is being carried on by means of Credit, and that because of this fact the function of Banking has been increased

beyond its proper economic utility, and its power unduly increased. It will be observed, on consideration, that the function of loan-manipulation and control has become of undue importance owing to the same cause. Industrial enterprises, in theory made necessary and brought into being by the needs of society, are subject to the control of the professional dealer in money, the promoter. Public borrowings are unduly influenced by the loan issuer.

The Stock Exchange, which, like Banking, is in itself a highly-efficient commercial organisation, that records the value of securities according to the prosperity of the undertaking as reflected in the supply for sale and demand for shares, and which facilitates transfers, is controlled by operators having the power to create entirely artificial movements in the value of securities to their own advantage.

The atmosphere tends to become entirely financial. The "money" involved becomes an actual commodity, an end in itself. As a result, the idea of service is lost; the monetary values that are but the "measure" of economic needs become more and more removed from their real position as the servants of a community applying the triumphs of science to an industrial machine, for the creation of that economic security necessary to the happiness of man.

RÉSUMÉ

If this discussion were to follow the fashion of financial writers, and ignore facts in order to justify the present disposition of responsibility and power in the financial sphere, it would be necessary to say that the investors hold securities of the monetary value of £13,000,000,000, in round figures, and that in due course this "money" that they "saved" and subscribed will be returned to them.

But the preceding notes on Banking show the absurdity of such a contention. The currency used by the investor, the company, the public body, or the state, is all carried by the banking system. The monetary wealth of the same economic units is embodied in the deposits disclosed by the banks. But the banking system, on the current monetary theory, is hopelessly insolvent; it is, in fact, merely holding an illegal and precarious balance between persons who have trusted it, and persons whom it has trusted; the balance is held only by the element of confidence, or credit, and by the active support of the Government, when necessary.

If the dealers in money do not themselves possess such a thing, (except in an artificial conception, on their own showing), how much less then may the borrowers of money (that is in fact artificial) expect to acquire the power of repayment in anything other than the same artificial creation?

And the further question arises; how was the fund of "money" created, from which the fabulous sums herein noted were made available for investment? Between 1913 and 1919, the British National Debt increased by £7,000,000,000; where did the money come from? In the same period, we know bank deposits increased by more than £1,200,000,000, so that even admitting the claim that investments are made from savings, the potential savings of the period were obviously insufficient to meet the demand for loans.

Thus, since it has been seen that the creation of currency, in theory the prerogative of the State, is controlled by the banks, the fact emerges that in some way the banks must also have created financial values sufficiently great to account for the great increases of currency available for investment. One more fact is thus added to those considerations that demand a

clear undertaking of the Money Market and the extent of its powers.

It will be interesting, also, to find out how currency "disappears" when invested, because, though the huge sums mentioned were invested *as currency,* yet so soon as this currency was converted into securities, it ceased to exist; the Banking balance sheet discloses all the currency of the nation, and it is not there.

CHAPTER VII

CREDIT INSTRUMENTS AND INTERNATIONAL EXCHANGE

EXTENSION OF THE CREDIT PRINCIPLE

THE second department of the Money Market that should be considered, so that the complete organisation may be understood properly, is the extension of the credit system embodied in the Bill of Exchange.

It has been seen that the major part of the operations of commerce are conducted on a system of perfected barter, based on credit, and operated by the banks. Currency in the shape of cheques is created by the banks, and by this means goods are bought and sold. The credit circle is complete; the vendor, the purchaser, and their respective bankers, have mutual confidence in each other.

But occasions may arise where the credit circle is broken; where, say, the vendor has confidence in the purchaser, and is willing to give him credit, but the purchaser may not hold the confidence of his banker beyond a certain point.

Then the following position arises; (1) On the one hand a person desires to buy goods, but has not the money to do so and cannot obtain a loan, (or does not wish to apply for one). He proposes to the vendor that, if the latter will trust him, the goods will find

a ready market within, say, sixty days, and out of the proceeds of the sale the purchase price can be paid at the expiration of the stated period. (2) On the other hand, the person holding the goods is willing to trust the would-be purchaser, believing that the latter would in fact sell the goods and refund the purchase price according to his promise. But the vendor, unfortunately, could not afford to wait so long; though of "good" credit, he must finance his business by a rapid and continuous turnover of money against goods, in order to meet his own liabilities.

Therefore a bridge must be built between their respective necessities, and by an extension of the credit principle the Bill of Exchange is made to meet the requirements.

THE BILL OF EXCHANGE: INLAND BILLS

The following is the legal definition contained in the Statute governing Bills of Exchange; "A Bill of Exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer." This is much clearer than many legal definitions, and, by careful reading and a judicious use of punctuation marks, it will be found to be easily interpreted and applied to the actual transactions of commerce. But it may be understood much more clearly by examining the actual transaction itself.

Continuing the negotiation of the last paragraph, there is now the position of the vendor, having good "credit" with his banker, being prepared to grant credit to a prospective purchaser who, for this particular transaction at least, cannot issue a cheque or pay in currency, unless permitted to realize upon the goods by sale.

Therefore they may agree to meet the difficulty by a bill of exchange, and the whole operation may be concisely explained as follows (Diagram No. 4) :—

THE SYSTEM OF PERFECTED BARTER
BY
INLAND BILLS OF EXCHANGE

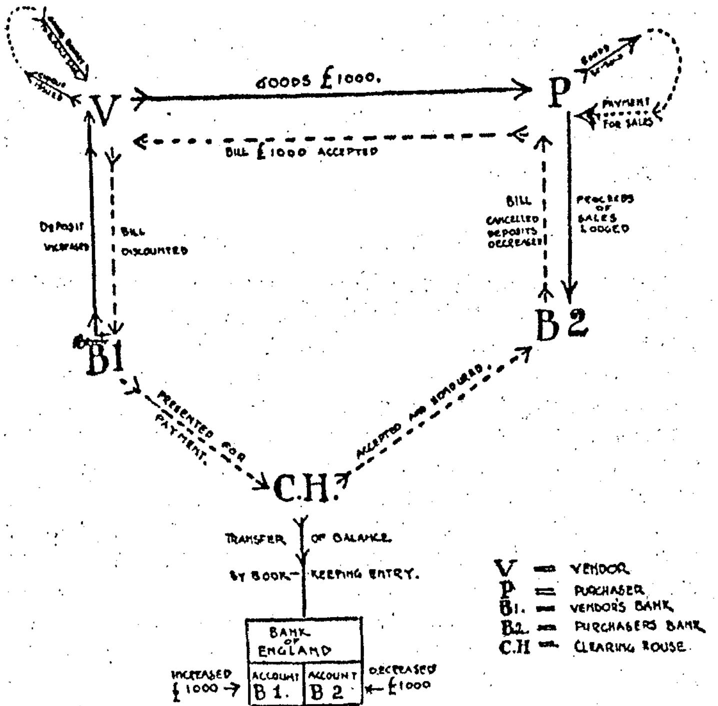


Diagram No. 4.

(1) The Vendor (V.) forwards the goods to the purchaser (P.), at the same time "drawing" a Bill of Exchange and sending it to P. for "acceptance" by signing the order specifying that P. shall pay to V. the value of the goods at the expiration of the stated time.

(2) P. receives the goods, and accepts the Bill by signing it formally, now having received, say, £1,000 in goods but given nothing but his promise to pay in sixty days.

(3) V. receives the accepted bill, which is valueless until 60 days have expired, and he has given £1,000 in goods and received nothing.

(4) Being unable to wait for this length of time, V. endorses the bill with his own signature, thereby adding his own credit to the credit of the acceptor, and making himself liable to meet the amount of the bill if the acceptor should fail to pay, (or dishonour), it on presentment at the specified date. He now lodges the endorsed bill in the ordinary way with his banker, (B1), who though he does not know and reposes no "credit" in the acceptor, nevertheless is willing to trust V. on his endorsement. Therefore B1 credits the value of the bill to V.'s account, less a percentage called discount. This operation is called "discounting" the bill, and V. has now received the value of his goods, (the discount being allowed for in the sale price), without waiting until P. should be in a position to honour his promise to pay.

(5) Meantime P. sells the goods in the ordinary course of business, by a series of separate transactions, and receives payment in some form either cash, cheque or bills, that is acceptable by his banker, (B2), with whom the proceeds of the various sales are lodged as they accrue.

(6) At the expiration of the period (plus the legal allowance of three days), the bill is

due for payment, and, as instructed on the bill, B1, who has held it since advancing its value to V., now forwards or "presents" it to B2, with whom P. has now lodged sufficient to meet the claim. B2, therefore, "pays" B1, in the ordinary banking method, through the Bankers Clearing House (C.H.) along with his paid cheques, and the bill is cancelled and returned to P., thereby extinguishing his liability.

Thus, remembering the analysis already made of the banking system, here again it is seen that money as a medium of exchange has been eliminated and replaced by a credit instrument whereon the value of the goods is defined by reference to the standard money as a measure of value.

It is mere quibbling to describe the Bill as a "medium of exchange"; to do so destroys the whole edifice of the Quantity Theory of money, and admits that the necessities of industry have evolved a more convenient "medium" based upon a credit-system that is, in fact, a system of perfected barter.

It may be said that the net result of the operation is that V. sells not to P., who has no money, but to P.'s customers, who have, the profit accruing to P. being a reward for the goodwill of his connection or market, and that therefore, though V. does not receive payment for sixty days, someone else is being paid meantime.

