

## A. C. Pigou's Membership of the 'Chamberlain-Bradbury' Committee

### Part I

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**Abstract:** In 1924-25 A. C. Pigou was a member of the "Committee on the Currency and Bank of England Note Issues", which became known as the 'Chamberlain-Bradbury' Committee after its two chairmen. The Committee's report is historically important for recommending a bold and quick return to the gold standard, which the British government accepted and acted on. Pigou's personal copies of the transcripts from the hearings of the Committee include Pigou's pencil annotations that highlighted parts of the hearings that he regarded as significant. The present study, which is the first part of a larger study, presents that highlighted testimony by witnesses at the hearings in a thematically organised manner with a view to establishing the character of Pigou's membership of the 'Chamberlain-Bradbury' Committee. The contribution of this paper is twofold. First, it reveals the specific themes associated with Pigou's reading of the witness testimony, which suggest a more cautious and moderate approach to the return to the gold standard than what could be reasonably inferred from the bold and urgent recommendations included in the Committee's report. Second, a possible reason has emerged as to why Pigou was unwilling to oppose the pro-gold position being articulated by the other Committee members as well as many practical men from finance and industry.

### 1) Introduction

Few topics in economic history have been investigated more thoroughly than the gold standard. Within the subfield of 20<sup>th</sup> century British monetary history, the events that preceded the announcement by Winston Churchill, the Chancellor of the Exchequer, as part of his budget speech of 28 April 1925 that Britain would be returning to the gold standard, together with the economic effects of returning to gold, have spawned a substantial

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scholarly literature. The scholarly response was swift, with T. E. Gregory's small contextual monograph *The Return to Gold* (1925) and J. M. Keynes's small, and critical, pamphlet *The Economic Consequences of Mr Churchill* (1925 [1931]), both published in the same year that the change in monetary policy was announced. Since then, economic historians' interest in this episode has been both extensive and profound, with considerable attention directed towards the role played by Treasury's 'Committee on the Currency and Bank of England Note Issues', established without public announcement by the Chancellor of the Exchequer in 1924 and which reported to Churchill in 1925, effectively providing him with the case for taking the position that he announced in his budget. Donald Moggridge's *British Monetary Policy 1924-1931* (Moggridge 1972) and Barry Eichengreen's *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (Eichengreen 1992) are two notable studies on that topic, but they are not isolated examples. Other significant works include those by B. W. E. Alford (1972), W. Ashworth (1960), N. H. Dimsdale (1981), Susan Howson (1975), E. V. Morgan (1952), Sidney Pollard (1962, 1970) and R. S. Sawyers (1970).

This episode in monetary history has not, however, been extensively considered in relation to individual thinkers who have contributed to the history of economic and monetary thought. The obvious exception is, of course, John Maynard Keynes who, by following his *Tract on Monetary Reform* (Keynes 1923) with critical comment on Churchill's announcement produced a dramatic reaction that has since become a significant element of the narrative on the evolution of Keynes's thinking on monetary matters.<sup>1</sup> In contrast, little has been said on this episode in relation to Pigou, who was not only a member of the committee that advised Churchill, he was also, following the publication of his classic article 'The Value of Money' (1917), a significant monetary economist himself. Consequently, there is an obvious gap in the historical literature concerning the character of A. C. Pigou's membership of the 'Committee on the Currency and Bank of England Note Issues', henceforth referred to as the Chamberlain-Bradbury Committee after the first and second chairmen of that committee respectively.

The notes taken by the Treasury reporters at the meetings of Chamberlain-Bradbury Committee, including transcripts of interviews with witnesses appearing before the Committee, are maintained in the UK National Archive and have been used to inform historians' investigations of the re-introduction of the gold standard. The 'Papers of Arthur Cecil Pigou' held at the Marshall Library in Cambridge also contain Pigou's personal copies of these documents, which reveal additional information about Pigou's reflections on matters before the Committee because he drew a vertical line, in pencil, down the margin of the paper next to the text of discussions that he wished to highlight. There is little doubt that these lines were drawn by Pigou because, not only are the transcripts Pigou's personal

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<sup>1</sup> Examples include Keynes's biographies, such as *Keynes: The Return of the Master* (Skidelski 2009), and in monographs on Keynes, such as *Keynes's Theoretical Development: From the Tract to the General Theory* (Kirai 2008).

copies, but the pencil lines match the one occasion when a few words were written in pencil on the transcript.<sup>2</sup>

A full study of Pigou's membership of the Chamberlain-Bradbury Committee will be presented over two papers. The contribution of the present paper, which is Part 1 of a two part study, is the identification of the themes that Pigou highlighted on his personal copy of the transcripts of interviews with witnesses and to reflect on their relevance to Pigou's contribution to the Committee, with some regard also being given to his prior contribution to monetary economics. A subsequent paper, Part 2 of a two part study, will be written to address the character of Pigou's questioning of the witnesses that appeared before the Committee and to discuss the relationship between that questioning and the text from the transcripts that Pigou highlighted when he was not in attendance; and the relationship between Pigou's overall contribution to the Committee and his ex-post assessment from *Aspects of British Economic History 1918-1925* (Pigou 1947).

This paper is structured as follows. The basic historical context to the Chamberlain-Bradbury Committee is outlined in section 2. The next three sections are all devoted to specific themes that Pigou highlighted in the transcripts of interview: the highlighted contextual themes are introduced in section 3; the highlighted transitional themes are presented in section 4; and the highlighted on-going themes are presented in section 5. The major recommendations of the Committee are then summarised in section 6. The possible relevance of Pigou's study on monetary economics, the 'Value of Money' (1917), to his considerations as a member of the Committee is considered in section 7. Finally, the paper concludes, in section 8, that the text which Pigou highlighted suggests that his inclination was to be more cautious and moderate than the bold and urgent position reflected in the Committee's report; but he was unwilling to oppose the urgings for a return to gold from practical banking people and representatives from industry because, using his own contribution to monetary theory, it would not have been possible to establish a definitive position on whether, or not, to return to the gold standard.

Finally, unless otherwise indicated in this paper, all quotations from the Committee's interviews cited in the paper come from text in the transcripts that Pigou personally highlighted.

## **2) The Committee and its Historical Context: World War I and British Monetary Policy**

Under the gold standard, one pound sterling exchanged for four US dollars and eighty six cents (i.e. £1.00 = \$4.86). This represented these two currencies' respective command over gold; with monetary authorities in the US guaranteeing to convert one American dollar into 23.22 grains of fine gold and monetary authorities in Britain guaranteeing to convert one

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<sup>2</sup> Those words, which are inconsequential, are written in Pigou's unmistakable scrawl.

pound sterling into 113 grains of fine gold. When the exchange rate for these two currencies agrees with the ratio of their respective command over gold, there is a parity between both currencies relative to the standard against which they are issued – convertibility to gold. During the hearing of the Chamberlain-Bradbury Committee, this situation was often referred to as ‘parity’, as it is in this paper too.

Britain abandoned the gold standard at the commencement of the Great War to free itself from monetary constraints as it attempted to consider ways of paying for the war. To prevent Britain’s gold from flowing out of the country as the exchange rate fell below parity, a legal prohibition was imposed on the melting of gold and a ban on the export of gold. In that environment, the British Treasury entered the business of producing money. In the wording of Clause 1(1) of the *Currency and Bank Notes Act (1914)*:

“The Treasury may, subject to the provisions of this Act, issue currency notes for one pound and for ten shillings, and those notes shall be current in the United Kingdom in the same manner and to the same extent and as fully as sovereigns and half sovereigns.”

