Thomas, Samuel Evelyn
The Macmillan report

THE MACMILLAN REPORT

A Short Summary of its Main Points

AUT OPTIMUM AUT NIHIL

PREPARED FOR THE GUIDANCE OF STUDENTS

BY

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THE MACMILLAN REPORT.

For some years past there has been growing support for the view that the present conditions of depression in this country are largely due to the faulty organisation of our banking and credit system and to the monetary policy pursued by the authorities during the last decade.

Accordingly, in November, 1929, the Government set up a Committee of economists and business men, under the Chairmanship of Lord Macmillan, " to enquire into banking, finance and credit, ... and to make recommendations calculated to enable these agencies to promote the development of trade and commerce and the employment of labour ".

After many months of exhaustive investigation, during which a large number of witnesses from banking, commercial, industrial, professional and academic circles were examined, the Committee issued its Report, Cmd. 3897, dated July, 1931.

Part I of the Report is devoted to an historical survey of the banking and monetary systems here and abroad ; the international gold standard, its functions, objectives and conditions ; the economic position of Britain ; developments in the economic situation since 1925 ; the fall in world prices and the influence of monetary policy on the price level.

Part II, with which we are primarily concerned, contains a number of conclusions and recommendations whose main purport should be known to every commercial student.

PART I.

HISTORICAL AND DESCRIPTIVE.

INTRODUCTORY.

The Committee points out that the present troubles of this country are neither wholly domestic nor wholly international in character. The recent increase in unemployment is, it is true, due in the main to the " world depression " ; but before the world depression we had a domestic problem of over a million unemployed ; and even after the troubles of the world as a whole are redressed it would appear that the domestic problem is likely to remain. The Committee hence found it necessary to consider proposals relating to both international and domestic monetary policy.

THE SPECIAL PROBLEMS OF GREAT BRITAIN.

Britain has necessarily suffered severely from the depressed international situation because of her markedly " open " position, *i.e.*, her extreme dependence on foreign trade, on her income from foreign investments and on her profits as international banker, merchant and financier. In such circumstances, the disequilibrium associated with prolonged unemployment may be due to any of three factors : (*a*) that in this country selling prices do not adequately cover costs of production; (*b*) that similar conditions exist throughout the world; and (*c*) that our costs of production are above those of our competitors.

The Committee attributes our unemployment mainly to the first and third of these, and expresses the opinion that the disparity between our costs and those of our competitors is due not so much to the inefficiency of our industries as to the fact that sterling costs of production did not adjust themselves to the rise in the value of sterling which was involved by our return to the gold standard. The effect of this lack of adjustment has been intensified by the world-wide collapse in prices, and because, though our export industries have reduced their own costs, that reduction has been nullified by an increase in the costs of "sheltered" services, such as transport, which enter into the prices of all our products.

PART II.

CONCLUSIONS AND RECOMMENDATIONS.

I. THE MAIN OBJECTIVES OF THE MONETARY SYSTEM.

THE GOLD STANDARD.

After its exhaustive review in Part I of the Report of the working of the gold standard, both national and international, the Committee expresses the opinion that, so far as this country is concerned, the sacrifices involved in returning to the gold standard at the pre-war parity have not been justified by the anticipated advantages of external price stability.

Difficulties in the Operation of the Gold Standard.

(1) The effects of the re-adoption of the gold standard in different countries varied. In *Great Britain* our policy of deflation meant that the existing level of sterling incomes and costs was relatively too high in terms of gold. This necessitated a *downward* adjustment, pending which industries subject to foreign competition were at a disadvantage. In *France and Belgium*, the policy of devaluation gave an artificial advantage to export industries, pending an *upward* adjustment of costs.

(2) *International lending power* has been re-distributed, largely as a result of the character of the final settlement of the War debts, by which Britain resigned her own *net* creditor claims in favour of France and the United States. Consequently, the surplus available for lending has relatively increased in the latter two countries while Great Britain has a smaller surplus, further reduced since 1925 by the adverse effect of the return to gold on her visible balance of trade. Instead of using their receipts as Great Britain used hers, in increasing imports or in making additional long term foreign loans, these two countries have required payment of a large part of their surplus either in gold or in short-term liquid claims.