But the time-element must be considered; the fact that V. receives £1,000 less discount on the day of sale when his bank accepts the bill as a deposit. Therefore the bank's deposits are increased by £1,000, and V. proceeds to draw cheques upon it which are paid away and lodged elsewhere as actual money. There is also the probability that the sales of P. to

his customers may be paid for by bills, or by cheques drawn upon loans.

The actual net result is therefore that the second function of banking has been invoked by the two merchants, and currency has been created for the financing of their transaction.

Bills of Exchange are negotiable instruments; that is to say, they can be used as money for the settlement of debts, though they have not the "liberating power" of legal tender. And, though most of the inland bills, also called "internal" or "domestic" bills, in which all the parties are domiciled in the same country, are discounted with their banks by the Drawers, yet at the same time great numbers of them are endorsed and paid away as money, to settle a debt. They may thus be used as actually new currency, and if traders were well enough organised it would be quite possible for them to finance their mutual transactions by this means alone, ignoring the banks.

Again be it emphasized that it is only by convention that the creation of credit-money is vested in the banking system. The banker is entitled to levy no charge upon the community other than the proper reward for his skill and work in facilitating the exchange of goods.

FOREIGN BILLS; THE FOREIGN EXCHANGES

A foreign bill, as its name implies, is a bill drawn by a Vendor in one country, and accepted by a Purchaser in another country. There is no essential difference between it and an inland bill, excepting that it is affected by the difference in currency and in some cases by the difference in laws between the two countries.

A cheque is a bill of exchange, "drawn upon a banker and payable on demand," but it is noticeable that the cheque system rarely functions internationally. The banking system operates in all parts of the civilized world upon more or less similar lines, facing the same problems, and exercising the same monetary control in a varying degree within the respective countries. And it is therefore the banking system whereon falls most of the reaction of international trading, since such trading is financed principally on loans.

But the cheque ceases to be the medium of exchange as in the domestic trade of a country, and the Foreign bill of exchange fulfills the function of "the currency of international commerce."

In the trade between different countries, the object aimed at is the satisfaction of economic wants; the important element is the transfer of commodities. It is, in effect, a system of Barter between nations that has grown with the development of the world market, and that has been made possible by the triumphs of applied science over time and distance in the transportation both of information and goods.

Therefore, as in domestic trade, there is the system of perfected barter, whereby the transfer of commodity money (or gold) is eliminated from the transactions of individual traders, and relegated to the financial operators. In one country, it is remembered, the Banking system, using cheques as its currency, and based on the credit of the community, operates the "system of perfected barter." Internationally, the operations of the Foreign Exchanges have made the bill of exchange the international currency, and by very similar means created a "system of perfected barter" between the citizens of different nations.

By further analogy, also, it is noted that just as the function of currency-creation had been acquired by the Banks for one country, so the actual creation of international currency has come under the control, not of the trader or the merchant, but of the bill-brokers and other Exchange operators.

These operators are:—

The Bankers of each country, acting on behalf of their own nationals.
The Discount Houses, dealing exclusively in Bills of Exchange for their own circle of customers, and, in common with
The Accepting Houses, having an international sphere of activity.

Thus it is seen that again, just as the actual commodity, gold, has been eliminated as a medium of exchange so has the operation of finance become more and more detached from the actual commodity-exchange which it is designed to measure, and functions as it were for its own ends only. In other words, the credit of nations has been subordinated to the control of those holding the power of converting that "credit" into currency. An examination of the actual machinery establishes the fact.

PRACTICAL OPERATION OF THE FOREIGN EXCHANGES

(1) PRINCIPLES OF EXCHANGE

"The term Foreign Exchange refers to the system whereby debts and credits that are near together are made to settle debts and credits which are far apart."

In the case of the "internal" bill, the parties were the Purchaser, the Vendor, and their respective bankers, in which the credit-cycle was broken but mended by the Bill for the benefit of the Purchaser.

But in dealing with foreign bills, both purchaser and vendor may have good "credit" with their bankers; the credit-cycle, however, is effectually broken by the fact that the respective bankers function internally only.

Now, however, note the "barter" element in the case of the inland bill. The Vendor sent out the goods, and got an accepted bill which he lodged. He then drew cheques on the lodgment with which he may be assumed to have replenished his stock; ignoring the element of profit, he has replaced one commodity, that he sold, by another, that he bought, by means of the few "scraps of paper" mentioned and with the assistance of his banker.

But if the same Vendor has sold, say, to a Purchaser in France, it could not be assumed that he would complete the "barter" transaction internationally, by buying in France with the proceeds of his sale. Therefore the transaction of barter is completed between the two countries by the introduction of another trader who has already bought from France to an equivalent amount.

This necessity of completing the transaction by international "barter" will be discussed later; ("imports must be paid for by exports").

So there is now the example :—

In England: The Vendor (1) selling to The Purchaser (1) in France.

In England: The Purchaser (2) buying from The Vendor (2) in France.

That is to say, there are two transactions, and if we assume that in each transaction the goods are value £1,000, it is seen that each country has replaced one commodity by another of equal value, by "barter." But trade is not international; it is individual, and here the individual Vendors must be paid by the individual Purchasers.

Now as in the previous example of the inland bill the Vendor in England receives an "acceptance"

from his customer, and again he cannot wait until the customer sells the goods. Again, therefore, he discounts the bill with his bank, and uses the proceeds.

Exactly the same process is adopted by the French Vendor and his customer; in this case the bill is lodged in a French bank, and the French Vendor gets the proceeds and uses them again as the basis of further purchases.

Both vendors have now been paid for the goods they sold. Now by using the cheque system they complete the "barter" by buying other goods within their own respective countries. They are thus eliminated from the international transaction.

Until the bills mature, therefore, the English buyer owes £1,000 to a French bank, and the French buyer owes a similiar amount to an English bank. But the bankers do not trouble to collect; they sell the bills in the open market that exists in each country for dealing in foreign bills :—

(A) The English bank offers the bill, accepted by the French buyer, for sale in the Royal Exchange, London, or the Paris Bourse, and it is bought by the broker or agent of the French Bank.

(B) The French bank offers the bill, accepted by the English buyer, for sale in Paris or London, and it is bought by the broker or agent of the English bank.

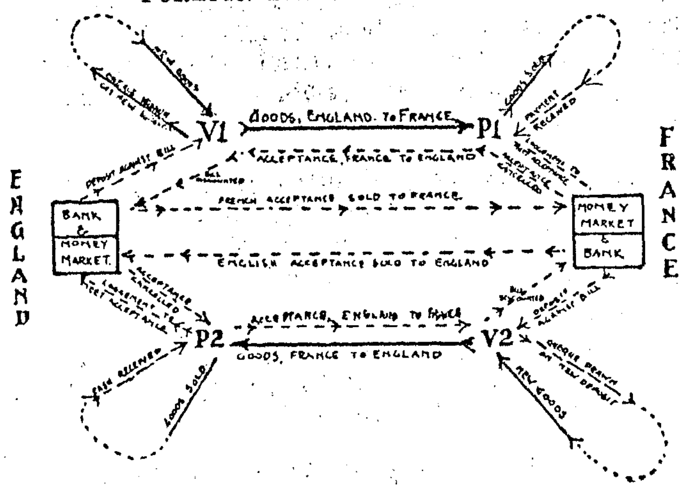
But be it noted, they do not transfer gold when buying the bills. If we assume the case to be a simple one as stated here, the purchase and sale, by a process similar to the Clearing House for cheques, is made by exchanging the bills themselves.

Therefore, still without any element other than the barter of goods, the position now arises where the French buyer owes £1,000 to the French bank, and the English buyer a similar amount to the English bank.

When the bills mature, the banks present them and receive payment by cheque or any other method that is acceptable; but usually through the banker of the person owing the money, when the operation of the Clearing House would be employed as in the case of an inland bill.

The transactions are outlined in detail in the diagram (No. 5).

THE SYSTEM OF PERFECTED BARTER
BY
FOREIGN BILLS OF EXCHANGE



V1=Vendor of Goods in England.
P1=His Customer, Purchaser of the Goods in France.
V2=Vendor of Goods in France.
P2=His Customer, Purchaser of the Goods in England.
Diagram No. 5.

(1) Goods cross the sea to balance=international barter.
(2) Each vendor buys other goods under the "cheque" system in his own country=domestic barter.
(3) Each Purchaser receives goods for "nothing" but his name, sells them and passes the money on to the Vendor or holder of bill, retaining only profit.

(2) RECONCILIATION OF CURRENCIES

In the example just quoted, for simplicity it has been assumed that the values were all expressed in British currency, and that the bills were of equal amount. The purpose of the Foreign Exchanges,—the settlement of international debts without the transfer of coin or bullion,—(that is, anything accepted in both countries as legal tender),—was therefore attained merely by the exchange of the bills in question. This is an accurate statement of the theory of the exchanges, but to attain this end in practice, with the multitudinous transactions of commerce to be dealt with, certain principles govern the operation of the exchanges that may be explained concisely under the headings of :

(A) The Mint Par of Exchange.
(B) The Course (or Rate) of Exchange.
(C) Specie Point.

and in dealing with these the actual metallic basis of currency is assumed. The principal nations base their currency on gold, according to the generally-accepted theory, and it is this basis upon which international exchange between them is based. But as in the case of the "system of perfected barter" within one country, it is observed that gold is equally absent from the individual transactions of foreign trade and that its transfer, where made, is relegated to financial operations by a process analogous to the Clearing House system of dealing with cheques.