(ACP 04/01)

But while currency notes could be converted at the Bank of England into gold at face value, the issue of such notes was not required to be backed by a reserve of gold coins. Some of the currency note issues were indeed backed by gold coin, but, most often they were issued as fiduciary money (i.e. notes not backed by gold coins but supported by a promise that the Bank of England will pay gold on demand). As a consequence, pounds Sterling were being issued by the Bank of England, in the form of ‘bank notes’ and by the Treasury in the form of one pound and ten shillings ‘currency notes’, with the domestic exchange rate of ‘bank notes’ and ‘currency notes’ being one for one.<sup>3</sup>

By 1916 Sterling had been pegged to the US dollar, but at an exchange rate of \$4.76, which was below the rate needed to maintain the gold standard. The cost of maintaining that exchange rate, in terms of an outflow reserves, was so great that the peg had to be removed in March 1919, with the Sterling/Dollar exchange falling to a low point of \$3.30 in early 1920 (Dimisdale 1981, p. 307). In 1917, the below parity pegging of the Sterling was already under pressure when Walter Cunliffe, the Governor of the Bank of England, chaired the “Committee on Currency and Foreign Exchanges after the War” (the ‘Cunliffe Committee’ as it became known). The ‘Cunliffe Committee’, of which Pigou was also a member, issued its final report on January 1918 and recommended that the government should continue to issue currency notes but that such note issues should be accounted for, along with Bank notes, by the Banking Department of the Bank of England; and set the

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<sup>3</sup> Today the Bank of England Museum displays a one pound ‘currency note’, which it labels a ‘Bradbury pound’ after Sir John Bradbury, the Secretary to the Treasury between 1913 and 1919, whose signature appeared on such notes.

actual maximum fiduciary circulation of currency notes in any one year as the legal maximum for the following year. Currency note issues backed by gold coin were not, of course, affected by the recommended limit. The remainder were issued on a fiduciary basis – although Bank notes were also being transferred into the Currency Note Reserve account to support the fiduciary issue – and were subject to the limit.

By 1919, the British economy entered into a major slump and public debt was high. Between 1920 and 1922 deflation was very significant (29.4% decline in GDP deflator), real GDP was falling (down 3.4%) and real public expenditure on goods and services was falling (down 4.9%) (Dimisdale 1981, p. 309). Between 1922 and 1924, the economy began to pick up again, with real GDP growing significantly, but real government expenditure on goods and services was still declining as the government attempted to manage its debt problems and general fiscal constraints; but price levels were still falling, although more moderately.

By the time that the Chamberlain-Bradbury Committee had been convened, in mid-1924, the worst of the economic slump had past, but recovery had not been fully achieved and the spectre of deflation remained a consideration for monetary policy. On 21 May 1924, Sir Otto E. Niemeyer, the Comptroller of Finance in His Majesty's Treasury, sent the following 'private' letter to Pigou:

“Dear Mr Pigou,

The Chancellor is appointing a small Committee to advise him privately whether the time has come to amalgamate the currency and the Bank of England notes issues, and if so, on what terms and conditions. Mr Austen Chamberlain will be the chairman of the Committee and there will be four members, of whom Sir John Bradbury and myself will be two and one will be a banker. The Chancellor would be very grateful if you would consent to serve on the Committee, and I should like to add my personal hope that you will be able to do so. Though the subject is very important I do not think the work will be very exacting. It is not intended that the appointment of the Committee should be made public at present though no doubt ultimately their report will be published. I should be grateful if you would let me know if, as I hope, you would be willing to serve.

Yours very truly,

O. E. Niemeyer”

(Bank of England Archive, G1/433)

The Committee met for the first time on 27 June 1924, with Pigou joining Chamberlain, Bradbury and Niemeyer as members of the Committee, along with the

'banker', Gaspard Farrer (Director of Bearings, Merchant Bankers), who had also been appointed to the Committee. Mr N. E. Young, from the Treasury, was the Committee's secretary. As the Committee's title suggests, its brief concerned the question of whether Treasury's currency notes should cease being issued and be replaced by Bank of England notes (the *note amalgamation* question). But its brief was wider in that the Committee was heir apparent to the Cunliffe Committee, from which it was clear that the *note amalgamation* question was to be seen in the context of two other questions that also had to be answered. Namely, the Committee needed to come to a view on whether the embargo on the export of gold, which was set to expire on 31 December 1925, should be allowed to expire or whether it should be extended (the *gold embargo* question); and the related question of whether Sterling should return to the gold standard (the *gold standard* question).

To consider these questions, the Chamberlain-Bradbury Committee convened nine meetings to hear testimony from twelve invited witnesses. The people interviewed by the Committee were prominent individuals within government, the finance industry, in particular, and industry more generally. Past and present Bank of England officials interviewed included Montagu Norman, the Governor; and Charles Addis, a former Governor. Past Chancellors of the Exchequer, and their advisors, interviewed by the Committee included Reginald McKenna, Chancellor of the Exchequer (1915-16) and Chairman of Midland Bank (1919-43); Sir R. S. Horne, Chancellor of the Exchequer (1921-22); and Sir George Paish, former advisor to the Chancellor of the Exchequer. Bankers and industry representatives consulted included: L. Currie, partner of Glyn, Mills Currie & Co; Sir Felix Schuster, director of the National Provincial Bank and representing the Chamber of Commerce; Sir W.H.N Goschen, partner of Goshens and Cunliffe; Mr Walter Leaf, chairman of Westminster Bank; Mr F. C. Goodenough, chairman of Barclay's Bank; and Messes Chisholm and Glenday, representing the Federation of British Industries. Two academic economists were also interviewed by the Committee, J. M. Keynes, fellow of King's College Cambridge; and Edwin Cannan, professor of political economy at the University of London.

### **3) Pigou's Reading of the Transcripts: Contextual Issues**

A significant portion of the interviewees canvassed matters that can be broadly described as contextual themes. Three main contextual issues highlighted by Pigou were the underlying objectives of the Cunliffe Committee Report and their relevance to the current review; the similarities and differences between the monetary system prevailing in 1924 and that which had prevailed prior to the Great War; and the need for due regard to be taken of post war economic reconstruction in the Continent.

### *3.1 Relevance of the Cunliffe Committee's Report to the Present Committee*

J. Bradbury: "It seems to me that the plan contemplated by the Cunliffe Committee's Report was, first of all, to ascertain the normal level of the gold reservoir under free import and export conditions, then fix the fiduciary issue and then transfer the note issue to the Bank of England. I do not say, of course, that the Cunliffe Committee's Report should necessarily be followed."

*(ACP 04/01, transcript of Interview with W. Leaf, p. 11)*

It is probable that Pigou highlighted Bradbury's comment because he agreed with it. Not just because it succinctly captured the key elements of the Cunliffe report, but mainly because it emphasised that the core elements of the Cunliffe Committee report that were open issues for the current committee. As such, the Cunliffe report 'suggests' the type of on-going issues that the Chamberlain-Bradbury Committee may wish to be concerned with. As is evident from sections 5 and 6, the issues that the Committee considered are broadly in line with Bradbury's summary statement cited above.

### *3.2 British Monetary System: Prior to the Great War v. 1924*

The Cunliffe Committee's recommendation to restrict fiduciary issues was sometimes thought of as an initial step back towards the British monetary system prior to the Great War. However, Keynes pointed out to the Committee that the monetary systems of 1914 and 1924 were still very different in two substantive ways.

J. M. Keynes: "... the present system is different from the pre-war system in two very important respects. The first one is the very familiar one that the maximum is liable to vary downwards from one year to another, and never liable to vary upwards. That is familiar. The other point I do not think is quite so familiar, although it is really obvious. It is that under the present system, although there is no means of increasing the non-fiduciary portion, so that, whereas under the pre-war system we had a fixed fiduciary issue and a fluctuating non-fiduciary issue varying with imports of gold, what we have in effect now is a fixed total issue."

*(ACP 04/01, transcript of Interview with Mr. Keynes, p. 1)*

J. M. Keynes: "it is a mistake for the reason I elaborated a few minutes ago, to think that this system of rigid limitation is the pre-war system. It is much more dangerous than the pre-war system, because the pre-war system was always capable of expansion without any violent re-adjustment of the situation."

(ACP 04/01, transcript of Interview with Mr. Keynes, p. 3)

It is likely that Pigou highlighted these comments as part of his attempt to understand the full extent of the weakness in the current monetary system. The risk to future British economic activity associated with the asymmetric rigidity of the kind prevailing was dangerous and did, it appears, contribute to Pigou's acceptance of the idea that change is needed. As a negative assessment of the present relative to the past, it might have, in Pigou's mind, lent some support for a return to the pre-war gold standard because it was not asymmetrically restrictive. However, that would have only been one of many influences, as sections 4 and 5 suggest.