This position can only be temporary, since *if a creditor country is unwilling to lend its surplus*, its own export trade must be destroyed through the relative reduction in the gold costs of other countries. This effect has been delayed by the sterilisation of gold imports in the creditor countries, France and U.S.A., and by the inelasticity of wages and other costs in the debtor countries.

The Committee concludes, however, that the promise of international co-operation and the dependence of this country on overseas trade and on invisible exports make it desirable that **we should maintain the gold standard at the present parity.**

THE INTERNATIONAL PRICE LEVEL.

The fall in wholesale commodity prices has adversely affected shareholders and entrepreneurs and has led to an increase in unemployment. A *rise in prices*, however, would transfer purchasing power from those in receipt of fixed incomes to the shareholder and entrepreneur and those whose employment is increased. Moreover, **it would lead to a decrease in the burden of war debts.**

Hence, the Committee concludes that the **International Price Level should be forced up to the 1928 level** by the Bank of England and other central banks working in the closest co-operation. Although this clearly involves a system of international currency management, and manifold difficulties which only experience can solve, it should, nevertheless, be " the prime object of international statesmanship " to attain the new level of prices and, having achieved it, to maintain it with as much stability as possible.

DOMESTIC CURRENCY MANAGEMENT.

" The monetary system of this country must be a Managed System ". The main objects of a sound monetary policy—(*a*) maintenance of the parity of the foreign exchanges ; (*b*) the avoidance of the Credit Cycle ; and (*c*) the stability of the price level—cannot be achieved automatically, as was thought to be the case under the old gold standard. They require the constant exercise of knowledge and judgment by an institution of ripe experience, great resources and unchallengeable authority. Hence—

The managing authority should be the Bank of England, " an excellent instrument for the purpose ; independent of political influences, yet functioning solely in the public interest ; with long traditions and experience and clothed with vast prestige, yet not distrustful . . . . of evolutionary change or hesitant of new responsibilities ". The Committee suggests that the Bank of England should endeavour to promote the stability of output and of employment at a high level by influencing the regular flow of savings into investment at home and abroad. The banking system can supply short-term loans but funds for long-period investment must be provided from sources outside the banking system. The machinery of investment must be so adjusted that a proper balance shall exist between facilities for domestic and foreign borrowers.

II. INTERNATIONAL MONETARY POLICY.

In brief, the Committee concludes that the objectives of our monetary policy should be : (*a*) to adhere to the gold standard at the existing parity ; (*b*) to use our influence to raise the international price level, *i.e.*, to lower the value of gold ; and (*c*) to maintain the stability of national and international prices at the new level. Thus both permanent and temporary measures are called for.

A. PERMANENT MEASURES.

CENTRAL BANKING.

Stability of international prices over long and short periods can be maintained only by co-operation among central banks. Over long periods stability is largely a question of gold reserves in relation to credit. Stability over short periods in order to mitigate the Credit Cycle is a question of co-operative monetary management.

Central Bank Reserves.

The problem of the inadequacy of the world's gold stocks and future gold supplies is not regarded as immediately pressing, particularly as gold currencies no longer circulate and gold stocks are concentrated in the reserves of the central banks.

The sole use of gold reserves to-day is to enable a country to meet temporary deficits in its international balance of payments. Yet in many countries legislation fixes a definite proportion between the total reserves of gold or foreign gold exchange and the volume of notes issued by the Central Bank. Such a basis is now almost meaningless and has the effect of forcing a drastic restriction of credit whenever the reserve approaches the legal minimum. **Greater freedom in the use of Central Bank reserves is, therefore, desirable.**

Suggestions.