(A) The Mint Par of Exchange. Theoretically, the exchange of goods between gold-standard countries is paid for by gold. The exchange is gold for goods; goods for gold. Therefore by the bill system, when the transfer of gold is avoided, the transaction of barter is goods for goods, based on the value of gold accepted by both countries. For the financial operator, therefore, (who does not deal in goods), the values of the Foreign Exchanges are assumed to be gold against gold.

But the currencies of the two countries (say, England and France) are expressed in a different form and furthermore gold is used differently in their standard coins. Therefore since it is by the coinage denominations that price is stated in each country, a reconciliation must be made to express the difference.

In the theory "gold for gold" cannot be exchanged between the two coinages, since gold must be measured by weight, upon which it is valued. Therefore the problem is to express the unit of one country, in an ascertained portion of the foreign currency that will contain exactly the same weight of pure gold (technically called "fine" gold). The proportion of fine gold in coins is called the "caratage," since alloy must always be added to the pure metal for use as a "medium of exchange." The caratage is fixed by the currency laws of a nation, and as between England and France we have the particulars :—

(1) That the proportion of fine gold in English Currency is 11 parts out of 12.

(2) That the proportion of fine gold in French Currency is 9 out of 10.

(3) That one sovereign weighs 7.98805grs. (being 11/12 fine).

(4) That 900 grammes "fine" gold is made into 3,100 francs;—it is therefore easy to find how many francs contain exactly the same weight of gold as one sovereign,—

The result being $\dfrac{7.98805 \times 11 \times 3100}{12 \times 900} = 25.2215$ francs.

Therefore the "Mint Par of Exchange" between England and France is 25.2215 francs to one sovereign, (or the converse thereof). If all exchanges therefore were at Par, that is transfers of value for value, in goods, or weight for weight of gold, from the financial standpoint the values in either would be easily determined :—

Francs to be expressed in sovereigns = Number of francs ÷ 25.2215. Sovereigns to be expressed in francs = Number of Sovereigns × 25.2215.

Thus it is seen that the international currency of the world market, like the theoretical foundation of banking, is gold, but that similarly it is used as a "measure of value" only, as in the Mint Par of Exchange, while practical transactions are carried out by Bills of Exchange based on non-existent gold and controlled absolutely by the financial operators of the Money Market.

(B) The Course (or Rate) of Exchange. The Bills of Exchange drawn and accepted by merchants are, as we have seen, generally discounted with their bankers or with special "discount" houses dealing exclusively with bills. They are then a measure of the exchange of goods between the countries; they measure the volume of trade. On or before maturity, as in the example, the bills are bought and sold by the bankers and other financial operators, to whom they have become a "commodity." The element of goods, in the trading sense, has then been eliminated and in the Money Market the bills themselves have become commodities or "goods."

Therefore they are subject to fluctuations of price owing to the ratio between supply and demand, that is to say, between the number and value of bills due to be paid by Purchasers of goods (debtors) in one country, compared with the corresponding value due to be paid from the other country.

If English purchasers have imported goods value £10,000,000 from France, and accepted bills for them, then the French vendors have discounted this value of bills with French banks or brokers, and in due course the latter will require to sell them to those desiring to meet the debts due to English vendors, who have sold goods to purchasers in France. In the latter case, the bills would be discounted, but if the value of the goods sold were only £5,000,000 then obviously the balance of debts to be paid favours France.

On this basis, obviously, there will be a number of merchants or financiers in England who must either find bills payable in France or be prepared to remit gold in settlement of their debts. Therefore since only £5,000,000 of such bills will be offered, the demand (to satisfy £10,000,000) will exceed the supply and the would-be buyers will be willing to pay a premium to avoid the trouble and expense of sending gold. Accordingly more is offered (in pounds sterling) for the bill on France than the Mint Par of Exchange would justify.

In other words, owing to the excess of Imports over Exports, the Rate of Exchange moves in favour of France because the debts represented thereby become a "commodity" in the Money Market, and the demand for the purchase of French debts exceeds the supply.

It is obvious that such fluctuations may be considerable even as an expression of the Balance of Trade between countries. Therefore, leaving out of consideration the problem of depreciated currencies, in ordinary commercial transactions there is a point at which the buyer of bills will find it cheaper to remit gold. This is called "Specie Point."

(C) Specie Point. This is the rate of exchange at which it becomes cheaper to remit gold than to buy bills, when the "premium" on the latter above the Mint Par becomes excessive. If the supply of bills is much less than the demand, the price may rise to a premium equal to the cost of transmitting the actual money.

This is obviously equally true with a falling rate of exchange; there is thus an outgoing or export specie point, and one favouring the incoming or import of gold. To find the export gold point the cost of freight, insurance, packing, and other charges are deducted from the mint par of exchange, and to find the import gold point these expenses must be added to the mint par.

EXCHANGE OPERATORS

The operation and control of foreign exchange transactions lies with the bankers, bill-brokers, discount-houses, and bullion brokers.

The activities of the Bankers have been made sufficiently clear. In general, they discount bills for the benefit of their customers, to whom an increased deposit is granted, with the ability to issue cheque-currency to an equivalent amount. This from the trading point of view is the "system of perfected barter" applied to foreign trade, and is the proper function of the foreign exchanges. The holder of the bill endorses it when presenting it for discount, thereby adding his "credit" to that of the acceptor.

Similarly, when selling the bill the banker endorses it, and adds his further credit to it, and it is apparent that in the actual Exchange Market an endorsement or acceptance by the banker is of most credit-value.

London foreign exchange business is operated from the Royal Exchange, London, although it could be transacted elsewhere. Here the "exchange" brokers who acted as agents for the dealers in foreign exchange, such as the bankers, were wont to meet for the purchase and sale of foreign bills, and upon the prices ruling at their bi-weekly meeting the "course of Exchange" was based.

But the post-war period has seen a remarkable development of their activities and the leading exchange brokers now confine themselves entirely to working between the various exchange dealers, acting from their own offices, and mainly by telephone. There is practically no business done between exchange dealers without the intermediary of a broker, who therefore occupies a position analogous to the stock-broker in the joint-stock system. This development led at the end of 1920 to the abolishing of those bi-weekly meetings that had been held between dealers for generations on 'Change.

The discount houses are a group of joint-stock companies and private firms, functioning as bill-brokers, who deal particularly in the buying and selling of bills of exchange, and for this purpose use money very largely borrowed from the banks. They are in fact operators of the financial credit created by the banks, using the bill of exchange as their credit instrument. They deal with bills of exchange as a commodity, and have an international connection. Though performing a banking function, in one way their activities tend to increase the amount of credit-money in use as currency and to remove currency creation ever further from the control of the economic

organisation of man, as producer and consumer, that it was designed to serve.

The bullion-broker, as his name implies, is the person who attends to the delicate business of transferring gold from one country to another, usually acting as agent for the bankers, when they decide to remit gold to avoid an adverse rate of exchange.

ACCEPTANCES FOR HONOUR OR ACCOMMODATION

The Bill of Exchange has been shown to be the method of "mending" a broken credit-cycle, so that a commercial operation could be made possible, and the financial weakness of one of the parties counteracted.

But as the banks have the power of creating cheque currency or banker's money merely by using the credit-system, so in a similar manner the exchange operators can create new currency in the shape of credit-instruments, to finance either domestic or international transactions.

It has been noted that when the holders of Bills of Exchange (the Bankers or discount houses who have given the original holder "credit" for them by discounting), wish to realize upon a foreign bill, they "sell" it to a broker acting for some other exchange dealer who is anxious to buy. In such a connection, also, it is obviously the banker's or other dealer's endorsement that renders the bill saleable; the purchaser would not know anything about the credit of the mercantile parties to it.

Similarly, it is obvious that when a bank guarantees payment by "accepting" a bill itself, such a bill is regarded by all purchasers as even more preferable than a good mercantile bill. A bank may be prepared to "trust" an international trader, whose "acceptance" on a bill might not, for some reason, be regarded as sound. Therefore the bank permits the trader to draw a bill upon it which it accepts, and with this acceptance the bill becomes good in the eyes of all financial operators, and the holder is able to realise upon it by discounting, or by giving it in exchange for a consignment of goods, trusting that by selling the latter sufficient " money " of some kind will be accumulated to meet the bill when it becomes due.

This amounts to an actual creation of credit-money, and by such means the bill of exchange becomes the currency of international commerce. So important has such a function become, from the financial point of view, that a group of private financial firms of high standing amongst money-operators, are now engaged in the business of bill-creation as their principal if not their sole activity. Acting in the same way as the banks, and knowing that their acceptance on a bill would not be disputed in any of the world's money-markets, they are thus, by accepting bills used in commercial payments or for financial accommodation all over the world, in a sense creators of credit and currency so long as their paper is readily taken and discounted.

While many of these bills are drawn against goods or securities (or gold) actually in existence and often in immediate transit from one country to another, many others (called finance bills) are drawn in anticipation of future transactions, or merely against the credit of the drawer and acceptor.