### *3.3 Post War Economic Reconstruction*

The final contextual issue concerned relevance of the likely outcome of the 'Dawes' Committee. Following Germany's default on war reparation payments, troops from France and Belgium occupied the Ruhr Valley, leading to major disruption to production in this coal and steel producing area of Germany. In response, the *Allied Reparations Commission* established an international committee, with representatives from Belgium, Britain, France, Italy and United States, chaired by an American, Senator Charles Dawes. Bradbury was Britain's principal representative on the Dawes Committee, which met during early 1924 with a brief to work out the terms under which troops would be withdrawn from the Ruhr Valley and reparation payments repaid, and still leave scope for the advancement of German reconstruction. The resulting Dawes plan was published in April 1924. As the hearings of the Chamberlain-Bradbury Committee commenced in June 1924, all members of the Committee, not just Bradbury, were aware that the Dawes plan called for loans for reconstruction, facilitation of a rescheduling of reparation payments, fiscal arrangements (such as customs and excise duties) to raise revenue to fund repayments and the reorganisation of Reichsbank under allied supervision. However, the Dawes plan was introduced not until August 1924. Consequently, during the 1924 hearings of the Committee, there was some uncertainty as to whether the Dawes plan would be accepted, modified or rejected by the nations sponsoring the Allied Reparations Commission.<sup>4</sup> However, by the time that the Committee reported, that uncertainty had been removed.

The parts of the transcripts that Pigou highlighted concerned the possibility of Germany adopting the gold standard; the implications for Britain if Germany did adopt an indirect gold standard; and the effect on the 'Bank Rate' when raising loans in Britain for German reconstruction; and the relevance of reparation arrangements for the proposed amalgamation of currency and bank note issues under the control of the Bank of England.

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<sup>4</sup> That as the report of the Chamberlain-Bradbury Committee was submitted in 1925, the uncertainty associated with the Dawes plan had ceased when the recommendations of the Committee were being developed.



These concerns are evident from the Committee's interviews with Chisholm, McKenna and leaf, as the following extracts of transcript reveal.

J. A. Chamberlain: "Assuming – for the purpose of agreement, at any rate – that that Report [Dawes' Report] goes through, and Germany is placed upon a gold exchange basis, would you consider that a reason for action by us?"

Mr Chisholm [in reply]. "... The idea of Germany being put by us on to a gold standard would seem to be ridiculous if we were not on one ourselves."

(ACP 04/01, transcript of Interview with Mr Chisholm and Mr Glenday, p. 3)

Perhaps the main relevance of the above discussion is that the Committee, and Pigou, were conscious of the multilateral international dimension to the issues before the Committee. The parity question is defined with reference to the Sterling – US dollar exchange rate and discussion of that bi-lateral relationship dominated the Committees discussions, no doubt because the US was the only major power on the gold standard at the time. Nevertheless, the multilateral dimension was not completely ignored, especially concerning the extent to which European nations, with which Britain is economically interdependent, do or don't introduce a gold standard.

J. Bradbury: "Admitted that there is no intention of establishing a German free market in gold. It is, as I read the Dawes Report, the intention at any rate to attempt to stabilise the exchange values of the market in terms of the American dollar, which is a currency based on gold."

R. McKenna [in reply]: "Yes".

J. Bradbury: "That policy may, or may not, be successful. Assuming that it is successful, then you will have a condition in which the dollar-mark exchange rate is stable. If the value of commodities in gold is variable, you will have concurrently a condition in which the sterling gold, sterling-mark exchange, is unstable, because sterling will follow commodities, and the mark will follow gold. Do you see the danger?"

R. McKenna [in reply]: "I see great danger to dollars and marks, but not to sterling. Sterling would be the stable, and the others would be fluctuating."

(ACP 04/01, transcript of Interview with Mr McKenna, p. 27)

The US dollar is directly on the gold standard, but the German Mark could go indirectly on the gold standard by being pegged to the US dollar. Pigou highlighted the uncertainty associated with this problem. The positions of Bradbury – that Britain may have a problem – and McKenna – that the United States and Germany, and not Britain, may have a problem – are both highlighted, and it is not possible to be certain which side of the

argument Pigou accepts. However, as evident from the highlighted testimony reproduced in sections 4 and 5 of this paper, it is evident that Pigou was particularly interested in McKenna's views. There is also a consistency between the position McKenna takes above and his discussion of transitional and on-going themes. It is, therefore, likely that at the very least he is giving serious consideration to McKenna's observation on the problems associated with the US and Germany concerning the return to the gold standard.

Bradbury also raised the effect of a change in the Bank of England's 'Bank Rate' on the success, or otherwise, of relatively high interest European reconstruction loans, such as those envisaged under the Dawes' Report, on the London market.

J. Bradbury: "I do not want to indicate the sort of terms on which it might be possible to raise a German loan, but assuming, for instance, it was on terms perhaps a little better than the recent Hungarian Loan, merely for the sake of argument, on a 7% or 8% basis, would the raising of 10 to 15 millions sterling in the London market on such a basis be appreciably more difficult if the Bank Rate were 5% instead of 4%. That is the short point.

Mr Leaf [in reply]. "Of course, the Hungarian Loan has been raised on a 8½% basis and the Bank rate is 4%. One would naturally expect a proportionate increase – if the credit in Germany is no better – if the Bank rate were 5%."

(ACP 04/01, transcript of Interview with Mr Leaf, p. 18)

Pigou probably highlighted this text as an illustration of potential economic consequences for other countries if Britain has to adjust the Bank rate to prevent an outflow of gold following the scheduled lifting of the British embargo on gold exports from 31 December 1925.

#### **4) Pigou's Reading of the Transcripts: Transitional Issues**

A number of strictly transitional issues pertaining to the three core questions –the *note amalgamation* question, the *gold embargo* question and the *gold standard* question – stand out because Pigou repeatedly highlighted them. When considering these issues, Pigou's highlighted text fell under five general areas: the determinants of the exchange rate over the period of transition and the relative influence of sentiment and price levels on exchange rates in the transitional period; the potential relevance of prior announcements of policy change and the timing of removing the embargo on gold exports and the amalgamation of notes; the relative effects of a single bold, or cautious multistage, transition on British industry; use of the Bank rate to stem outflows of gold; and use of possible alternatives to the Bank rate to stem outflows of gold.

#### *4.1 Determinants of the Exchange Rate in the Period of Transition: Sentiment or Price Levels*

Pigou highlighted a number of exchanges between the members of committee and McKenna, which emphasised that the decisive influence on changes in the UK-US exchange rate was, in fact, relative price levels in the UK and US, not sentiment. The emphasis on change price levels is, of course, reminiscent of another famous parity, the relative version of the purchasing power parity thesis. If that view is accepted, the possibility of returning to the gold standard depends on the expected direction of relative changes in the purchasing power of a unit of currency in the UK and US, at least when restricted to bilateral considerations.

J. McKenna: "In the language of a great statesman, 'wait and see'. American prices will probably be up to that level before the 1<sup>st</sup> January 1926. We shall automatically be on the gold basis when we open our mints."

*(ACP 04/01, transcript of Interview with Mr McKenna, p. 18)*

But the Chair of the committee was particularly interested in the role that sentiment could play, and he interrogated McKenna further to elicit views on whether the impact of a shock, like amalgamating bank notes and currency notes or the removal of the embargo on gold export, could be mitigated in some way through announcements by public authorities. Looming largely in the minds of Chamberlain, and Bradbury, was the potential for sentiment to be influenced by the timing of public announcements and thereby influence the exchange rate.

J. A. Chamberlain: "Is not the present level of the dollar exchange largely the result of sentiment?"

McKenna [in reply] "No."

J. A. Chamberlain: "You think it is entirely dependent upon the price level?"

McKenna [in reply] "Price level entirely."<sup>5</sup>

*(ACP 04/01, transcript of Interview with Mr McKenna p. 19)*

Horne was also of the view that variations in the US-UK exchange rate is largely given by change in relative domestic price levels in each country, and, like McKenna, he argued that the direction of those changes will lead to the exchange rate given by the gold standard being shortly attained. In that regard, one important factor noted by Horne was the influence of the US budget on inflation in the US.

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<sup>5</sup> McKenna goes on to clarify that divergences between movement in relative sterling-US dollar exchange rates and relative British-US price levels is probably due to error in deriving price estimates and not the influence of sentiment.

J. Bradbury: "... on the figures for the last two or three months the position of the Federal Reserve Banks, from the point of view of resisting the effect of a gold influx, appears to have strengthened, that is to say the marketable securities of those Banks, after showing for a good many months a decrease, are now showing an increase.

Horne [in reply]: "I have not been into that, but I should think that the large expenditure put forward in the latest programme of the American Congress – those soldiers' pensions, for instance – is going to involve a very large expenditure on the part of the United States, and I imagine that that is going to have its effect upon prices. It seems to me it inevitable (sic) should.