The Committee endorses the views expressed in the second interim Report of the Gold Delegation of the Financial Committee of the League of Nations and suggests the following principles for the guidance of central banks generally :

(1) Gold standard countries should agree not to allow gold coins or gold certificates to pass into circulation.

(2) Central banks should collectively consider whether national legal requirements as to gold reserves should be relaxed or tightened. At the present time they should probably be relaxed.

(3) Central banks should be permitted, *at their discretion*, to regard balances with central banks in other gold standard countries or with the Bank for International Settlements as the equivalent of gold for all purposes.

(4) Central banks must not be unduly limited in their power to expand credit without a corresponding increase in their gold holdings, or to restrict credit otherwise than by a restriction of such holdings.

In this way, the available quantity of monetary gold would not limit the available supplies of currency and bank credit, and consequently need not affect general price levels.

Obstacles facing Central Banks.

(1) Non-monetary causes of instability nullifying effective control, *e.g.*, political troubles, war debts, seasonal variations, changes in tariffs, in fashion and in demand, over-borrowing by some countries and over-lending by others, rigidity of economic conditions and especially of costs of production, and local or general lack of confidence.

(2) Divergence between the interests of their own country and those of the rest of the world.

(3) Inadequate control over the monetary machine and its working. Neither the Federal Reserve system, the Bank of France nor the Reichsbank has as complete a control over the creation of credit in their respective countries as has the Bank of England, whose control, within the limits of the international standard, is "remarkably complete". Nevertheless, even if the central bank *can* control the amount of money, it cannot control the uses to which it is put. This is the sphere of the commercial banks.

Central Bank Control over Bank Credit.

A central bank should regulate the volume and price of bank credit so as "to maintain output and employment at the maximum compatible with adherence to the international gold standard and with maintenance of the stability of the international price level". To do this, it must watch not only "the short-money market, the gold movements and the pressure on the exchange and conditions abroad, but also the internal price level, the unemployment figures and the capital market". It is reiterated, however, that owing to the international effects of monetary conditions, **effective internal control can be achieved only by concerted action by all central banks.**

Summary of Conclusions Relative to Central Banking Policy.

(1) The aim of central banks should be to maintain the stability of international prices over both long and short periods.

(2) This implies the regulation of the volume and terms of bank credit so as to maintain stability in the rate of new investment and new enterprise, both at home and abroad.

(3) Central banks should frequently confer to decide on the general tendency of their *individual* credit policies, without prejudice, however, to the individual discretion of each institution to safeguard its national interests by altering its own bank rate, or by attracting or discouraging gold imports.

(4) Whilst each central bank should retain complete autonomy, it should aim at avoiding *unnecessary* imports of gold. Its duty should be to **prevent unbalanced internal conditions from creating international instability,** and, to this end, it should endeavour to combat any national tendency to maintain too high a proportion of liquid investments or to undertake an excessive amount of long-term lending.

B. TEMPORARY MEASURES.

To meet the present emergency, creditor countries which have been requiring balances to be paid in gold or short-term liquid claims should be induced to lend their surpluses and to buy goods. Loans should be made to solvent borrowers to finance new productive enterprises and should be made either to foreign borrowers or to home borrowers. To this end central banks should (*a*) endeavour to remove existing hindrances to foreign lending, and (*b*) maintain cheap credit in their money markets. It is essential that concerted action be taken, as increased lending or buying by one creditor nation might result in the claims against it being used, not to buy more goods, but to meet the demands of the other creditor nations.

The task is two-fold : (*a*) to attract borrowers by low rates of interest on long-term loans, and (*b*) to remedy the shortage of sound borrowers for new enterprise. The first of these objects may be attained if central banks exert their influence to **promote public confidence in the duration of low short-term rates,** and **to lower deposit rates** so as to encourage investment. The second object involves some action to reinforce the credit of borrowers and so **overcome the unwillingness to lend** which has followed the extensive unwise use of borrowed funds. The difficulty might be overcome by some form of guaranteed credit under a state-aided international guarantee fund or by the establishment of a powerful international financial corporation to safeguard the interests of investors in foreign loans.