RÉSUMÉ

On a review of the question of Bills of Exchange, it may be stated shortly that in domestic trade the bill system is an extension of the cheque or credit-money system, with particular applications necessary where the " credit-cycle " is broken. By the assistance of the inland bill it is therefore possible to delay payment for goods until they have been re-sold, while at the same time the seller is not forced to wait for his money. The bank acts as the good fairy, and increases its volume of credit-money by accepting the bill as currency, and adding it to the deposits of the vendor.

But in foreign trade, the credit-cycle between traders is replaced by a financial circle, by means of the exchange operators in each country, and the Bill of Exchange replaces the cheque as the currency of commerce.

Also, it has been observed that a transfer of gold, at the specie point, is a normal operation of the foreign exchanges. Therefore a country with a favourable exchange is in a position where it is able to increase the stock of gold whereon the financial system within the principal countries is supposed to be based, and, as will be explained in the next chapter, an increase of gold means an increase of credit-money to a much greater extent.

Therefore the importance of a favourable exchange to one country becomes exaggerated enormously, and a favourable balance of trade becomes an ideal to be attained at all costs.

In a word, the foreign trade of a country comes to be regarded as the most important department of its industry; yet, since the monetary problems of all modern countries are similar, a favourable exchange in one country must be balanced by an unfavourable exchange elsewhere, and unless the latter country can continue to " create " and export gold, something about the system must go wrong.

But nothing does go wrong, for this favourable exchange, or balance of trade conception, is that by which most advantage accrues to the financial operators. And since the whole financial apparatus of bills, bill-creation, gold-control, and gold-transport, is worked by the money market, it is obvious that all incidental effects of the system are also under their control.

Some remarkable results follow this financial interpretation of foreign trade,—remarkable, that is, to the business man seeking to know the cause of disastrous trade-cycles and exchange movements. One or two examples, with comments, will suffice; the quotations are from Professor Franklin, writing on "Foreign Exchanges."

(1) "That State interference with the natural movements of exchange, excepting for a limited period and with success practically assured, is a mistake and likely to lead to disastrous results." The expression "natural" movement is emphasized while the net result of this statement is that the foreign exchanges are said to be beyond the capacity of Government, and, since the exchanges are controlled absolutely by financial operators, the latter are seeking to establish a function higher than that of the Governments of the world.

(2) "That, to a creditor country, especially one which depends for its prosperity to a large extent on its import trade, a favourable exchange is a distinct disadvantage, which can only be overcome if the nationals of that country are willing to invest a substantial proportion of the value of their exports in those foreign countries which buy their goods." This is surely a triumph of absurdity for any system, that implies the sale of goods but the fear of accepting "money" for them, lest the system becomes disgraced. Thus a British exporter of textiles to India must "invest" the value of

his goods in that country; the capital thus acquired is promptly used by the native to buy textile machinery, and in due course the "export market" becomes self-supporting and itself capable of export. This tendency in Anglo-Indian trade, and in international trading generally is so constant and outstanding that comment is needless. The point to be emphasized is, that a favourable exchange, being in theory greatly to the advantages of the actual dealers in economic utilities, has become a thing to be avoided because it will adversely affect the money-system that controls production. Good has indeed become an evil. (Mr. Hoover, American Secretary of Commerce, has recently stated: "I believe that we have to-day an equipment and a skill in production that yield us a surplus of commodities FOR EXPORT beyond any compensation we can usefully take by way of IMPORTS. . . . The only REMEDY is the systematic, permanent investment of our surplus production in reproductive work abroad, reducing the return we must receive to INTEREST and PROFITS.").

(3) "On the other hand, manufacturing countries whose exchanges have depreciated heavily and rapidly are in a very favourable position to compete in foreign markets." Therefore, it is presumed a country should suffer the sorrows incidental to a heavy and rapid depreciation of exchange in order that it may gain a "favourable" position for competing in foreign markets. But the fact of competing on such terms must be an increase of exports, a favourable balance of trade, and the loss of the "favourable" position of depreciation.

Must the adverse exchange be acquired by artificial means, as Germany has done in post-war years? It seems rather that the whole organisation of international exchange is artificial, and if that be so, further examination of those who control that organisation is justified.

The preceding chapter, and the present one, exemplify the absolute necessity of examining those expressions which normally bestrew a discussion of the Money Market in great profusion. The labour of clearing the ground has now made a concise explanation possible, and the presentment of a picture, as it were, in acute focus, and thereby an appreciation of the eternal dominance of the economic system by an artificial and grotesque creation is made possible.

CHAPTER VIII

THE MONEY MARKET

PRELIMINARY

DURING the course of this discussion, though the point of view taken of money and monetary functions has been that of the new economic analysis discussed later, it has been sought to express accurately the generally-accepted "orthodox" opinions of financial economists, using, where necessary, their own words.

And in this brief outline of the Money Market, treated as a whole, of which the component parts have already been examined, it is well to obtain an understanding of the orthodox view as stated by an eminent writer.

That view is the one already referred to herein; that the Money Market has become the "natural" and "only" controller of national production as dependent on finance, and of money-creation; that it is above Governments and is in itself entitled to abrogate the functions of Government.

Mr. Hartley Withers, in "Bankers and Credit," on page 1 notes Sir Robert Horne as quoting Compte's belief that in a well-governed community all political power should be wielded by bankers; incidentally, the book seems to have been written in this belief.

On page 2 he states "there can be no doubt that political rulers have lately shown amazing capacity for creating chaos in the world of banking. Under the stress of war they seized and warped for their own purposes the banking and currency system. . . ." Note the phrase, "for their own purposes," as applied to a Government acting on behalf of the nation wherein the banks function.

On page 5; "They did so because they found, in the Money Market's almost unlimited power to create credit, the easiest and most popular way of getting money that was wanted for the war."

On page 18; "Thus in the three generations before the war the bankers had taken the manufacture of money, in the widest sense of the term, out of the hands of the Government into their own. . . ."

The implications of these statements are obvious, yet very startling; and that they represent the accepted opinions of the financial community and economists will be immediately demonstrated.

PRESENT FUNCTION

The Money Market, then, is a general term applied to several distinct commercial organisations, already examined, that function collectively as the operators of the modern interpretation of the Financial System.

The economic subordination of Finance, as a measure of value, was the starting-point of this investigation, but it must now be noted that in following the course of the system to its most modern conception, a direction has been imposed leading away from the original definition towards a point where the subordinate function, though still performed efficiently, is superseded by an elaborate machinery wherein the element of "goods" or economic necessities has been lost. The Financial System has become a law unto itself, operated by

men infinitely removed from the needs of the economic man.

Their operations may be summarised.

(1) *The System of Perfected Barter.* The Money Market, as a purely commercial organisation, operates the "financial" or "measuring" or "Book-keeping" side of "the system of perfected barter." This in itself is a national and international organisation of the highest efficiency, comparable to the detailed achievements of scientific industry, of which it is the necessary complement. The conduct of trade without any "medium of exchange" other than paper authorities addressed by merchants to their financial "servants," first to banking for domestic trade, and then to Foreign Exchange operators for international transactions, has already been examined in some detail.

(2) *The Control of the World's Gold.* As already explained, to carry on the system of perfected barter all the gold that is the theoretical basis of currency must run within the banking system of one country, or by points of contact between different banking systems for international commerce. Therefore the merchants who carry on the world's work never see the gold. It would be a nuisance to them. Accordingly, the gold of the world is operated exclusively by the Money Markets of each country, reacting upon each other, and is controlled absolutely by them.

(3) *The Creation of Credit-Currency.* But the supply of gold is entirely inadequate to cover even a small fraction of the economic activities of the world market. Therefore the function of the Money Market has been elaborated to include the monetisation of the mutual confidence upon which industry is based, and practically all the currency now used is banker's token money created by the Money Market.

PENALISING POWER IMPLIED BY FUNCTIONS

This control and creation of currency is in theory the prerogative of Governments, and the formal details respecting coinage, and the larger questions of legal tender, etc., are in fact controlled by them. Therefore, when the fundamental power of creation and control is handed over by "a convenient convention" to the money market, it would seem that the operators of the latter would be willing to pay heavily for the privilege, amounting to a monopoly of the life-blood of commerce.

But they do not pay. Rather do they exercise their power by the imposition of penalties, the only method, it is to be feared, by which even this age of miracles has learned to appreciate the incidence of power.

In return, therefore, for their favour in creating the credit-currency by which commerce is carried on, the Money Market has imposed certain conditions upon the economic system. These conditions are said to be the natural evolution of the system; that remains to be seen. The conditions, then, are as follows:—

(1) *Economic Domination by the Gold Standard.* The quantity of gold in existence is not capable of carrying the burden of world trade. Therefore the creation of credit-currency is imperative, and is the monopoly of the Money Market. But the Money Market refuses to abandon the theoretical gold basis of money, and they therefore create an entirely fictitious and artificial standard, whereby they measure the issue of credit-currency upon their own estimate of a "safe" ratio between the total amount of credit-currency in circulation and the total value of gold in their possession. Thus, the creation of currency no longer depends upon the inventive genius of man, nor upon his ever-increasing conquest of natural "wealth," nor even upon his direful necessity.

It is based instead upon the quantity of a metal that is under the absolute control of the Money Market, and, though the fallacy was conclusively exposed by the world war, this disastrous imposition is now re-advocated by all the overwhelming strength of the financial operators. The practical application of the standard is explained hereunder, (Chapter IX).

