THE ECONOMICS OF SAVING

BY

J. HARRY JONES, M.A.

(Professor of Economics, University of Leeds.)

Author of "The Economics of Private Enterprise", "The Federal Reserve System", "Social Economics", etc.

LONDON:
REED & CO.
Publishers of The Building Societies' Gazette
37, CURSITOR STREET,
CHANCERY LANE, E.C.4.

THE ECONOMICS OF SAVING

FIRST PUBLISHED, 1934

*Made and Printed in Great Britain by C. Tinling & Co., Ltd.,
Liverpool, London and Prescot.*

CONTENTS

PAGE

INTRODUCTION vii

THE ECONOMICS OF SAVING:

CHAP.

I. GENERAL CONSIDERATIONS . . 1

II. INTEREST AND SAVING . . . 11

III. SAVINGS AND CAPITAL . . . 20

IV. ECONOMY 30

V. THE FUTURE DEMAND FOR CAPITAL 38

VI. EXPENDITURE AND PUBLIC POLICY 50

VII. EXPENDITURE AND PUBLIC POLICY—(*continued*) 63

VIII. METHODS OF RESTORING PROSPERITY 76

IX. STOCKTAKING 88

X. THE HOBSON THEORY OF OVER-SAVING 100

XI. THE THEORY OF UNDER-SAVING . 110

XII. CONCLUSION 123

THE ECONOMIC SIGNIFICANCE OF THE INTERNATIONAL THRIFT AND HOME OWNERSHIP MOVEMENT 132

THE FUTURE OF INTEREST RATES . . . 162

Introduction

THIS short book consists of a series of articles that have already appeared in *The Building Societies' Gazette*, together with a paper read in June, 1933, before the International Congress of Building Societies, and published in the transactions of the Congress. An article (recently published in the *Gazette*) has also been added on the future of interest rates. My illustrations have therefore been drawn largely from the housing problem. But the nature of the illustrations does not restrict the character of the analysis. My subject is saving and investment, not the building society movement. I hope, therefore, that if what I say is of any value, it will appeal to all who are interested in the subject denoted by the title of the book.

I have endeavoured to avoid technical terms now common (and often necessary) in economic analysis, and in particular I have avoided algebraical symbols and curves which not merely bewilder the average reader but actually mislead some writers who believe, with undue optimism, that they understand mathematics and are competent to use it as an instrument of analysis. Nor do I believe that an apology is necessary for stressing the importance of the subject at a time when the value of saving appears to have been largely destroyed by the depression in trade and has actually been challenged by distinguished citizens. There appears to be a glut of savings. But there is also, in the same sense, a glut of butter and bacon (though thousands still

have nothing but bread and margarine for breakfast), of cloth (though thousands shivered last winter), of baths (though but a small minority of houses yet possess such a " luxury ") and of everything else—even of workers. But this so-called glut *is* the depression. Those who attribute the depression to overproduction are therefore merely stating that something is caused by itself, which is impossible. And those who state that it is due to a glut of savings are no more logical than if they stated—as indeed some do—that it is due to a glut of workers, or over-population.

Rightly interpreted, saving is as necessary to-day as it was in the past.

We prefer the spendthrift to the miser. We think of the former as a warm-hearted and generous, if somewhat foolish, individual. We picture the latter a hard, grasping individual. The far-seeing, cautious and thrifty individual we are apt to place somewhere between the other two, but usually nearer the miser than the spendthrift. We are inclined to think of him as somewhat mean and selfish and as uninteresting as the nineteenth century books that extolled his virtues. At a time of severe depression, like the present, we wink at even the worst forms of extravagance on the part of the spendthrift; we say that his expenditure at least stimulates employment, while the savings of the thrifty merely intensify the depression and add to the volume of unemployment.

The picture is out of focus. The real spendthrift is usually selfish and weak, lacking a sense of proportion and will power. Often he covets a reputation for generosity; he tries to buy it but secures, in return, another kind of reputation.

True generosity is not to be sought among such people. Nor is there any greater economic virtue in his action. Even as a stimulus to immediate employment, during depression, his expenditure is apt to be disappointing, for he is easily fleeced and his extravagance is largely a transfer of money to others in return for the minimum of service. Again, it is not the expenditure of the confirmed spendthrift that appears to give a jerk forward to employment, during depression, but a newly born extravagance on the part of others. The former merely maintains his old quota of expenditure. Those who save, on the other hand, include all sorts and conditions. They possess one feature in common—the power to save combined with the will to save, about which more will be found in these pages.