III. DOMESTIC MONETARY POLICY.

THE BANK OF ENGLAND NOTE ISSUE.

The volume of bank deposits has now a more important influence on monetary conditions than has the volume of cash, notes being used for few purposes except wage payments and small transactions. Hence **an increase in the active note issue is not so much a cause as a result of trade activity,** this activity in turn being traceable to an expansion of the Bank's deposits. Yet the Bank is not regulated in respect of deposits. This, however, is to the advantage of central banking operations. What is required is more elasticity with regard to the note issue.

The provisions made by the Act of 1928 are inadequate, for the existence of a fixed fiduciary issue involves the immobilisation of gold for export purposes to the extent of the difference between the fiduciary issue and the actual circulation. Moreover, an approach to the Treasury under existing provisions for powers to increase the note issue may be interpreted as a sign of weakness and give rise to undesirable nervousness. **The Bank of England should, therefore, have greater freedom with regard to its reserves** and should be allowed to reckon as part thereof any balances held by it with the Bank for International Settlements.

Recommendations.

(*a*) Parliament should give the Bank power to put into *active* circulation notes to the amount of £380,000,000 with an absolute maximum of £400,000,000. Temporary additional elasticity to be provided by reference to the Treasury.

(*b*) The Bank should not allow its gold reserve to fall below (say) £75,000,000 except temporarily with the permission of the Treasury. In ordinary circumstances the gold should not fall so low as this statutory minimum. On the contrary, the Committee suggests that the Bank's normal reserves of gold or gold exchange should be increased.

Separation of the Departments.

Although the separation of the Departments provides a convenient formula for dividing the profits of the Bank between the Bank and the Treasury, it has not been satisfactory from any other aspect, and is confusing and misleading to other than experts. **The Departments should be amalgamated** and the statements in the Bank Return amalgamated without preventing the calculation of the division of profits as before.

Notes in Circulation.

Of the " notes in circulation " a considerable amount is held by the joint stock banks as till money ; but this position could be avoided if the banks would increase their deposits at the Bank of England. In this way the amount of notes stated to be in circulation would be reduced to a figure more representative of notes actually in circulation.

RESOURCES OF THE BANK OF ENGLAND.

Before the War our liquid international assets consisted mainly of the Bank of England's gold and of sterling acceptances on foreign account. These were at least equal to and sometimes in excess of our short-term international liabilities. In recent years, however, London has conducted a vast business in international deposit banking, and **her liabilities** in respect of short-term bills and deposits held on foreign account **greatly exceed her claims in respect of acceptances.** At the same time, London is now doing a larger volume of long-term financing than is justified by the surplus which we have available for long-term overseas investment, with the result that we are financing long-term foreign loans by short-period borrowing in the form of precarious foreign deposits, which can be retained in London only at the cost of high rates of interest. In brief, **our position is less liquid.**

The Bank of England's liquid assets should, therefore, be substantially increased at the first opportunity. Bank rate should be used sparingly when the object is merely to balance moderate changes in the short-term position by attracting foreign funds. It should be rightly used to contract credit either at home or abroad.

Temporary contingencies would often be better met by the Bank relinquishing its own liquid assets. For this reason, fluctuations in the volume of assets should be allowed to a greater extent than in the past

Thus the Bank's gold reserves should be allowed to fluctuate between, say, £175,000,000 and £100,000,000, and they should be supplemented by liquid resources up to £50,000,000 held in foreign centres and with the Bank for International Settlements.

DAY-TO-DAY POLICY OF THE BANK.

The chief means by which the Bank manages the monetary system are :—

(1) The official bank rate.

(2) Open market operations, *e.g.*, the sale of securities, which result in a change in the aggregate amount of the Bank's *private deposits*.