(2) *Credit-currency becomes a Debt to the Money Market.* The function of the Money Market of creating credit-currency, in itself a useful one, is carried to the logical conclusion of the word "creation." Credit-money created by the Money Market implies ownership by it. The need of an expanding currency should normally be a sign of progress, the evidence of an increasing population, a higher standard of living, and a more efficient means of supplying economic needs. In such circumstances currency created by a government should be issued, even under the Quantity Theory, so that an increased number of tokens or measures of value should be available to "balance" the increased supply of commodities. Such new currency obviously should become the property of the community, as consumers. But in the case of the credit-currency issued by the Money Market a tag of ownership is already attached; it is already allotted to the ownership of those financial operators who are an infinitesimal fraction of the community. Therefore such currency, when issued, must be returned to them at their demand. To this statement the answer is usually made that banks lend the "money" of their depositors. The absurdity of that statement has been demonstrated in the chapter on Banking, while it will be shown hereunder that the cancellation of a loan is usually achieved, in a continually-expanding industrial system, by the granting of another and larger "value" of credit-currency.

(3) *Subordination of Government Credit.* The most

astounding result of the present monetary system is the fact that Governments, representing the "credit" based upon the whole wealth of their nation, are now required to subordinate that credit to the power of creating credit-currency that they have allowed to become the monopoly of the Money Market. Therefore the spectacle is seen of a Government pledging the credit of its nation with a bank, so that it may be allowed to use "money" the creation of which is its own prerogative, and receiving, in fact, a fictitious substitute for money based upon the "financial" credit of the Money Market. Also in war and post-war years currency actually issued on Government credit, (as Treasury Notes), has not been paid away directly by the Government, but has been issued via the banking system, and, being legal tender and regarded as the equivalent of gold, has by means of the credit-currency based thereon *become a debt due to be repaid to the Money Market.*

(4) *Control of Consumption by Prices.* In a later chapter it will be demonstrated that the rigid imposition of the foregoing conditions requires a particular method of price-fixing to meet them, and implies a control of the community's "effective demand" by the Money Market. The flaw in the price system created by the second condition, above, will also be explained.

It is natural that a series of deliberate statements should raise questions in the mind of the reader, and again the necessity of a clear understanding of general terms becomes apparent. Accordingly concise answers will be made to the obvious queries;—What is the precise composition of the Money Market?; How does the Gold Standard work?; How does the Money Market create money?; and How does it subordinate State Credit?

PRACTICAL OPERATORS

The Money Market in its widest interpretation is composed of all those persons who operate the complete machinery for the manipulation of existing currency and of representative money standing in the name of individuals, and who further hold a monopoly of the Financial Credit carrying the power of creating such currency as required.

Therefore in its widest sense the Money Market is composed of :—

(1) The Banking System.
(2) The Accepting Houses.
(3) The Discount-Houses;
(4) The Bill-brokers;—which between them operate the system of perfected barter, with the cheque and inland bill of exchange as the currency of domestic trade, and the Foreign Bill of Exchange as the currency of international commerce.

(5) The Bullion Brokers; who perform their special function of the buying, selling and transporting of gold under the operation of the gold standard, and who therefore work in a subordinate capacity for the assistance of the first three.

(6) Company Promoters;
(7) Loan Issuers;
(8) The Stock Exchange—who deal with currency already in existence and available for use; that is to say, they collect money saved by the public, or borrowed by the public from bankers, and hand it over to the Governments, municipalities, or industrial and commercial users, to be used by official borrowers for works of public utility or for armaments, both offensive and defensive, and by the industrialists in widening the basis of production and facilitating the distribution of ultimate or consumable commodities.

The activities of the last five members of this monetary association have already been examined briefly. Their function is well understood; they perform definite duties connected with a material (credit-currency), already at their hands; the last three transfer surpluses of capital to the points of deficiency, and thereby tend to equalize the potentialities of further production. In their operation of the system of perfected barter, also, the three principal organisations are usually well understood.

But in this general conception all these operators would appear to work within an all-embracing system, and to react, as it were, to a superior force. Therefore, considering that the whole financial edifice is based upon the use of Credit as money in exchange, it is apparent that the enveloping system is that constructed by the directors of monetary policy; in short, by those holding the monopoly of financial credit, and the power of currency-creation attached thereto.

And it might be said, in common with all experience showing that power tends to become autocratic or the rule of minorities, the fact emerges that the control of Financial Credit is highly centralised within the wider interpretation of the Money Market.

It is this narrower conception, and its creative and controlling power, that must be examined now for the better understanding of the foregoing statements.

"The Money Market, in its strict and narrower sense, not only collects money, but creates and expands its supply." (H. Withers.)

In England before the war it had reached its highest point of operating efficiency and actual power, and it worked under the control of the first three members of the foregoing list:—

(1) *The Banking System.* A ring of banks with the Bank of England at their centre. These banks operated the paper tokens whereby the system of perfected barter worked, through the medium of their widely flung network of branches, all centralized and controlled by the Clearing House system, which used the Bank of England as the actual centre of the organisation. By the same means, also, the credit-money created by the banks and the Bank of England was made fluid, and contracted or expanded at will. Thus the dual rôle of currency-creation and its control by means of the Gold Standard theory was embodied in a compact organisation that may be examined concisely;

(2) *The Accepting Houses.* A group of private firms of high standing who performed the important function of creating bills of exchange upon their own credit, thus inflating the currency of international commerce;

(3) *The Discount Houses and Bill-brokers.* A group of joint-stock companies and private firms, who specialized in buying and selling Bills of Exchange, using for this purpose money largely borrowed from the banks.

THE BANKERS' CLEARING HOUSE SYSTEM

The Clearing House System makes possible the control of the overwhelming number of transactions of the industrial system, and reduces banking operations to a point of great efficiency.

When a trader "draws" a cheque in favour of his creditor, he uses it to pay for the goods or services received; it is the "medium of exchange." But, as shown in the chapter on Banking, a cheque does not carry the liberating power of legal tender; the cheque must be "honoured" before the liability of the drawer is extinguished. Therefore the cheque is in effect an authority to the creditor, whereby he is informed that the drawer has so much money, (in theory, so much gold), at his bank, which will be paid to the creditor on demand.

But the creditor probably lives at some distance from the debtor sending him a cheque. Therefore the creditor "lodges" the cheque with his own bankers. It should be noted that the lodging of a cheque is in effect the "discounting" of a Bill of Exchange, which the banker performs without charging discount. It should also be observed that from the point of view of the two merchants, both banks, however distant, are merely branches of the same monetary organisation.

Therefore when the creditor lodges the cheque, his action may be interpreted as an intimation to the bank that the Drawer of the cheque owns a stated portion of the "stream of gold" within the banking system, to which all branches have equal and immediate access, and further that the cheque authorizes the receiving bank to allocate the stated value of gold to the creditor's use.

Tens of thousands of cheques pass through the banking system daily and banks thus become mutually indebted to one another. Therefore, instead of closing the individual items, as would appear necessary, by presenting each cheque to the bank upon which it is drawn, and demanding gold, all the cheques held by one bank against each of the others are listed, lodged with the Clearing House, and set against similar lists lodged by the other banks of cheques due to them.

Thus if Bank A. holds 1,000 cheques of £1 each, drawn upon Bank B., and similar numbers drawn

upon Banks C., D., and E., these cheques would be lodged with the Clearing House as 4,000 cheques, value £4,000, due to BANK A. by the others. Then, from the similar lists lodged by the other banks, it might appear that 1,005 cheques of £1 each, drawn upon Bank A., were held by Banks B., C., D., and E. Thus the total due by Bank A. would be 4,020 cheques, value £4,020, which is £20 more than the amount due to it, consisting of a balance of £5 due to each of the other banks.

All the banks, finally, are required to keep an account with the Bank of England as the centre of the system, which thus becomes the "bankers' bank." All the gold owned by the other banks, except that amount actually required for currency purposes, must be kept in their Bank of England account. Therefore, in the example given, the balances that in theory must be paid in gold to each of the Banks B., C., D., and E., are in practice settled by the representative of Bank A., in the Clearing House, issuing an authority to the Bank of England to make the necessary transfers in the accounts kept there.

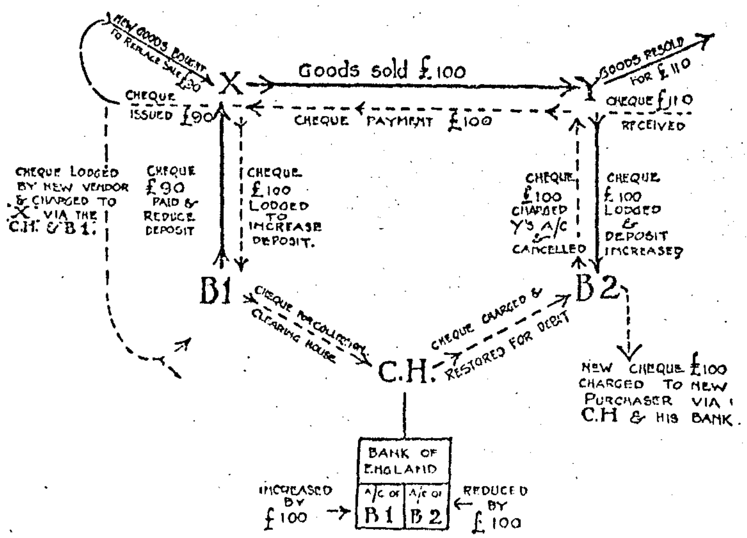
When the account of Bank A. has been reduced by a debit of £20 and the accounts of Banks B., C., D., and E., have been increased by credit entries of £5 each, the whole of the transactions covered by 8,020 cheques, value £8,020, have been completed within the banking system by a series of book-keeping entries.