In the distant past the thrifty individual (we are told) saved by placing his money in a stocking and hiding the stocking in the dark recesses of the chimney. That is no longer done. The gas stove now blocks up the chimney. Stockings are transparent and reveal their contents. The money that is saved now consists of flimsy bits of paper which, if placed in the chimney, would meet the usual fate of combustible material. But the people of the past, who found an alternative use for stockings, were not necessarily hoarders, in the modern sense. The stocking was the only available or the most secure savings bank, while investment in any form of enterprise was virtually impossible for such people. Their descendants live in a different economic environment. They deposit their savings in appropriate institutions or invest them in appropriate (or inappropriate) enterprises, the mythical

British widow showing a marked preference for brewery shares.

Very few, under ordinary circumstances, hoard their savings. The first essential—security—is easily found associated with interest payments. But there may be times of crisis when people feel that nothing is secure that they cannot see and feel. They revert to hoarding. If the money is gold coin, it will serve, but if it is merely paper that may rapidly lose its value, they hoard (like the Germans in 1922–23) linen or billiard balls, or (like many Jews) diamonds. The American widow in 1931 withdrew her deposit from the tottering bank, in the form of Federal Reserve notes, descended to the bank strong room, placed the notes in her private box and handed the key to the bank official. That is the modern Chicago equivalent of the old English chimney. There might be a "run" on the bank upstairs, but the contents of the box were her own property, which the bank could not touch nor the receiver appropriate if the bank failed. Hoarding is the product of fear.

Now saving, including hoarding, in the sense in which I have already used the word, is the action of an individual who sets aside a sum of money. Normally the money is invested in one of many ways. In most cases it is handed over to someone else, who spends it. The latter may be acting on behalf of a private or public company or a public authority. Regarded from the individual point of view, saving is normally followed by investment, which is essentially expenditure. From the point of view of the community, however, saving *is* investment, i.e., expenditure. There is no saving which is not expenditure, though there may be

much expenditure that is not saving or investment. A community cannot hoard. Time cannot be recalled. The unemployment of people and resources during the past three years represents a loss that cannot be recovered. A community can only " save " by working, and its savings are represented by the products of certain types of work. But the ease or difficulty of supplying such products is largely determined by the action of the individual. The latter cannot divest himself of responsibility in the use of his resources.

The spendthrift is the man who ignores the claim of the future, the saver the one who listens to its call. I refer, of course, not to the multi-millionaire who is literally unable to spend more than a small fraction of his income, even with the aid of a secretariat; or to the recipient of a wage insufficient to provide the necessaries of life, whose only way of responding to the call of the future is by spending all that he receives; but to the great mass of people, to whom saving is possible, yet means abstention from expenditure that would bring immediate pleasure. In such cases the future that calls is his own future or that of his family. But in responding to that call he is also adding to the resources of the community and making possible a higher standard of living for those who follow him.

Such is the burden of the chapters that follow. The final conclusion is that there is such a thing as quality in expenditure, and that the ultimate " conflict " is not between saving and spending but between different types of expenditure. The spendthrift has acquired no new economic virtues, the thrifty no new economic vices. Economy of

time, of effort, of resources of all kinds, remains desirable if economic and social progress is worth maintaining. And such progress includes the growth of leisure, as well as the enjoyment of that rhythm of life of which even idleness forms part. Economic terms are of course always relative. Even economy can be pushed too far. We are told (by Aberdonians) that Aberdonians are now being born in London to save train fare—which illustrates my point.

There are people in America who preach a doctrine as queer as the label that it bears—technocracy. The producing capacity of the nation is now so great (they say) that it is impossible for the community to consume all that could be produced under normal conditions. The only way to employ everybody is to reduce the working day by a substantial proportion and thereby reduce the sum total of good things to an amount within the consuming power of the community. That is utter nonsense. Leisure is worth having, and worth paying for. It has been paid for in the past and will have to be paid for in the future. To say that it is a condition of full employment within the community is to say that human capacity for enjoyment (other than the enjoyment of leisure) has reached its limit, like the capacity of the human stomach. The causes of unemployment are independent of the length of the working day in any given generation.