(3) Open market operations which may consist of changes in the form of the Bank's *assets* but not necessarily their volume. They may take three forms :—

(*a*) Purchasing and selling securities to offset gold movements
(*b*) Buying long-dated securities (Consols) and selling short-dated securities (Treasury Bills).
(*c*) Forcing the market to discount or obtain advances at the official rates, with the object of bringing market rates into closer conformity with these, by selling securities.

(4) Adoption of technical devices for directly influencing foreign exchanges, *e.g.*, sales or purchases of foreign balances (gold exchange methods) dealings in forward exchange, and small variations in the Bank's buying price for gold.

(5) Personal influence or advice to prominent elements in the money market.

In regard to (1), the Committee's views, as stated above, are that it should be used sparingly.

The success which in the past has attended the Bank's open market operations is in itself a justification for their development, but in regard to (2) above, the **Bank's position could be strengthened if it were afforded more detailed information respecting the nature and extent of the cash holdings and deposits of the joint stock banks**, and if there were closer collaboration between the Bank and the joint stock institutions.

RELATIONS WITH THE JOINT STOCK BANKS.

The published reserves of the clearing banks show a figure of about 10·5 per cent. of the deposits, comprising 6 per cent. in cash and 4·5 per cent. in balances with the Bank of England. But this latter figure is higher than is actually the case from day to day, for the averages are not daily averages but relate to particular days, when the reserves are inflated by "window dressing". The Committee recommends that **the process of window dressing be abandoned** and that **the London clearing banks should keep a daily average of cash, in bank notes and balances with the Bank of England, of not less than 10 per cent. of their deposits**. This would involve their keeping larger reserves.

A further recommendation was that returns by the joint-stock banks should be more informative.

Banks other than the clearing banks should also increase their liquid reserves to a proportion to be determined in each case after consultation with the Bank of England.

If, following frequent and regular meetings with the Bank of England, the banks would from time to time accept the Bank of England's advice as to the average figure at which to keep their reserves, it is possible that the relaxation or tightening up of this figure could be made an important part of the Bank's machinery for the regulation of credit and that it could usefully replace some open market operations, particularly if the joint stock banks' deposit rate were made more elastic. **But these arrangements can be successful only if the joint stock banks are taken into the Bank's confidence and plainly informed of its current credit policy.**

The main object of these larger reserves is to provide the central bank with adequate resources with which to manage the monetary system. With the same object, the Committee further suggests that **the Bank of England should consider an appreciable increase in the amount of its capital.**

IV. THE CAPITAL MARKET FOR HOME INVESTMENT.

FINANCE AND INDUSTRY.

Although British manufacturers and traders have always been able to find cheap accommodation, yet the relations between British banks and industry have never been so close as those between German and American banks and industry.

In **Germany**, scarcity of capital and of independent investors compelled the banks to supply industry with long-period as well as short-period capital. These responsibilities obliged them to keep in intimate touch with the industries themselves.

In **France**, the individual investor had usually relatively small resources and relied on the investments suggested to him by the big banks which made practically all the industrial issues.

In the **United States**, the great industries and railroads were affiliated to particular banking houses or issuing institutions which usually sponsor all industrial issues of well-known concerns and, in addition, make loans to investors and speculators either direct or through brokers.

In considering the most beneficial system for British industry, the Committee states that **progress necessitates closer association through appropriate organisations of the financial and industrial worlds.**

Financial leaders, through their wide international operations, are competent to advise not only on home conditions but also on affairs throughout the world. Industry is becoming more internationalised; and British industry must be ready to meet American and German competitors who are generally financially powerful and backed by banking and financial groups. Without similar support, British industry will undoubtedly be at a disadvantage, particularly in the establishment of British enterprises abroad. It will, therefore, have to keep in close touch with institutions connected with international finance. Industries and financial institutions will thus have to co-operate so that each is thoroughly intimate with the affairs and position of the other.

Investment.