To trace the operation by diagram as it affects one transaction only, displays the operation of the system of perfected barter, when the credit instrument becomes the medium of exchange, and the collective operation of the system emphasizes the complete replacement of "money" by credit.

THE SYSTEM OF PERFECTED BARTER

THE BANKERS' CLEARING HOUSE SYSTEM

INDIVIDUAL TRANSACTION



X = Vendor of Goods value £100, receives Y's cheque and lodges with Bank—B1.

Y = Purchaser of Goods value £100, paying for them by cheque drawn on Bank—B2.

X replaces Goods by purchasing others for cheque £90.

Y replaces purchase price by re-selling Goods for cheque £110.

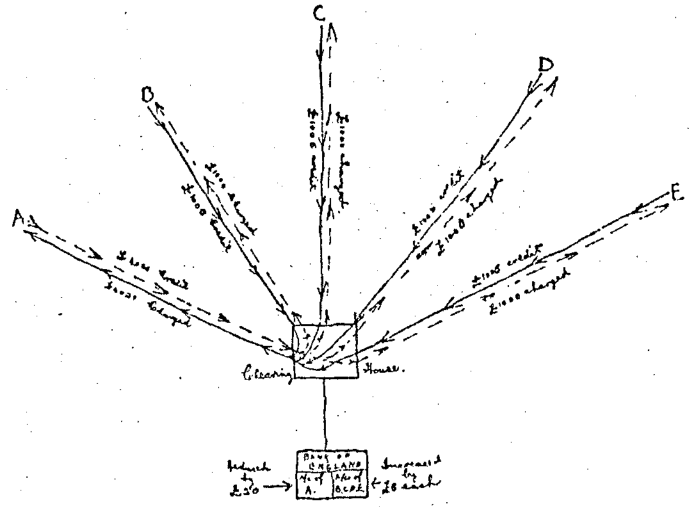
Diagram No. 6.

THE SYSTEM OF PERFECTED BARTER

THE BANKERS' CLEARING HOUSE SYSTEM

COLLECTIVE TRANSACTIONS

BANK A. IN ACCOUNT WITH BANKS B., C., D., AND E.



(1) 4000 cheques of £1 each due *to* Bank A, from B. C. D. & E., 1000 each = £4000.

(2) 4020 cheques of £1 each due *by* Bank A, to B. C. D. & E., 1005 each = £4020.

Diagram No. 7.

CURRENCY-CREATION BY THE BANKS

In the foregoing exposition of the method by which the cheque system is used as currency, it must be remembered that in theory every item of representative money is convertible on demand into legal-tender cash. Every person who receives a cheque is entitled to demand gold or Bank of England notes. Even the Bank of England note represents gold, since their issue is governed by the Bank Charter Act of

1844. Under this Act, the Bank of England is entitled to issue £18,450,000 in notes against the security of the Government, but beyond this amount every note issued has to be covered by the Bank holding of gold. Each note put into circulation, therefore, "represents" gold. (The present issue of Currency Notes is dealt with later.)

This is the theoretical gold basis. But it is quite obvious that, so long as the "credit" basis of commercial transactions remained unbroken, the operation of the cheque system, through the Clearing House, could continue even if gold were entirely absent. In the operation of the cheque system within one country, no gold need be transferred at all. The only point in the monetary organisation where gold is actually moved is the operation of the "specie point" in settling international debts. But even this, as has been shown, is not performed by the merchants concerned but by the financial operators who move the gold for their own profit.

And as explained in the chapter on Banking, the element of gold is usually absent; on a gold basis the banking system is insolvent and by no means could it become solvent, if solvency means the ability to meet the legal demand of every currency-holder for gold.

The only consideration, therefore, necessary to the understanding of currency-creation by the banks, is the question—"How is the issue of cheques by private business increased in total volume, without a corresponding increase in gold, the legal basis?" The means adopted to achieve the increase may be summarized briefly. They are:—

(1) The Bank of England, Issue Department.
(2) The Bank of England, Banking Department.
(3) The Joint Stock Banks, who have accounts with the Bank of England.

(1) The Bank of England, Issue Department. The Issue Department is the repository of the gold reserve against which the Bank of England notes are issued. This represents the Gold Reserve of the whole monetary organisation of the country, and is regulated by the terms of the Bank Charter Act of 1844. By this Act, as already stated, the Bank is permitted to issue notes up to the value of £18,450,000 against securities, but beyond that gold must be held for each note issued. The Bank is required to publish a weekly account of both the Issue and Banking Departments, and a typical example is appended:—

Bank of England

Account for Week ending Wednesday, July 15th, 1914
Issue Department

Notes Issued	- 56,908,285	Government Debt	11,015,100
		Other Securities -	7,434,900
		Gold Coin and Bullion -	- 38,458,285
	£56,908,285		£56,908,285

The power of increasing legal tender currency was thus circumscribed, and made to depend upon the gold reserve held by the Bank of England. And, though the Bank Charter Act was suspended immediately the banking crisis occurred at the outbreak of war, the Bank did not in fact increase its fiduciary issue at any time after the first few days of disturbance. Thus, though controlled in theory by Statute the gold that is the basis of the country's monetary system is operated by the banking system.

(2) and (3) The Bank of England, Banking Department, and the Joint Stock Banks.

It must here be noted that though the Issue Department is controlled by the Bank Charter Act, the Banking Department is free from any restriction and therein credit may be created to any extent, in common with the Joint Stock Banks.

The essential facts are :—

(A) That the notes from the Issue Department, representing gold, are transferred to the Banking Department.
(B) That they are held in the Banking Department to meet demands for legal tender currency and to "represent" the accounts that the Joint Stock banks keep with the Bank of England as the centre of the Clearing House System and the repository of the Gold Reserve.
(C) Thus, though the Banking Department conducts the ordinary business of banking, it has the special feature of holding the accounts of the other banks and of the Government.
(D) Finally the other banks regard the balance of their account with the Bank of England as representing their holding of gold and include it in their Balance Sheet as "Cash on hand and at the Bank of England."

Now here at the centre of the system it would seem that the gold basis of banking must be honoured. But this is not the case. The Bank of England could not without breaking the law expand its note issue without an equivalent expansion in its holding of gold, but in the Banking Department it could "create credit" to any extent, the only restriction being its own judgment.

This judgment is exercised by the Bank of England

and the Joint Banks in common, on the question as to the safety limit to which they can re-loan deposits, or create deposits by loan; in other words, as to how much legal tender they must actually hold to meet all probable demands, from those to whom they are indebted by deposit or otherwise and assuming the banking business of the country to be carried on by the mutual "credit" of merchants, using cheques for most of their transactions.

As a result of experience the bankers have concluded that it is necessary to maintain in the form of "cash" a reserve of only 11 or 12 per cent. of their liabilities on deposit, current and other accounts and that, therefore, all their assets above that figure are available for re-issue for profit-earning. This figure of 11 or 12 per cent. is obtained by consolidating the items for those banks which are members of the Clearing House. It rises as high as 15% for one bank, and occasionally falls as low as 7% for another, but it is wonderfully steady for each as well as for all taken together.

Note, therefore, that the net result of this convention, and the exercise of this banker's prudence, is the fact that an increase of, say, £1,000,000 in "legal tender," or, in the case of the Joint Stock banks in "Cash at Bank of England" can be made the basis of loans amounting to nine or ten millions sterling, which appear in due course as an increase in deposits upon which cheques (or credit-currency) may be issued.

The operation may be understood best by examining the actual Balance Sheets—first column showing the pre-war figures—and the second column the figures of 1916, when the process of inflation owing to war conditions had been in operation.

BANK OF ENGLAND

Banking Department

(in millions of pounds sterling)

	1st July, 1914.	27th Dec., 1916.		1st July, 1914.	27th Dec., 1916.
Capital -	- 14½	14½	Government Securities	- 11	57
Rest -	- 8¼	8¼	Other Securities	- 49½	106½
Public Deposits	- 17½	52	Reserve (Bank of England Notes, Gold and Silver Coin) -	- 28¾	33
Other Deposits	- 54	126¾			
	£89¼	£196½		£89¼	£196½

Aggregate Balance Sheet of Nineteen Principal English Banks.

	30th June, 1914.	31st Dec., 1916.		30th June, 1914.	31st Dec., 1916.
Capital and Reserves	69,804,000	72,497,000	Cash in hand and at Bank of England	115,242,000	251,875,000
Acceptances & Endorsements	37,640,000	57,498,000	Investments	114,583,000	303,461,000
Deposits (including Undivided Profits, etc.)	747,243,000	1,095,574,000	Money at Call or Short Notice, Discounts and Advances	571,451,000	592,056,000
			Cover for Acceptances and Sundries	53,477,000	78,177,000
	£854,753,000	£1,225,569,000		£854,753,000	£1,225,569,000

Taking the pre-war condition to which the Money Market now insists on returning, the Bank of England is shown as holding the Government account (represented by Public Deposits) of £17,000,000, and the deposits of the Joint Stock Banks and its own customers, £54,500,000, (represented by "Other Deposits"). But in spite of the fact that the other banks regard their deposit here as legal tender the Banking Department held a reserve of £28,750,000 only, in notes and coin, against its total indebtedness of £89¼ millions. The Balance was represented by "securities," consisting of Treasury Bills of Exchange, and other securities accepted by the bank from those to whom deposits were granted as loans.