If the bacillus technocracy had remained within the confines of the United States there would have been no need to refer to it in these pages. But it has infected many people in this country, who injure the prospects of valuable proposals for

reform—such as, for example, the proposal to raise the school leaving age—by employing specious arguments in their support. The working day was reduced, here and elsewhere, in 1919, and in the following year we were plunged into a deep depression, from which we only partially recovered. The depression was not caused by the reduction in hours. Nor will prosperity ever be restored by such means.

The world is not weighed down by the burden of good things. It is not wealthy but relatively poor. If everybody in this country suddenly decided to be decently clothed, at the expense of other things, the textile industries would be unable to supply the necessary material. If everybody decided to live on good food, with ample variety, at the expense of other things, there would be a "shortage" of food. If everybody decided to go to places of amusement, once a week, at the expense of all other things, the queues would exceed those of the war period. The mere fact that there may soon be an acceleration in house building has already raised the prices of building materials—the shadow thrown by the coming "shortage." In spite of all the inventions and improvements in organisation in the recent past we remain poor in the sense that we do not yet possess sufficient resources to maintain our population even at a standard of living which would impose not the slightest strain upon the imagination or "consuming power" of the average individual. Leisure is a good thing—provided we have the material resources necessary to enjoy it. But if it means spending half the day idle, half-starved, thinly clad and ill-shod, the average individual would prefer a longer working day with

the elementary comforts of life thus made possible.

Profitable and pleasurable leisure, with the material comforts that we all desire (whether as means or as ends), is made possible by saving and investment, that is to say, by increasing the capital resources of the community. We are enjoying the legacy of the past, and must accept our obligation to posterity. And these are only divided by the immediate present, when, therefore, the obligation is due to be fulfilled. If, as a community, we are sincere in our desire to bring within the reach of everybody that standard of material comfort which is a necessary part of well-being, we will add to the resources that alone can provide that standard, that is to say, we will supply the necessary saving or investment. If, as individuals, we do not voluntarily provide the necessary flow of savings, we shall unconsciously, but none the less truly, add to the difficulties of the community in making the desired provision for the future.

In the pages that follow I have endeavoured to elaborate these general statements. It has been part of my task to examine controversies that are partly covered by the title. It has been necessary to refer to those alternating periods of good and bad trade that are commonly known as trade cycles. Some of the controversies to which I refer are less directly concerned with saving and investment than with the trade cycle itself. The references to saving are incidental to the main subject. I wish to make it clear, therefore, that the trade cycle is not itself the subject of this book, and that references to it are made only in so far as they are essential to the treatment of the real subject, which is the economics of saving. My comments upon current

theories of the trade cycle are likewise not intended to be complete in themselves.

To have pursued the discussion farther, would have not only necessitated an extension of the task that I had set myself, but also made the articles, and the book, too technical for the type of reader in whom I was interested. The question whether the true explanation of the trade cycle is to be found in the relation between the rate of voluntary saving and the rate of investment is as important as it is difficult. But I was not seeking an explanation of the trade cycle. If I had done so I should have been compelled to examine many features of booms and depressions which lie far beyond the scope of a book upon the present subject. My difficulty merely illustrates everybody's difficulty in writing adequately upon any economic subject without covering a far wider field than that denoted by that subject.

Again, I have made but little reference to the relation between the rate of interest and the price level. It is well known that changes in interest rates appear to be related, in some form or other, to changes in the price level. The apparent connection between the two exists not only for cyclical movements but also for long-term movements extending, it may be, over periods of two or three decades. Nor is this apparent long-term connection to be dismissed as a coincidence or, in statistical terms, a "nonsense correlation." It represents a true association which economic analysis enables us to explain. But the subject is one that is more suitable for specialists than for lay readers. The problem itself can only be stated, effectively, with the aid of statistical technique,

while the discussion cannot easily be reduced to simple terms. I have therefore felt justified in excluding it from the present volume.

For the readers in whom I was interested, when writing the articles, were the workers in those institutions which seek to stimulate saving—the building societies, the national savings movement and the savings banks of various kinds. The leaders, both local and national, of such institutions are frequently asked to justify the faith that they profess. They feel that they are right, but—particularly at the present time—they experience difficulty in explaining the relation of saving to social progress. I share their view, and I hope that the discussion in the pages that follow will help them, in some measure, in their work. Nor is it necessary for them to take a holiday until prosperity is restored. Habits, once destroyed, are not easily restored. Saving is a habit. Further, I have tried to show that since the war the rate of real saving has fallen. In spite of the "glut" of individual savings now on the capital market, seeking investment, the rate of voluntary or individual saving is probably lower than at any time even since the war. Saving in the wider sense, that is to say, investment or capital expenditure, is in even worse state. Nor is the Government free from responsibility. In wasting material and human resources now available it is worse than the spendthrift. It is like the individual who lights his pipe with the pound note received in wages. To-day's availability of such resources will be gone to-night, never to return.