Particularly in the matter of investment have our financial institutions been weak. Greater attention must be given to directing our capital into domestic enterprise and into British-owned concerns abroad. Long established issuing houses assist those who invest abroad and frequently vouch for the issues they sponsor; but with few exceptions little guidance is forthcoming in respect of home issues, and **many ignorant investors are misled merely by the appearance of the name of a large joint stock bank on a prospectus.**

Though industry should in no way be managed by the banks, both industry and finance would benefit from a closer relationship between British industry and the City of London, especially if the intrinsic merit of industrial issues were vouched for by institutions of first-class strength and repute specialising in the finance of particular industries. It would also be better if the joint stock banks did not give the appearance of sponsoring any issues for which they could not vouch.

CREDIT FOR INDUSTRY.

Every industrial and financial company has to provide itself with (*a*) permanent capital and (*b*) seasonal or temporary credits. Sometimes intermediate credit also is required.

SHORT-TERM CREDITS. The principal function of the banks is to provide short-term credit. This a lucrative source of business and the facilities afforded to British industry in this respect compare favourably with those available in other countries. The Committee concludes that "*our banking system is adequate and satisfactory in the provision of the normal short credits to industry and their distribution.*" In this connection, however, all would benefit by a more extended use of commercial bills—bills given by a purchaser to a supplier—rather than mere book entries.

INTERMEDIATE CREDIT. This is credit advanced (*a*) for periods ranging from one or two up to five years and is required for hire purchase sales, in which the ownership of goods is retained by the seller until payment is completed ; (*b*) for advances against deferred payment, in which ownership of goods passes to the buyer and payment is spread over a period ; and (*c*) for long term credit contracts, such as road building and harbour construction.

Excellent facilities exist for these purposes for use internally, but the trading community does not take as much advantage of them as it might, especially in the first two groups.

In the case of sales and contracts abroad, credit facilities are not adequate and frequently British firms have to resort to foreign institutions. To remedy this situation, **British institutions should be established for the purpose of assisting British industry and trade abroad.** Some of these facilities should be provided by the joint stock banks and other existing financial institutions. The banks would run no undue risk in financing longer term contracts than is their custom, provided they were of a sound character, and amounted only to a small proportion of their advances.

LONG-DATED CAPITAL : PROPOSALS FOR A NEW INSTITUTION.

Closer co-ordination between British industry and the City of London would be advantageous for the provision of long-dated capital, especially for large-scale industry. In some respects the City has better facilities for providing capital to foreign countries than to British industry, and there is need for new institutions to fulfil the following functions :

(*a*) To act as financial adviser to existing companies ;

(*b*) To advise as to the provision of permanent capital

(*c*) To secure the underwriting of and to issue the company's securities to the public and, if necessary, to assist previously in arranging for temporary finance in anticipation of an issue ;

(*d*) To assist in financing long-term contracts at home and abroad, or new developments of an existing company, and to found companies for new enterprises ;

(*e*) To act as an intermediary and financial adviser in the case of mergers or in the case of negotiations with corresponding international groups ;

(*f*) To be free to carry out all types of financing business.

Such an institution must have a substantial capital. When financing contracts for periods up to five years, it might be able to supplement its resources by the issue of its own short-term notes. It should be able to rely on co-operation with existing financial institutions in making temporary advances. It must also build up an expert staff, establish gradual connections with industry and instil confidence in its issuing ability and credit.

Though the big joint-stock banks could perform these functions it "**is doubtful whether the banks can with advantage depart from their traditional banking sphere.**" The same difficulty applies to the big private banking houses. Such institutions could, however, with no change in their present banking practice, take an interest in the share capital of an institution set up for this purpose. "**The best course might be if the leading private institutions and the big banks were to co-operate in creating one or more such concerns.**" The Bankers' Industrial Development Company, at present an offshoot of the Bank of England, might form the nucleus of a new institution on the lines suggested, but it should at a convenient stage be separated from the Bank of England and have a separate, self-supporting existence. To provide financial facilities for the small and medium sized concern the Committee recognises that it may be desirable to form yet another type of finance institution which would confine itself to smaller industrial and commercial issues.