In the 1916 figures, it is seen that the total indebtedness was increased to £196½ millions while the "reserve" of legal tender was increased by £4¼ millions only. This emphasizes the actual power of the bank to increase its deposits without limit, by accepting securities and granting deposits.

The same increase of liability is seen in the Aggregate Balance Sheet of the other banks, and taking the two sets of figures for 1916 together, the following facts may be noted:—

(A) That the Nineteen Banks hold "Cash" £251 millions against total liabilities of £1,225 millions, or about 20%.

(B) But of this "Cash" probably £100 millions was represented by their account at the Bank of England, and a further £100 millions was held in Currency Notes issued by the Government.

(C) The Bank of England, however, had a legal tender reserve of £33 millions only, and a total indebtedness of £196½ millions.

(D) Therefore, the huge debts due by the bankers to their customers was based upon the £33 millions representing gold held by the Bank of England, plus the actual coin held by the other banks. The treasury note, obviously, was used similarly to gold as the basis of the credit-pyramid.

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Now, how are these results obtained?

The points of importance are that the Bank of England can increase the deposits of its customers by a book-keeping entry, discounting a bill or granting a deposit upon other security, and secondly that the other banks regard such increase as an addition to their "cash."

Taking the case of Government borrowing first, when the Revenue is not sufficient to meet the current expenditure the Government may require to borrow, say, two millions from the bank to meet interest on Consols or an instalment due on a ship-building programme.

Therefore the Bank of England increases the Government's account by the required amount, receiving the usual short-term bills as security. In the weekly account, "Public Deposits" would be increased by two millions sterling, and "Government Securities" increased by the same amount, balancing the account.

This obviously is merely a book-keeping entry. But the Treasury promptly draws upon the "credit" thus created and sends out cheques to the shipbuilders or the holders of Consols, who regard such cheques as "money." The recipients lodge the cheques, as "money," with their own banks, and under the operation of the Clearing House system, already explained, in due course the Bank of England accounts of the other banks are increased by the amount of the lodgment.

Note, now, the effect of the credit-creation of £2,000,000 by Government borrowing:—

(A) In the Banking Department "Public Deposits" are reduced when the Treasury issues the cheques for £2,000,000 and when these cheques have passed through the Clearing House they are credited to the other banks receiving the lodgement, "Other Deposits" thus being increased and balancing the reduction of the Government Account.

(B) Therefore deposits in the Bank of England remain £2,000,000 more than they were.

(C) When the Government cheques are lodged with the various banks and passed through the Clearing House, they are placed to the credit of the various customers. Thus, in the Aggregate Balance Sheet, "Deposits" would be increased by £2,000,000 and on the other side "Cash at Bank of England" would be increased by a like amount, to balance.

(D) But the other banks regard this as an addition to their holding of legal tender, and since their deposits are increased by £2,000,000 only, they now consider themselves entitled to grant loans to their customers until the £2,000,000 represents 11% to 12% of the deposits created thereby; (see below).

The foregoing illustrates direct borrowing, and when an increase of "Cash" is required by the Joint Stock Banks, there is nothing to prevent them acting in a manner similar to the Government, depositing their own bills or other security and receiving an increased credit with the Bank of England to be added to "Cash on hand" in their own Balance Sheet.

But these advances are seldom or never made directly to the other banks. The latter, when they require a supply of "money" on which to build credit, call in some of their Assets represented by "Money at Call and Short Notice," which are usually made to Discount Houses and stockbrokers. These debtors, to meet the call, are thus forced to borrow money from the Bank of England, which they do by discounting bills or depositing security, and being granted a deposit. Upon this deposit they draw their cheques and pay the banks to whom they are indebted; the latter, when the cheque has passed through the Clearing House, would thus again increase their holding of "Cash at Bank of England."

Therefore the new item to be regarded by the other banks as the equivalent of "legal tender," is actually based upon an increase in the paper or credit represented by the "Other Securities" in the Bank of England Account.

The transaction may be shortly tabulated:—

(A) A Joint-Stock bank demands payment of, say, £10,000 from a Discount House.

(B) The House discounts an "Accommodation Bill," with the Bank of England, and receives a credit or a book-keeping entry representing a deposit in the books of the latter. Upon this it draws a cheque, and pays the creditor bank.

(C) Therefore in the Bank of England Account "Other Securities" are increased by £10,000, and "Other Deposits" by a like amount, first to the credit of the Discount House and later transferred to the credit of the other bank.

(D) The other bank has had "Money at Call" reduced by £10,000 when it is paid off, and "Cash at Bank of England" increased to balance, the latter increase being regarded as legal tender and used as the basis of further credits, on the 12% basis.

The operation of the Bank of England in creating credit-currency has been made sufficiently clear, and

the similar activity of the other banks is accordingly easy of comprehension. On this basis of "Cash on Hand and at Bank of England" the other banks have built up the great organisation which has covered England with a network of branches which have collected, distributed, and created cash and credit for the community. Just as the Bank of England, by lending "money" or discounting bills, increases the amount of its own deposits, so the other banks increase the aggregate of general banking deposits. The borrowing customer gets a credit (say, for £10,000) from his bank A, against which he would draw a cheque to make the payment for which he requires the money. The person receiving the cheque would regard it as "money," and lodge it to his own deposit account. If he dealt with the same bank as the other person, the "Deposits" of this bank would therefore be increased by £10,000 and the "Loans and Advances" on the Assets side increased by a like sum, the cash on hand remaining the same. The deposit is therefore clearly "created" without any cash movement. And if the cheque were lodged with another bank, it would pass through the Clearing House, so that the first bank would have its "Cash at Bank of England" reduced by £10,000 and its "Loans" increased by the same, while the second bank would have "Deposits" on one side and "Cash at Bank of England" on the other side increased equally by £10,000. In this case, in the Balance Sheet of the banking system as a whole, the "Cash at Bank of England" obviously would be unchanged while the general total of deposits and advances would be increased equally by the amount of the loan.

It is therefore true to say that in all the foregoing cases the transactions are an actual creation of credit-currency, and since it is obviously impossible that such loan-creation should ultimately be repaid by legal tender money, gold, that is almost non-existent by comparison with the total of credit-currency, it is also accurate to state further that the cancellation of the loans that might be expected to result in the subsequent reduction of deposits equivalent to the original increase, is in practice usually achieved by the issue of a new loan. In a continually expanding economic system, also, the aggregate of new loans will continually tend to be larger than those they cancel.

Finally the banks create credit-currency by "lending their name" to customers, on bills of exchange accepted by the banks for accommodation or honour. The customer thus holds a first-class security which he can discount or otherwise negotiate, and while he is bound of course to put the bank "in funds" to meet the bill when it becomes due, the intermediate period enables him to finance the particular transaction involved.

ACCEPTING HOUSES

It has been explained that, when the need arose, a bank would "lend its credit" to a customer by accepting his bill drawn upon it, so that the customer could finance his undertakings by discounting the bill in any part of the world, the banker's acceptance being received with confidence anywhere.

Similarly, the Accepting Houses have been granted an undisputed position in the money market that makes their name equivalent to the Money Market's "legal tender" in any part of the world. They accept bills on behalf of their customers, but, unlike the banks, this in fact forms the principal part, if not all, of their business. Many of the bills drawn upon them are on the security of goods or "securities" or gold in course of transport to England or from one country to another; in this way the Accepting Houses have been the means of financing foreign trade. In many other cases, however, the bills are drawn in anticipation of shipments of goods, or merely against the good name or "credit" of the drawer; these bills are "finance" or "accommodation" bills, already described. The solvency of the London accepting houses thus depends to a certain extent on the ability of foreign customers to remit funds for meeting Bills of Exchange at their due date.

Such transactions are actual creations of credit-currency. An industrialist requires to import raw materials for which he cannot pay until they are manufactured and sold; his credit is not good enough to enable the vendor to discount his acceptance; therefore he arranges that the bill drawn upon him is accepted by an Accepting House, and he forwards it to the foreign exporter, the latter realising upon it immediately. In due course the industrialist converts the materials into saleable goods, and disposes of them, probably receiving cheques only in payment, and, prior to the maturing of the finance bill, he can place the Accepting Houses in funds to meet it, the profit of the transaction remaining in his own banking account.

When the Accepting House discharges the liability to the foreign holder, the sum-total of currency in use has therefore been increased by the amount of the manufacturer's profit, plus the amount of the commission charged by the Accepting House; also, if any of the buyers of the commodity have paid for it by loan-currency, the amount of such loan is also an increase of currency. A similar process in the case of exports, or wholly foreign transactions (when the Accepting House grants its credit to a foreigner), has a similar effect.

DISCOUNT HOUSES

"The position of the Discount Houses, also, is already to a great extent apparent. They, using their own capital and to a much greater extent money borrowed from banks and others, bought bills of exchange accepted by the banks, accepting houses, merchants, and traders, and either held them until maturity or sold them to banks or others who required a short investment that could be relied upon to become 'cash' at due date. By the rate at which they borrowed from day to day or for short periods from the banks, they established the rate of money in the market, and by the rate at which they bought bills they established the discount rate. As their most important lenders and their most important buyers of bills were the banks it followed that the extent to which the banks were prepared to lend the money and buy bills had an important influence in fixing rates for loans and discounts.