J. Bradbury: "Your view would be that our right policy for the moment is to pursue a credit policy in this country which would tend to keep prices steady?"

Horne [in reply]: "Yes."

J. Bradbury: "And to take advantage of any rise in American prices to return, so to speak, automatically to the gold standard."

Horne [in reply]: "Yes."

(ACP 04/01, transcript of Interview with Mr Horne, pp. 13-14)

Horn also contended (ACP 04/01, transcript of Interview with Mr Horne, p. 9) that the world has appreciated Britain's efforts to meet her war debts by imposing a higher tax burden on itself than any other country. The goodwill that that action generated would mitigate any adverse international reaction to a renewal of the export embargo on gold. Finally, if a gold standard is not adopted, Keynes' too indicated that he could see no alternative criterion other than through price levels.

J. M. Keynes: "... If the criterion is not gold, I do not know of any alternative criterion which has been seriously put forward except the level of prices. But the difficulty of that is that we cannot easily – in fact, we cannot at all – apply that criterion, the criterion of prices, until we have decided whether our policy is to raise prices or lower them or to keep them steady in the transitional period. I exclude the policy of any material rise in prices because I do not think anyone defends it."

(ACP 04/01, transcript of Interview with Mr Keynes, p. 3)

#### *4.2 Announcements and the Timing of Change*

Notwithstanding the firm views of McKenna and Horne on the primary role of changes in price levels in shaping changes in the exchange rate, the Committee repeatedly returned to the issue of the timing of announcements. Associated with this were the arguments for and against the 'bold' approach being taken to end the embargo on the export of gold. The idea of getting the timing of announcements correct was typically considered after discussing the correct policy sequence: between the end of the embargo on gold exports and the replacement of currency note issues with Bank note issues; and then in the between the end of the embargo on gold exports and the full adoption of the gold standard.

The first of the above issues was put clearly by J. A. Chamberlain when he restated his understanding of the goals of the Cunliffe committee report and his suggestion that the Chancellor of the Exchequer could only come to a position on the immediate matter before the present Committee – namely, on whether or not to amalgamate Bank note and currency note issues – after some experience of the effect of removing the embargo on the export of gold.

Chamberlain: "Of course, the Currency Committee contemplated I think it was impossible to fix the proper amount of the fiduciary issue until you have had a year's experience, they said, of the working of free gold, of free export of gold. They therefore proposed that the free export of gold should be first; after you had the experience of that, the notes should be transferred."

*(ACP 04/01, transcript of Interview with Mr Goschen, p. 2)*

If returning to the gold stand is the intention, McKenna similarly argued that the amalgamation of the currency should be considered subsequent to the return to a gold standard, although the achievement of that standard was to be given by movements in market for exchange over time.

J. Bradbury: "Of course the chief object of this Commission for the moment is to advise the Chancellor of the Exchequer as to the immediate steps, if any, which out to be taken in regard primarily to the question of amalgamating the two issues, behind which is the question of the ultimate return to the gold standard. Now am I correct in saying that the advice you would be disposed to give would be to do nothing at all until such time as the pressure of events brings Sterling to par, and then to have an international monetary conference with a view to settling the general terms, as between nations, for the ultimate resumption of the gold standard? Is that a correct summary?"

McKenna [in reply] "That is a correct summary".

*(ACP 04/01, transcript of Interview with Mr McKenna, p. 24)*

However, if that was not the goal, if returning to the gold standard was not the goal, then Pigou highlighted both McKenna's and Goodenough's endorsement of the amalgamation of note issues sooner rather than later:

R. McKenna: "If we are not going back to the gold standard; if we are able to find a better standard for ourselves or if we feel that the gold standard, while it is a pretty good standard, is nevertheless too costly under existing conditions for any nation but the united States to support, then I would amalgamate the two issues now."

*(ACP 04/01, transcript of Interview with Mr McKenna, p. 8)*

O. Niemeyer: "You would see no objection to amalgamation without that [early announcement of the removal of the embargo on the export of gold]?"

F. C. Goodenough [in reply]: "Without that I should be in favour of doing it, but not coupled with it, because I think the objection is stronger than the argument in favour of the amalgamation of the issue."

*(ACP 04/01, transcript of Interview with F. C. Goodenough, p. 16)*

F. C. Goodenough: " I should not be in favour of amalgamating the issues if coupled with an announcement that in 1926 you are going to remove the restriction on the export of gold. I think it is too dangerous".

*(ACP 04/01, transcript of Interview with Mr Goodenough, p. 16)*

J. Bradbury: "Mr Goodenough, I understand that you think it would be unsafe as part of this amalgamation to make an announcement that the embargo on the export of gold will not be continued. Would you think it desirable or undesirable at the time when the amalgamation is provided for that it should be definitely represented as a step in the direction of the ultimate restoration of the free market in gold without committing myself as to dates?"

F. C. Goodenough [in reply]: "It depends very much on the wording. I think that something of the kind might be said with excellent effect so long as it [does not] ... produce anything which might be a disappointment in the public mind supposing it did not come about. It would require careful wording, and should be very indefinite indeed."

*(ACP 04/01, transcript of Interview with Mr Goodenough, p. 17)*

Similar to the cautious manner exhibited by McKenna and Goodenough, Schuster warned that once the embargo on the export of gold is removed it cannot be reversed and noted that, in view of this, he also argued that is prudent to wait until the exchange rate is moving favourably before removing restriction on the free export of gold, and even then, do so by progressively increasing the number of export licences (*ACP 04/01*, transcript of Interview with Mr Schuster, p. 13). But Chamberlain challenged that cautious note:

J. A. Chamberlain: "If we don't show any want of confidence nobody will have any confidence in us, will they? Is this not one of those cases where if you are doing anything at all the boldest course is also the safest course?"

F. Schuster [in reply] "Well, we have so many elements of uncertainty in Europe now that I would rather like to see how they settle themselves. I would like to see the Reparation question got out the way before we take the irrevocable step."

(*ACP 04/01*, transcript of Interview with Mr Schuster, pp. 13-14)

Horne differentiated between policy; the announcements pertaining to policy; and the question of uncertainty. He argued that while removing the embargo on gold would be good policy; announcing that removal at a future date when that outcome is not certain would lead to markets disappointment; and such uncertainty is not good policy. As a consequence, he did not wish to see any kind of early announcement at the present time.

J. Bradbury: "As regard the question of the embargo on the export of gold, I take it that your view would be that it is undesirable at the moment to make any kind of announcement ...?"

Horne [in reply] "That is exactly my view. I should myself be disappointed if it has got to be continued, but I think an announcement at the present time would be detrimental."

(*ACP 04/01*, transcript of Interview with Mr Horne, p. 15)

#### *4.3 Relative Effects on British Industry of One-Off v. Multi-stage Transition*

A number of witnesses testified about the effects of monetary transition on British industry. The passages that Pigou highlighted tended to focus on the relative merits of a bold movement to the gold standard, with industry largely undergoing adjustment at one point in time, and a more cautious and less bold movement to the gold standard, with industry undergoing adjustments across more than one period of time. The implicit context of such

discussion is the standard for redeeming gold in exchange for one pound is the same standard that applied prior to the Great War.<sup>6</sup>

Mr Goodenough, representing the Barclays Bank, argued that industry is best able to adjust to gradual incremental change.

J. Bradbury: "Assuming ... [that] a restoration of the parity of exchange resulted in a fall in domestic prices here, a fairly rapid fall of something like 10% or 12% ... not accompanied by fairly high money rates, would it be serious to industry? ..."

Goodenough [in reply] "... Contracts throughout the country entered into on one basis would have to be filled under completely different conditions. That must necessarily involve large losses."

J. Bradbury: "As a choice of evils, do you think a rapid fall or a gradual fall?"

Goodenough [in reply]: "A gradual fall... I think there is no doubt about that. It gives people an opportunity of turning round rather than being faced with immediate heavy losses."

(ACP 04/01, transcript of Interview with Mr Goodenough, pp. 21-22 )

Mr Glenday, representing the Federation of British Industries, answered in the same fashion as Goodenough, both favouring a slow adjustment to any price fall. In contrast, however, Sir R. S. Horne, former Chancellor of the Exchequer, gave a response to a more general question on transition that suggests trade in Britain is better able to deal with a single shock, rather than a series of shocks, provided that the single shock is not terminal.

J. A. Chamberlain: "...we have a difficult period of transition, as you say. Is it better that that period should be long and the transition gradual, or is it better that you should take your medicine in one dose and set to work on the new basis?"