V. INFORMATION AND STATISTICS.

Information and statistical knowledge are also essential. The provision of statistics could be undertaken by the appropriate Ministries. In particular the publication of the following statistics in new or improved form is recommended: the monthly returns of the clearing banks; classification of loans and overdrafts; returns from the other joint stock banks and other banking institutions; foreign balances and foreign liquid assets held in sterling; the volume of acceptances; the volume of cheque transactions; the balance of trade; the census of production; the volume of wages paid; the volume of retail sales; the aggregate and the distribution of profits; the value of capital construction.

The various Government Departments responsible for the preparation of statistics should co-operate in such work.

ADDENDA TO THE MAIN REPORT.

The Report was signed by all members of the Committee with the exception of Lord Bradbury, who dissented. Most of the other members presented Addenda which amplified rather than disagreed with certain points in the main report. The chief points of the two most important of these Addenda are summarised here.

ADDENDUM I.

Signed by Sir Thomas Allen and Messrs. Ernest Bevin, J. M. Keynes, R. McKenna, J. Frater Taylor, A. A. G. Tulloch.

The signatories to this Addendum recall that in the Main Report it is recognised that the remedies for the world depression lie in an expansion of purchasing power; in the encouragement of borrowing if necessary under guarantees; in a reduction in the cost of both long-term and short-term credit; and in the encouragement of enterprise and investment.

But the "open" position of this country is such that the initiation of independent action here, without concerted action abroad, would subject the Bank of England to a severe strain, to meet which it would be necessary for us to strengthen our position by (*a*) improving our balance of trade through (i) an increase of exports, (ii) the substitution of home-produced for imported goods, and (*b*) increasing investment at home.

Apart from the basic need of improving the relative efficiency of our industries, there are **three practical courses** open to us for achieving these objects :—(*a*) a reduction of salaries and wages ; (*b*) control of imports and aids to exports ; (*c*) State assisted schemes of capital development.

REDUCTION OF SALARIES AND WAGES.

While recognising the urgent need for greater elasticity of money-incomes and the fact that an all-round reduction would be beneficial, the signatories **emphatically reject the suggestion that a reduction of salaries and wages alone would offer a solution.** Such a policy would tend to cause further falls in prices and would render capital charges and taxation a greater real burden ; while it would inevitably defeat its own object by causing similar reductions in other countries.

But if an all-round reduction in money-incomes becomes plainly unavoidable, it may be attained by :—

(*a*) **Devaluation**—a policy rejected in the Main Report.

(*b*) **A National Treaty** for a simultaneous cut—a scheme which has many practical difficulties, but which should nevertheless receive consideration as a possible alternative.

(*c*) **Tariffs plus Bounties**—which would have the twofold effect of reducing money-incomes *and* improving our balance of trade.

CONTROL OF IMPORTS AND AIDS TO EXPORTS.

The signatories give their strongest support to the third method, which they consider would be attended by the advantages but not by the practical difficulties of the two others. They justify the abandonment of the policy of Free Trade on the ground that the economic position of this country is in a state of chronic disequilibrium, and they argue that the suggested policy would bring in a useful contribution to the National Exchequer. Hence, in the present circumstances, this is regarded as **the most practical plan of action likely to revive business confidence.**

SCHEMES OF CAPITAL DEVELOPMENT.

In conjunction with a system of tariffs plus bounties, the signatories recommend the development of state enterprise with subsidies for domestic investment. In particular, the following schemes are suggested :—(*a*) Rebuilding and re-planning schemes for larger towns and industrial centres; (*b*) Refitting of our staple industries on modern lines; (*c*) Electrification of the railways as suggested by the recent Weir Commission.

It is pointed out that there is no danger that such State-directed schemes will result in a transference of private investment since there is, at the moment, no lack of funds available for investment : rather there is a lack of confidence in borrowers. Above all it is considered desirable that **capital development should be organised and**

planned on a national scale through a Board of National Investment charged with " the deliberate guidance of schemes of long-term national investment ".