"Since there was no control by law in England over the extent to which the banks could create credit, and since, as has been shown, they were able easily to increase their holding of cash at the Bank of England, by calling in loans from the discount houses and so compelling them to borrow from the Bank of England, a temptation which was put before the banks to create too much credit has to be corrected by constant vigilance on the part of the Bank of England. In the case of all material commodities, cost of production is an influence against excessive supply at too low a price; in the case of credit, the creation of which is a matter of book-keeping, this consideration hardly arises, since no more clerical work is involved by an advance of a million than by one of a thousand pounds. Consequently an artificial check had to be provided by the regulation of the money

market by the Bank of England. If the banks created too much credit, with the result that the discount rate in London declined to a point that was not justified by England's position in international trade, an excessive number of bills of exchange on London would be created, and, being offered in foreign centres, would turn the foreign exchanges against London. Ultimately this process would correct itself because the depreciation of the exchange would at a point cause exports of gold from England, so reducing the basis of credit and compelling the banks to restrict its creation. But it was not considered safe to leave the market to its own devices until this tardy remedy worked. The Bank of England, as custodian of the country's chief gold reserve, was accustomed when the exchanges threatened gold exports to raise its official rate of discount, so giving notice to the discount houses that if they were obliged to borrow from it they would have to pay more for the accommodation, and making them more careful about buying bills at too low rates. But if, owing to the flood of cheap money with which the discount houses were provided by the other banks, this warning did not suffice, the Bank of England was accustomed to take further action by borrowing money itself in the market and so artificially restricting the supply. By this means the level of rates in London was raised, with the result in normal times that a demand for bills on London was stimulated among foreign capitalists who wanted to lend funds there, the exchanges turned in London's favour, the threat of gold exports was reduced and, if the policy was maintained with sufficient determination, gold imports finally resulted, thus materially reinforcing the basis of credit." (Hartley Withers, Enc. Brit.)

EFFECTS OF THE WORLD WAR

Evolution, it is said, moves in circles. From the year of grace 1914 the monetary system has curved through cataclysm and returned through catastrophe till the point of 1924, when, the lessons of the war learned, digested, and forgotten, the country stands at the nearest point to the 1914 "Normality" to which the force of tragedy and error can bring it. Enough has been said of the processes whereby money that is not money is invested with a phantom "reality," and produced from nowhere through the paper mills of a wonderful system to vanish again in due course into the mists whence the magic of "Credit" charmed it.

Enough, therefore, has been said also to understand monetary policy during the world war, and its effects. The details of Government action and interference are common knowledge; with the clarity of outlook gained by, more or less, patient examination of the money machine, it will be sufficient to place the broad outlines of the dark years in proper perspective upon the present plan.

The banking system, it has been demonstrated, is hopelessly insolvent if judged by the "standard" upon which its policy is based. Therefore, when the wars of the nations started and the delicate fabric of Credit met the hurricane of international terrors, it collapsed like a house of cards. The Bank Charter Act of 1844 was suspended, and the Government took action to save the honour of the bankrupt. Necessary and statesmanlike action, maybe; yet the national credit was pledged to save a national system operated without national control.

Thus the war was started with the Gold Standard banks in undisguised bankruptcy; they could not honour their debts in that commodity which they did not possess. What then?

Then, to the impartial observer, evolved the main features of monetary policy that may be summarised briefly :—

(1) In general terms, the credit of the nation became pledged more hopelessly than ever to the monetary power.
(2) The great mass of credit-currency represented by Bills of Exchange, practically swept out of existence by the upheaval, was replaced by an enormous development of Government borrowings on Treasury Bills.
(3) The Government, by submitting to the monetary convention, was forced in its extremity to borrow to an unprecedented amount from the Bank of England and the other banks.
(4) The creation of Treasury Notes, their use as a substitute for the gold basis for credit issues, and their immediate control by the Money Market, became an essential feature of the monetary system.

Examining these concepts in the light of the previous examination of the creation of credit-currency, the enormous inflation of bank deposits, and the loaning of money (which did not exist) to the Government to the fabulous amount of £7,000,000,000, is accounted for.

First, as to Treasury Bills. The reduction in the supply of ordinary commercial bills of exchange was much more than balanced by the huge total of Treasury bills, which increased from £15 millions at the outbreak of war to £1,124 millions at the Armistice. These bills, also, were sold from day to day at a rate of discount fixed by the Treasury. Therefore the discounting market instead of competing for a value of bills fluctuating according to the balance of trade, on which the value, and the stability of parties, had to be scrutinised, was flooded with an unlimited supply of bills backed by the Government credit. Thus the rate at which Treasury bills were offered became the dominant feature in the discount market. To quote again the spokesman of the Money Market: "At the same time a new market for Treasury bills came into being, and a large part of the new supply was bought by contractors, shipowners, and others who required big cash balances during the War. The following table shows the extent to which Treasury bills and Ways and Means Advances were created during and after the war:—

FLOATING DEBT OUTSTANDING

(in millions of pounds sterling)

Dec. 31.	Treasury Bills.	Ways and Means Advances.	Total.
1913	21	2	23
1914	117	58	175
1915	280	70	350
1916	1099	141	1240
1917	1058	279	1337
1918	1095	455	1550
1919	1107	243	1350
1920	1102	306	1408

Now let these figures be examined in the light of the detailed description previously given of the effect of Government borrowing. Add to these figures the direct borrowing of the Government from the Bank of England, either as Ways and Means Advances or by the deposit of other securities. It is noted, then, that the Government borrows millions of *money* that is nothing more than a series of cheques issued by

bankers and capitalists. This borrowing, under the inexorable duress of war, is immediately paid away by Government cheques to the suppliers of war material. Thus, the aggregate banking balance sheet is balanced by huge increases in the deposits of producers against the equivalent increases in the Government indebtedness.

Again by the operation of the Clearing House system, the increased deposits become credits in the outside bank accounts at the Bank of England, and in due course become "Cash on Hand" in the estimation of these banks. They are then used for investment, and for the creation of a further enormous load of credit-currency, which in turn is borrowed by the Government by Treasury bills, War Loans, or otherwise and again paid out, the credit-circle being traversed again and again upon a ever-lengthening axis.

But, it may be said, the Government issued Treasury (or Currency) notes that cost them nothing but the printing-costs; reaching the huge total of £360,000,000 in 1921. But these were not issued by the Government in payment for commodities; they were almost entirely passed through the monetary machine by being "bought" by the outside banks, and paid for by a transfer of their surplus "Cash at Bank of England." Thus, in place of the phantasmal "money" created by a series of borrowing and cheque transactions, they received the printed papers bearing the Government security, and these again they used as "Cash" and the basis of further credits. The Government meanwhile having by this gracious arrangement had an increase granted it in its account at the Bank of England, proceeded to issue cheques therefor to the producers, and again the credit-circle was traversed on a circumference far from the centre of reality and beyond the domain of reason.

For if the elaborate paraphernalia of financial juggling be discarded, what does the whole process amount to? Merely that the Government, representing the nation in extremity, and having conscripted the physical bodies of its male citizens, required the lesser things of steel and substance wherewith to sustain its defenders and slaughter its enemies. But, though men were cheap, money was required to buy the other things, and the Government exercising its dreadful powers of life and death, and thrusting immortal souls into the furnace of an earthly Hell, found that "by a convenient convention" it had lost the power of creating money, the medium of exchange that is the lifeblood of the economic organism.

Could it not have printed notes, as the banks printed cheques, and paid for its purchases in a new legal tender cash of its own creation? Unscientific and unwieldy as the method would have been, it could have been done, and it is difficult to see that its effects could have been more disastrous than the chaos seen in the world to-day, when, all roads seeming to be ended in a morass of misunderstandings, the nations seem hesitant, and on the point of returning along the bitterly-trodden road that leads to war,—for that, at least, they *understand!*

Note the comparison. The Government bought gigantic masses of war material, and threw them into the bottomless pit. Then they paid for them by severely orthodox borrowings. Then they borrowed their payments again, and bought more materials, to suffer a like fate; comparatively the only worthless commodity was human life. Result, the Government, representing the nation itself, owns nothing but bitter memories and a debt of noble proportions; and the self-sacrificing citizens who "gave their all" at five per cent., now own Government script of £7,000,000,000, and bank desposits of £2,000,000,000,

in the main representing goods and services blasted and smashed by the avalanches of heavy artillery during the years 1914-18. That is to say, they own something which they have bought and paid for, and which does not now exist, either as money or goods.

It would seem that if the Government had paid for these things directly by notes of its own printing, the citizens would still own, as they do now, a security with the Government (i.e., their own collective) backing, while the Government would own, as now, nothing material. But in this supposition the Government would not pay interest, nor would a crushing debt lean upon the failing strength of a poverty-stricken people.

Obviously, therefore, it is correct to say that the national credit, embodied in the Government, has "by a convenient convention" become pledged to the Money Market, and that the huge National Debt has been created by a system based upon bank loans and a fictitious monetary standard.

Even under the stress of circumstances the old convention and at least the theory of the Gold Standard were maintained, and this conception, productive of such remarkable results, may be examined in some detail.