R. S. Horne [in reply] "Well, all I can say is this, that if there was any kind of body in trade of this country at the present time, if there was anything that could give you confidence that it has strength enough to go through the difficulty, I would have taken my medicine at once; but I remember a very famous surgeon in England who always operated whenever there was anything wrong with a patient. His name was Rumford. At the end of an

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<sup>6</sup> It would, of course, have been possible to consider reducing the quantity of gold paid when a pound is redeemed so that, in effect, a 'new' gold standard based exchange rate could be set at a rate that is lower than US\$4.86. However, that possibility was not considered in anything that Pigou highlighted and the Committee's report explicitly indicated that the option had not been considered as it was unnecessary due to the rise in the exchange rate over the life of the Committee.



operation he would say to his students, who were standing around watching him, “Gentlemen, the operation has been entirely successful, but unfortunately the patient has died in the course of it”.

(ACP 04/01, transcript of Interview with Mr Horne, p. 12)

So the reference to a terminal shock is rather important, as Horne clearly had fears that the British economy may not be able to adjust to a gold standard. If the embargo on the export of gold is not renewed, he agreed that everything possible must be done to return the sterling to parity. But he suggested that British industry would prefer to continue the embargo on the export of gold for the following reason:

Horne: “... I do not think they [British industry] could meet that burden. The mere announcement would give people the idea that, since prices were going to be less, they must stop manufacturing because of the fact that there would be no buying; they may have bought the raw materials for their present manufacture at the enhanced price.”

(ACP 04/01, transcript of Interview with Mr Horne, p. 6)

#### *4.4 Using the Bank Rate to Stem Outflows of Gold*

Pigou also highlighted comments from several witnesses on the relationship between the end of the embargo on the export of gold and the Bank rate. Mr Paish was emphatic that there should be no contemplation of pre-announcing mechanisms by which the bank rate would be adjusted in the face of excessive outflow of gold.

Mr G. Paish: “no statement should be made about the bank rate; such a statement would tend to make people alarmed rather than reassured. The advisable course would seem to be to take off the embargo and to wait and see if gold goes out. Then, if gold goes out beyond the amount that the Bank of England feels justified in losing the Bank will raise the Bank Rate in the normal way.”

(ACP 04/01, transcript of Interview with G. Paish, p. 18)

Mr Currie (ACP 04/01, transcript of Interview with Mr Currie p. 7) agreed with Farrer’s suggestions that lifting the embargo on gold could push the British exchange rate up, relative to the United States dollar. But only initially, as it could also slip back down and a drain on gold resumed. He noted that the increase in value of the pound may make investing in America an even better investment; but he emphasised that if the announcement of free trade in gold may not result in a big enough increase in the value of

the pound sterling to sustain the gold standard. If so, he cautioned that the next step in policy – i.e. a return to the gold standard after announcing the removal of the embargo on the export of gold – could not be carried out.

Goodenough was concerned over the relationship between the Bank rate and the announcement that Britain would be going onto the gold standard at some not too distant date, although he also acknowledged that current price levels in the US and UK may lead to a rise in the Bank rate in any case.

Goodenough [by way of clarification]: “Do you mean to ask me whether I think that if it is announced today the intention to become a free gold market in 1926, that would in itself necessitate putting up the Bank Rate?”

J. A. Chamberlain: “Yes, that as a consequence of that the Bank Rate would go to 7% or 8% between now and then.

Goodenough: “I should not have thought that would happen straight away.”

J. A. Chamberlain: “You contemplate that quite apart from any announcement in respect of a return to a free gold market, circumstances are rather pointing to some rise in the Bank Rate?”

Goodenough [in reply]: “I have thought so, that in order to approximate price levels between this country and America it might be necessary to put up the Bank Rate here to some extent.”

*(ACP 04/01, transcript of Interview with Mr Goodenough, p. 9)*

F. C. Goodenough: “But I think that if we were now to move to a return to a free gold market, much as I desire to see it, I am afraid we might find ourselves involved in very stringent high money rates, the effect of which would be very much criticised – very much indeed – and undoubtedly would do a great deal of harm. My feeling upon the whole subject – I do not know if I am to the point on this?”

J. A. Chamberlain [in reply]: “Yes, very much”

F. C. GOODENOUGH “: .... Is that these steps are not be be (sic) forced.”]

*(ACP 04/01, transcript of Interview with Mr Goodenough, p. 4)*

G. Farrer: “So that you fear a large export of gold?”

F. C. Goodenough [in reply] "I think that might be possible."

G. Farrer:" What would you expect the effect on the public mind to be if, say, 20 millions went out?"

F. C. Goodenough [in reply]: "I think that, coupled with 8% or 10% bank rate, you would be anathematised everywhere. The point is really this. If you were perfectly free you would not, with the exchange at a heavy discount, suddenly today announce a free gold market and say: "I am going on a free gold market tomorrow morning"".

(ACP 04/01, transcript of Interview with Mr Goodenough, pp. 19-20)

Schuster also conceded that it may be that at some stage 'dear money' might be needed to get to the gold standard, but, contrary to the view of Goodenough, the increase in money rates would not, in his view, be great enough to be harmful to profits (ACP 04/01, transcript of Interview with Mr Goodenough, p. 18). Paish was even less concerned, suggesting that the potential for an increase in the Bank rate is merely an 'insurance' that the exchange rate can get to, and be maintained at, at the gold standard rate, it was not in his view a 'necessity'.

#### *4.5 Using Possible Alternatives to the Bank Rate to Stem Outflows of Gold:*

Other than through changes in the Bank rate, Pigou highlighted three alternative ways of checking the outflow of gold when the exchange is below parity: restricting domestic credit; restricting the issuing of currency; and buying gold at a loss. The relevance of these highlighted points to Pigou is that restricting domestic credit and restricting the use of currency are both ruled out by the witnesses, the former is impossible the latter as not operating to advantage, and buying gold at a loss is possible, only as a very short term measure.

##### (i) Restricting domestic credit

McKenna rejected the introduction of credit controls as a means of reducing the outflow of gold by deflating domestic prices because that will cause a more than proportionate reduction in the value of tax bases. The indirect result of such an arrangement will be public debt financed from borrowing, which is inflationary. But checking any outflow of gold on a sustainable basis requires parity in the exchange rate, which, in the period of transition, depends on British price levels deflating relative to the US before, and subsequent to that, for British price levels grow more slowly than US prices.

J. A. Chamberlain: "What would be the effect if the Chancellor were to announce this year at the earliest convenient date that it is his firm intention not to renew the embargo, and that he was confident of the power of this country to resume gold payments?"

J. McKenna [in reply]: "I should liken him to King Canute who told the tide to recede".

J. A. Chamberlain: "You think he would be undertaking what he could not perform?"

J. McKenna [in reply]: "You cannot get us on to the gold standard by any action of the Chancellor of the Exchequer in any way. You cannot do it. Nothing that he could do in the way of restricting credit here and forcing down prices in this country would get him to the gold standard. He would cause infinite trouble, cause unlimited unemployment, immense losses and ruin, but he could not balance his Budget while he was doing it, and he would have to begin to borrow. Before he got our price level down 10% he would be borrowing again because his revenue would not be coming in. He would be having to inflate before he got there. The Budgetary difficulty will always beat them in forcing down prices."

*(ACP 04/01, transcript of Interview with Mr McKenna, p. 18-19)*

## (ii) Restricting the use of currency

McKenna also quickly rejected the Chairman's musing as to whether some possible restrictions on currency might be a useful policy.

J. A. Chamberlain: "[the responsibility of the Bank of England] for its due exercise, requires in the Bank of England a power and a will to be unpopular at times. Might it not sentimentally or morally be of some consequence to the Bank in exercising its functions that there was some restriction on currency, the public understanding that more easily [than] ... restricting credit?"

McKenna [in reply] "... if the restriction operated, or could operate, advantageously I should agree; ... but as the restriction does not, and could not, operate advantageously, I am against it as a defence."

*(ACP 04/01, transcript of Interview with Mr McKenna p. 19)*

### (iii) Buying gold at a loss

The final alternative to using the Bank rate to stem any outflow of gold concerns the possibility of buying gold back at a loss. This was advocated by Mr Goodenough.

J. Bradbury: "What you say seems to me quite correct if it is coupled with a free gold market. But I am now on the transitional period. Before you get the exchange back to parity, you have under the plan which you advocate a rigid currency subject only to the willingness of the Bank of England to buy gold at what is apparently a loss."