In conclusion it is emphasized that these proposals are made not as an alternative to the main suggestion of raising world prices but rather as an " attempt to avoid the immense waste of the national productive resources " pending the necessary upward adjustment.

The signatories point out that those who dissent from these views contend that the proposals put forward are **merely temporary shifts** which do not get to the root of the trouble, viz., the unduly high level of our costs of production as compared with those of our competitors (see Addendum III). Nevertheless, the signatories, pinning their faith on the ultimate recovery of world prices, maintain that we **can** continue to support permanently our improved working class standards, and that to seek the remedy in a reduction of salaries and wages will involve practical difficulties and social troubles of the first magnitude.

ADDENDUM III.

Signed by Prof. T. E. Gregory.

Whilst admitting that the great problem to be faced is the disequilibrium between prices and costs, Prof. Gregory points out that the problem cannot be solved **except by co-operation between all countries**; consequently any attempt to achieve economic isolation of this country by the imposition of tariffs is to be deplored as incompatible with the attainment of international co-operation.

The Two Proposed Remedies should be combined.

Two remedies are available : to raise prices or **to reduce costs.** Each is open to certain objections which Prof. Gregory considers could best be met by combining the two, *i.e.*, by raising prices *and* reducing costs. In this way the tendency for a reduction in costs to produce a further reduction in prices would be counteracted. He points out, also, that a reduction in costs need not cause a proportionate contraction in consumers' purchasing-power, since the effect is merely to redistribute the proceeds of industry, more going to the entrepreneur and less to the wage-earner. Furthermore, the reduction in unemployment will itself increase the volume of purchasing power ; and the growth in profits will stimulate business expansion.

Objections to Tariffs and Capital Schemes.

Prof. Gregory is in complete agreement with the signatories of Addendum I regarding devaluation but he differs from them fundamentally on the question of tariffs, which, he considers, would **tend to make permanent the present disequilibrium between British and foreign costs.** He points out, too, the danger that **any temporary expedient might easily become a permanent part of our economic policy.** He argues that, if imports were reduced and foreign investment were not adjusted to the changes in the balance of payments, gold would flow in. This gold would be used to expand credit and a resulting boom in home industry would check foreign investment. The money income of society, especially money wages, would increase. This would act as a stimulus to imports and a check on exports, while a new disequilibrium between home and foreign costs would be established. Thus, to prevent a collapse, a higher level of tariffs would be necessary.

As regards the effectiveness of tariffs, he emphasises the fact that there would probably be vigorous attempts abroad to neutralise our tariffs and subsidy policy by anti-dumping measures. In any case the foreign goods which were shut out of British markets would probably appear in neutral markets where they would compete with our exports. Finally, he doubts whether the revenue from any such scheme (after deduction of administrative expenses and subsidies) would be sufficient to make the policy worth while.

The proposals for capital development, he considers, fail to meet the needs of the situation since they would not greatly affect the position of our export industries, which contribute most to unemployment.

The best solution is a reduction of money costs.

Prof. Gregory suggests that **the best solution put forward is the reduction of money-costs.** He suggests that this should be effected as far as possible by improved methods and by spreading overhead costs over a larger output. To facilitate this process rationalisation schemes may be found necessary and here it may be desirable to invest the State with statutory powers. He does not agree, however, that it is possible, or even desirable, to effect an all-round reduction of incomes on the lines of a National Treaty. The shareholding class already suffers by reduced dividends and capital reductions and the rentier by increased taxation. Thus **the main burden of the reduction must fall on wage-earners.** The fall need not necessarily be confined to the exporting industries, but might extend to ancillary and sheltered trades. In any case the fall need not involve an equal reduction in the standard of living and, to the extent that it makes possible an increase of productivity, it should result eventually in a betterment of the standard.

In brief, Professor Gregory contends that the tariff action, strongly recommended by Mr. McKenna, Mr. Keynes and the others, is merely a roundabout and possibly ineffective way of bringing into effect that reduction of costs which in his opinion is clearly imperative.

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