(ACP 04/01, transcript of Interview with Mr Goodenough, p. 12)

Of course, this measure could only operate temporarily because, after a short period, losses could become prohibitive.

## 5) Pigou's Reading of the Transcripts: On-going Issues

*A priori*, one may expect that a committee that ultimately advocated in favour of a return to the gold standard would have focused extensively on the long term implications for Britain once the standard was in place. Curiously though, Pigou's highlighting of the transcript placed greatest emphasis on issues related to the question of transition. Nevertheless, a number of the questions to witnesses did extend to on-going issues of genuine long run significance. Pigou's highlighting of on-going matters in the Committee's transcripts fall under five main themes: the on-going benefits for Britain from a return to the gold standard; the cost of returning to gold; the general relationship between price levels, exchange rates and credit control; the question of who should have the authority to issue sterling; and limits to the effectiveness of restricting the quantity of money issued once note issues have been amalgamated.

### 5.1 *The On-going Benefit for Britain from Returning to Gold: A Return to Stability?*

The most fundamental long term issue related to the Committee's activities obviously concerned the perception of on-going benefits from returning to the gold standard. Surprisingly, it was rare to raise the issue as most witnesses who favoured gold were hardly quizzed on its benefits for Britain, rather, expected benefits were typically implicitly assumed or asserted and not fully explained.

Federation of British Industries: "Since this country is the international clearing house, both for money and goods, a general return to the gold basis would, in the opinion of the Federation, be greatly to our benefit."

(ACP 04/01, submission to the Committee by Messrs Chisholm and Glenday)

The exception, however, concerns the evidence obtained from questioning McKenna. Indeed, his long term case for the gold standard was so highly qualified, his support for the gold standard can only be characterised as extremely weak – and only because we live in a less than perfect world. His three reasons why he believed that gold was an appropriate standard in the long run are discussed below:

G. Farrer: "You would say, then, that if we get back to a gold basis, it is the fact that it would then be stable with the dollar; while in its present condition it is 4.34 today but it may be 4.20 or 4.10 tomorrow for all we know?"

R. McKenna: "No, that was not any one of the reasons that I think would incline one to be in favour of the gold standard. My first reason was the universal but unfounded belief that a currency is safer if it is convertible than if it is not convertible; secondly, that we have tremendous interests in the maintenance of the value of gold - in Canada, South Africa and Australia; and thirdly, that in the control of credit you have something which is not readily understood by people. The amount of gold, they understand that better than the arbitrary control of credit by the Bank of England which exists today. But there is no question in my mind of there being any advantage of trade of the Exchange being at one level more than another level. There may be advantage in getting down to a level, there may be disadvantage in getting down to a level; there may have been advantage in getting up to another level, there may have been a disadvantage in getting up to another level. But when you are there, stay there so far as trade is concerned."

(ACP 04/01, transcript of Interview with Mr McKenna, p. 21)

The first and third reasons proffered by McKenna concern the 'world in which we are' and not the 'intelligent world', which he refers to elsewhere (as quoted in subsection 5.5 *Should there be Restrictions on the Quantity of Money Issued?*). The second reason, however, concerns the economic benefits to empire nations, which produce gold, of maintaining a gold standard. But the absolutely critical point for McKenna, is that he does not support the gold standard because it will stabilise prices; rather, 'in the world in which we are' he supports a gold standard only when there are stable prices.

R. McKenna: "If you had all that and got stability, then I am for stability, and 4.86 would be a stable point. But I would not be at 4.86 without that. I do

not want to fluctuate. If gold is going to fluctuate I do not want to fluctuate with gold: I want stability.”

(ACP 04/01, transcript of Interview with Mr McKenna, p. 22)

The implication is clear: stability is a pre-condition for, not a consequence of, moving to the gold standard.

### *5.2 The Cost of Turning to Gold*

Maintaining a stable gold price is, according to McKenna, one of the necessary means to stability in exchange rates under the gold standard. To achieve that, he argued that countries on the gold standard have to enter gold markets to purchase gold stocks even when such stocks are not required as reserves for strict monetary purposes. As noted in the previous sub-section, the empire as a whole is a gold producer, so nations within the empire gain from the premium on the gold price from central bank efforts to maintain the stable gold price. The extent of this benefit is greatest while the US is on a gold stand, and Britain is not, as the US meets the main cost of gold price maintenance, while Canada, South Africa and Australia reap the benefits of the higher international price for gold.

But when considered in the context of the on-going effects of a return to the gold standard, the net effect must be considered because Britain too would have to incur a cost associated with its share of gold purchases designed solely to maintain the price of gold, which had previously been met by the US. McKenna asserted that United States incur an annual cost of 60 million pounds on supporting gold prices, under the gold standard, Britain would have to meet some of that cost. Pigou also highlighted McKenna’s discussion of how the US buys its securities back to ensure that gold purchased for the purpose of gold price maintenance is sterilised so it does not flow through to the stock of money.

R. McKenna: “The output of gold reckoned in terms of sterling at the present price of gold, is in a year over seventy million in value. The world consumption of gold outside the United States, that is to say, genuine buyers who want the stuff, is not more than ten millions pounds sterling which, if somebody did not buy it, would immediately depress the price of gold enormously. Now if gold were depressed in value the United States being on the gold standard, that is today, having their Mints open and obliged to coin gold on demand into dollars, if the gold were allowed to fall in value the dollar would also fall in value and immediately prices would rise in the United States and the United States would get into a state of real bad inflation and rising prices. In order to prevent this happening the United States buy all this gold and do not allow it to become the basis of new credit. They achieve that object in this way. As fast as gold is poured into the Federal Reserve Bank

creating thereby an additional account of Bank cash in the hands of the Banks who have brought the gold and sent it into the Federal Reserve Bank, the Federal Reserve immediately reduces the amount of Bank cash by selling securities or Bills. I call a Bill a security of course. Just as I said the Bank of England could reduce credit by selling securities, so the Federal Reserve Bank reduces cash by as fast as cash would have been increased by the sale of gold.”

(ACP 04/01, transcript of Interview with Mr McKenna, pp. 9-10)

The on-going dilemma then that Britain will face when going back on the gold standard is evident. In the face of large national debts, it will be difficult to it follow the US practice of selling securities to sterilise the effect of the gold inflow on the quantity of money and credit without increasing the burden on British taxpayers. McKenna’s preferred solution was to allow much of the inflow to become a basis for new credit; to accept both an increase in the quantity of money and a modest degree of consequent inflation, as this would be conducive to economic growth.

McKenna: “...the effect would be to introduce a long slow period of rising or inflated prices due to varying value [stocks] of gold and, in view of the immense national debts, I think the easiest way to get rid of an excessive burden which the taxpayer cannot bear is by a slow process of inflation. You have to distinguish this from what is ordinarily termed inflation because I do not mean the inflation of 1919 nor the ordinary credit inflation which is done voluntarily. I do not mean that. I mean precisely the same inflation as this country had from the year 1901 to the year 1914. Prices were during that period steadily tending upward owing to the oversupply of gold. ... I think it would be good for our trade because it would mean a period of rising prices, rising prices restricted by the quantity of gold and, therefore, not due to an unrestricted issue of currency by a defaulting Government.”

(ACP 04/01, transcript of Interview with Mr McKenna, p. 12)

On the face of it, it may appear that there is a contradiction between McKenna’s abovementioned views on inflation and his unequivocal view that the sterling-dollar exchange rate depends on the ‘price level entirely’. On that basis, if the relative purchasing power between the US and the UK is altered by British inflation rising above that of the US, there is a potential danger that British gold reserves would come under pressure if the demand for sterling starts to fall below that implied by the rate fixed by the gold standard. However, such a contradiction is apparent, not real. Not only did McKenna testify that there should be no rush back to the gold standard, he also argued, and Pigou highlighted, that Bank of England credit would have to be used to prevent inflation getting out of hand. Consequently, there is an implicit logic and balance in McKenna’s overall testimony:



allowing inflation to increase is fine as gold reserves mount as it is good for growth, but if inflation rises relative to the US and a consequent outflow of gold develops, then the Bank of England should at some stage tighten credit. Given that Pigou highlighted the parts of McKenna's testimony related to all these points, it is safe to assume that he did not miss the implied relationship, and associated balancing between each of these points.

### *5.3 Price Levels and the Exchange Rates: Credit Control as an Alternative to Gold*

If price levels are adopted as the criterion for monetary policy, then, as Pigou highlighted, Keynes would place great weight on credit control and control of currency issue by the Bank of England. But, unlike McKenna, Keynes was content for this to be a permanent arrangement, as evident from the discussion between Bradbury and Chisholm that Pigou highlighted.

J. Bradbury: "I take it that for the immediate period you would aim at regulating the value of the pound more or less artificially by the Government credit policy and the Bank of England credit policy in such a way as to keep prices stable, which I take it is really Mr Keynes' policy, except Mr Keynes proposes it as a permanent policy, while you propose it as an interim policy pending the time when the fall in American prices, as you hope, will enable us to restore the gold standard?"

Mr Chisholm [in reply]: "I am not at all averse to a managed currency under certain conditions."

*(ACP 04/01, transcript of Interview with Mr Chisholm and Mr Glenday, p. 6)*

Pigou also highlighted Keynes's discussion of the relative effectiveness of credit control and placing limits on the issuing of money. He made it clear that the former is always more direct and generally more effective than that latter, which should only be considered as a very loosely defined back up to the former.

J. M. Keynes: "So long as credit control is successfully conducted, the limitation on the volume of currency ought never to be operative; and if you have a limit at all it is only as a second line of defence and as a thing which might possibly strengthen the hands of central authorities in the event of a serious collapse of their deliberate credit policy."

J. M. Keynes: "It is the most difficult conceivable way to attain any result, to try to do it by regulating the note issue, because you are acting on almost the last event in the causal train. When a tendency is set up to cause rising or falling prices, the very last thing which happens is the movement in the note issue."

J. M. Keynes: "If you insist on a fixed maximum for your note issue, this maximum should be appreciably higher [than the most recent actual] – I should say by not less than 15%; and I think even that is running it rather close ...there is a good deal to be said in favour of a margin of 20%."

(ACP 04/01, transcript of Interview with Mr Keynes, p. 5., p. 6 and p. 7)

#### *5.4 Who should have the Authority to issue Sterling?*

On the *note amalgamation* question, the fundamental question arose as to which public entity should have the authority to issue Bank and currency notes. At stake was the basic matter of whether the Government should have some on-going role on the issuing of money through the involvement of its Department of Treasury and potentially the Chancellor of the Exchequer, or whether the Bank of England should have complete authority on such matters (at least for England). Schuster put his response in the strongest unequivocal terms.

F. Schuster: "I think the transfer of this issue [Treasury's authority to issue 1 pound and 10 shilling currency notes] to the Bank of England would at once give you the opportunity ... [to] divest the government of all power in regard to the note issue."

(ACP 04/01, transcript of Interview with Mr Schuster, p. 3)

But the removal of Treasury from the management of note issuing is not the only benefit of amalgamation of note issues. Pigou also highlights views by Mr Glenday, that amalgamation will increase the 'elasticity', or flexibility, of monetary policy by affording a single monetary authority great opportunity to expand credit; by W. H. Goschen, that greater elasticity is a good thing, especially in the recovery period that Britain was going through; and F. C. Goodenough, that there is no danger in amalgamation and it is a step forward that might lead to something else (presumably a return to the gold standard).

However, not everyone agreed with the amalgamation of note issue as a desirable long term policy. Notably, Leaf argued that the amalgamation of note issues would be a technical issue only because, in people's minds, the currency notes issued by Treasury are regarded as if they were convertible.

#### *5.5 Should there be Restrictions on the Quantity of Money Issued?*

The transfer of responsibility for currency notes to the bank of England also raises the question as to whether the strict maximum limits that the Treasury applied to the issuing of currency notes should be extended to the Bank of England when issuing the amalgamated

Bank note. This was considered particularly relevant because, as Keynes had testified, by 1924 the limits imposed on currency had become 'operative' in that the actual currency note issue had approached the maximum issue. This brought Keynes's concern about the danger of the current arrangement into play and reinforced his views that great care must be taken not to impose a limit that is too close to the actual issue. Pigou also highlighted Edwin Cannan's slightly different take on the issue. Cannan termed the difference between the actual and the maximum issue of currency notes as an 'invisible reserve', but he suggested that it would not become negative even if currency note issue expanded because reserves such as gold, or Bank notes which come to the same thing could be transferred to the currency note (*ACP 04/01*, transcript of interview with E. Cannan, p. 9).

Pigou also highlighted the exchange between Bradbury and McKenna, in which McKenna, consistent with his entire testimony, reiterated that it is relative price levels that are of primary importance for the exchange rate and Bank of England credit is of primary importance as a direct safeguard from inflation (and indirect safeguard for stability in the exchange rate). Under such arrangements, the quantity of money issued would not be limited. In an 'intelligent world', he regarded that as a suitable permanent monetary arrangement for Britain. But in the 'world in which we are', he accepted compromises to these points, including a slow cautious return to gold (as indicated in McKenna's testimony cited in sub-sections 5.1 and 5.2).

J. Bradbury: "You would abolish that limit [on the issue of money]?"

McKenna [in reply]: "Yes." ...

J. Bradbury: "You would rely entirely as a safeguard against inflation – because I take it in the sense in which I use the term "inflation" you are an enemy of it – upon the discretion of the Bank of England in controlling credit?"

McKenna [in reply]: "Entirely."

J. Bradbury: "You suggest that discretion should be exercised by the Bank, not with reference to the size for the time being of the reserve of the banking department – because the size of the reserve of the bank is with the Treasury notes an illusory thing – but the examination of statistics of price levels?"

McKenna [in reply]: "It should be founded on price levels."

J. Bradbury: Should you contemplate that as a permanent currency system?

McKenna [in reply]: Well, if we were living in an intelligent world, yes I should.

J. Bradbury: "But in the world in which we are?"

McKenna [in reply]: "In the world in which we are, no."

(ACP 04/01, transcript of Interview with Mr McKenna, p. 29)

## 6) The Committee's Main Recommendations

The Committee reported to the Lords of the Treasury on 5 February 1925. On the *gold embargo* question and the *gold standard* question, the Committee, in its final report, opted for a quick and bold approach.

"(T)he early return to the gold standard should be declared to be the irrevocable policy of His Majesty's Government and that it should definitely be stated that the existing restrictions on the export of gold, which expire on 31 December next, will not be renewed".

(Bank of England Archive: G1/433)

This was justified because the Committee could find "no alternative comparable with a return to the former gold parity of the sovereign"; and the "mere announcement" that the "power to prohibit the export of gold would not be continued beyond 31<sup>st</sup> December 1925 would, automatically and rapidly, bring about the credit conditions necessary to effect the adjustments and that the effective gold standard could thus be restored" (Bank of England Archive: G1/433).

To support its recommendation, the Committee reported that the value of the Sterling had risen from 10% to 12% below parity, when the Committee first commenced its consideration, to 1½% below parity when the report was prepared and concluded: that the pre-war parity could be maintained into the future by employing credit control to adjust domestic purchasing power; and gold reserves are adequate to maintain a gold standard if the possibility of temporary increases in the Bank rate are contemplated (Bank of England Archive: G1/433). However, following concerns expressed by Pigou that a further fall in relative British price levels of around 6% would be needed before parity would be attained, the final report was adjusted to include words which cautioned that Britain would have to expect a significant but small decline in domestic price levels (Moggridge 1972, p. 64). Otherwise, to go on the gold standard at pre-war parity carried a risk of a net outflow of gold, but the report also included an expression of hope that much of the adjustment would be met by rising price levels in the United States.

In contrast to Committee's final position on the *gold embargo* and *gold standard* questions, the Committee opted for a drawn out and cautious response to the *note amalgamation* question. It did decide to recommend that Bank of England notes be substituted for currency notes, but only from 1928. This was partly due to the need for new legislation to be introduced to remove the restriction on the Bank of England from issuing

notes of below five pounds (so that it can start issuing one pound and ten shilling notes to replace the currency notes) and partly due to the technical reasons that require the Bank to receive notice of one year before it can print new notes. But the main reason offered for caution was the presumption (which, as the testimony demonstrates, reflects Chamberlain's understanding of the Cunliffe Committee's intention) that the gold standard be operative for a period so the Bank of England can develop its experience of fiduciary issues before setting the quantity of fiduciary, one pound and ten shilling, bank notes to issue.

## 7) Relevance of 'The Value of Money'

The decision to invite Pigou to join the Chamberlain-Bradbury committee would have, no doubt, been influenced by his standing as a significant contributor to monetary theory prior.<sup>7</sup> In view of that, it is appropriate to reflect on the extent to which Pigou's contributions to monetary theory influenced his contribution to the Committee. To that end, this section notes the key elements of Pigou's contribution to monetary theory in his classic study 'The Value of Money' (1917) and discusses how this may have influenced his considerations as a member of the Committee.

In his 1917 paper, Pigou formally documented the Cambridge equation for the demand for money for the first time, placing it in a market context by introducing the supply of money and demonstrating the formal equivalence between the Cambridge equation and the Fisher equation. He explicitly stated that he is not critical of either Fisher or the quantity theory of money in the paper, but in his careful exposition he revealed the circumstances under which changes in the value of a unit of currency and the quantity of money do not move in equiproportional, albeit opposite, directions.

Pigou's demand for money equation indicates that the real value of money (the power of a unit of currency to purchase wage goods) is the quotient of the real value of cash balances and the quantity of money. Between two periods, this equation shows that the quantity theory of money holds – that is, the percentage change in the real value of money,  $P$ , is equal to the negative of the percentage change in the quantity of money – when the demand for real cash balances is unchanged between periods. This corresponds to the proposition that money is neutral when the proportion,  $k$ , of real economic activity,  $R$ , that is demanded when cash balances ( $kR$ ) is unchanged.

Perhaps Pigou's main contribution in his 1917 paper is his outline of the circumstances when changes in the proportion of real economic activity demanded can be expected. To illustrate this, he established that a portion of  $k$  will alter when banks vary the proportion of customer's balances they hold in cash (with the remaining portion used as loanable funds). A consequence of this is that the proportion of real cash balances to real

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<sup>7</sup> The same can also be said of Pigou's invitation to join the earlier Cunliffe Committee.

economic activity will also alter with also alter as there is a change in the share of cash balances that bank customers hold in their bank accounts, on the one hand, and as currency, on the other. Pigou then provides a formal mechanism for adjusting  $k$  to account for variations in currency and deposits proportions, by individuals and institutions, and variations in the proportion of deposits retained as reserves and allocated to loanable funds, by banks. Once that adjustment is made, the percentage change in  $P$ , the real value of a unit of currency, is no longer equal to the negative of the percentage change in the quantity of money. However, this qualification still formally treats money as neutral with respect to  $R$ , the level of real economic activity. In effect, Pigou regards  $R$  as something introduced exogenously, as it may change for a variety of reasons, but his equation does not provide for  $R$  to be endogenously determined in response to monetary phenomena.

Of course, Pigou's formalisation of the Cambridge equation is framed in a domestic, and not a bilateral or multilateral international setting. But given the Committee's significant focus on the bilateral sterling-dollar exchange, it would be a trivial matter for Pigou to think of the exchange, as suggested by McKenna, in terms of price levels (or changes in price levels) using ratios of his equations for the UK and US. In the absence of the gold standard, ratios of Pigou's Cambridge equation for two countries would suggest that key determinates of a change in the exchange rate are twofold: the relative change in the proportion of economic activity held as cash balances (which is positively related to changes in purchasing power); and relative changes in the money stock (which is negatively related to changes in purchasing power). This is useful, for example, in considering McKenna's case for credit control, which acts positively on the share of cash balances,  $k$  after adjustment for banks reduction in loanable funds, and negatively on the quantity of money. In the case of a gold standard, any difference between relative real purchasing power of the UK and the US and the gold par exchange rate leads to outflows of gold. This too can be considered with references to changes in the money stock, although under the gold standard the proportions of fiduciary and gold back note issue will become an issue to manage in practice, along with any changing shares in real cash balances.

But given the matters investigated by the Committee, Pigou's Cambridge equation could not be used to shed light on the potential for changes to the real value of the economy,  $R$ , in response to changes in core monetary questions being considered. Of course, Pigou recognised that  $R$  changes for a variety of reasons, but those variations were beyond the scope of his formulation of monetary theory. In a non-gold standard system, the costs and benefits of assuming that  $R$  is constant can be debated. But when considering the replacement of a non-gold standard system with a gold standard system, with both transitional and on-going changes leading to variations in  $R$ , Pigou's monetary theory was unable to provide significant insight.

These theoretical limitations give some context to a draft note that Pigou prepared from which Bradbury cited in a letter to the Committee secretary, Mr Young, on 11 September 1924.

“For the moment we propose to wait and see which way the cat jumps. If she jumps one way, we can avoid jumping after her – and whether we can or not remains to be seen – everything will probably be all right. If it isn’t, we shall be prepared to be a good deal braver than we can be at the moment.”

(Pigou, cited in Moggridge 1972, p. 49)

The ‘cat’, of course, is the exchange rate. Given the limited assistance of Pigou’s monetary theory to the problem in hand, ‘bravery’ concerns a rapid recommend return to the gold standard before the exchange rate goes to parity of its own accord, when such change will clearly have consequences for real economic activity. However, he was unable to use his own contribution to monetary theory to establish the general significance and magnitude of those real economic consequences.<sup>8</sup>

## 8) Conclusion

Pigou’s reading of the transcripts – as transcribed in sections 3, 4 and 5 – reveal the major themes that he focused on as part of his deliberations. He looked for contextual themes that would assisted him in isolating the Committee’s purpose subject to the constraints implied by previous enquiries and the present world facts of a developed world still coming to grips the effects of war. He reflected on transitional themes that related to the Committee’s three main questions: the *note amalgamation* question, the *gold embargo* question and the *gold standard* question. Pigou underlined responses that gave varying emphasis to bold and quick transition; slow and cautious transitions; the effect of prior announcements of forthcoming changes in the three areas; and the best order of partial, and of complete, transitional arrangements. Underlying much of this was a general reflection of the relative importance of price levels and sentiment in exchange rate determination. The end result was that Pigou’s attention to transitional issues was very thorough and indicative of some cautious reflection on the issues.

From Pigou’s reading of witness testimony pertaining to on-going themes, it appears that his caution actually deepened. For example, his highlighting of the benefits of a return to the gold standard was modest compared to his more extensive highlighting of issues pertaining to the cost of gold price maintenance by countries adopting the gold standard. Similarly, his reading of the general relationship between price levels, exchange rates and credit control tends was attentive to potential dangers; as does his highlighting of the

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<sup>8</sup> Interestingly Bradbury is not impressed by this equivocation, as he presses Young on the need for ‘holding fast’ to the bold position on both the *gold embargo* and *gold standard* questions.

limited effectiveness of restricting the quantity of money as a means of dealing with exchange related problems that have significant macroeconomic and fiscal flow on effects.

Pigou was clearly in accord with the other members of the Committee on what were the major issues, as his highlights cover all areas related to the Committee's main recommendations. But even a cursory glance at the themes and the analysis which Pigou highlighted reveals that he reflected far on more nuanced and subtle issues than what is implied by the unequivocal and forceful language used in the Committee's report in regard to the return to the gold standard. In particular, Pigou was extremely interested in McKenna's weak case in support of a gold standard sometime in the future, once markets had restored parity, not beforehand. Moreover, McKenna's quasi-first best (intelligent world) and second best analysis interested Pigou, yet the Committee's report does not offer even a hint of such equivocation. In a draft note that Pigou prepared, which Mr Young quotes on a letter to Bradbury on 12 September 1929, Pigou even confirmed that he was leaning toward the cautious approach to the *gold embargo* question:

"On the main issue, which is one of practical political rather than economics, whether the Government should take the plunge now and announce no renewal of the embargo, I am only *just* on balance in favour of a 'wait and see' policy. It would be inappropriate of me as an academic person to *press* for heroism; but if the rest of the Committee had been in favour of it, I doubt if I should have opposed."

(Pigou, cited in Moggridge 1972, p. 49)

The reference to 'heroism' being inappropriate for an 'academic person' is particularly interesting too. As Pigou's own contributions to monetary theory were inadequate for identifying the magnitude of any real economic consequences associated with the mooted monetary policy change, he was unable to use that theory to inform his position on some core issues. As a result, he was not going to be 'heroic' on his own account and advocate bold change (where bold means a rapid return to the old days) as an academic person. But he was not going to oppose senior Treasury officials who were willing to be 'heroic', partly because they were supported by, among others, the Governor of the Bank of England, as well as many of the bankers and practical industry representatives who appeared before the Committee.

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