J. H. Jones.

April, 1934.

THE ECONOMICS OF SAVING

Chapter I

General Considerations

BEES have hives and ants have heaps. A wasps' nest is a work of art. Spiders employ a method of "preserving" their victims until hunger calls. Capital is not the monopoly of human society.

Robinson Crusoe employed capital. He was fortunate in recovering a large store of goods from the wreck. These alone placed him centuries ahead of a primitive native in a similar predicament; and along with such supplies he was endowed with qualities of mind representing many centuries of human progress. He immediately thought of, and prepared for, the morrow. The instinct of self-preservation was reinforced by a trained intelligence. Crusoe, from the first, was an investor. He did not save money and invest his savings. Money was the most useless of all his possessions. His "economy" was individual, not social.

Investment was synonymous with work. True economy meant planning the working day wisely. Among other things Crusoe was a soldier; he spied out the land, kept his weapons clean, built fortifications round his abode and, when the

enemy appeared, gave a good account of himself as a fighter. He looked after the inner needs of the day—he went hunting and fishing, and cooked his meals. But he also prepared for the future. He was furrier and tailor, house-builder and furniture maker. In short, this Jack-of-all-trades was perhaps the greatest economiser of time and organiser of effort ever known in the world either of fact or of fiction! Unlike the father of the *Swiss Family Robinson* he lacked the opportunity to waste time with his tongue—at least, until Friday arrived on the scene: and Friday was obviously not a stimulating listener!

Crusoe was constantly making a choice of two alternatives, work and leisure, and when working, he was always faced with the alternatives of working for immediate needs and working for the future. I do not suppose that he held rigidly to a choice made once and for all time. Probably there were mornings when he overslept—perhaps he had slept badly through the night, or had worked too strenuously the day before. I like to believe that on some days work went with a swing and everything seemed to be right, but I fear that on other days Crusoe's fingers were all thumbs, that he got irritated and ultimately gave up work in disgust. As with all of us, life with him had its ups and downs. Sometimes the spendthrift was uppermost, and he spent longer than usual in hunting for rare things or cooking a dainty meal; at other times he put a higher premium upon the future and snatched hasty meals while improving his abode or sharpening some new instrument. There was a rhythm in his life that we know to be in our own lives.

The double alternative which faced Crusoe faces all of us. We set leisure against work. It is, of course, true that most workers nowadays work in groups, and that group organisation involves discipline. We are all more or less slaves of the factory whistle or its equivalent. But the remainder of our time is at our own disposal; it is not enforced leisure. Again we set immediate satisfaction of current needs against provision for future needs. We can be extravagant—or miserly—in respect both of time and of income. A thriftless Crusoe would not have survived; there were no others to look after him. A thriftless individual only survives to-day because the society of which he is a member does not allow nature to exact her penalty.

The arrival of Friday, the slave, brought many changes into Crusoe's life. They co-operated, for example, by specialising—so, too, did Adam and Eve in the Garden of Eden, where one delved and the other span. But the alternatives of work and play, and of work for the immediate present and work for the future, presented themselves in the same form as before. As one was master and the other slave, the decision was left to the former. So, too, in the case of the Swiss Family Robinson and in the case of all small communities in which true communism prevails. But a fundamental change occurs when a community grows so large as to necessitate the use of money as the instrument of economic discipline. When money enters it becomes the immediate controller of the direction of economic effort. In a money economy, in the full sense of the words, the possession of money enables the individual to use it as he likes and to

prevail upon others, by the offer of such money, to supply (within the limits of practicability) what he asks for. At the present time Russia is experimenting with a system which is frequently called communism and at the same time using money. The system, however, is not communism in the strict sense of the word, but one which substitutes economic conscription for economic freedom; nor is the money that is employed comparable with money in the proper sense of the term. I refer to this experiment merely to point out that in using the words "money economy" I have in mind a system under which money is normally the guide to effort.

It is possible to conceive a society in which every member uses capital equipment and himself saves the money to purchase such equipment. But such a society has never actually existed. From the earliest days of the monetary system there have been lenders and borrowers. Moreover, from early times borrowing, as well as lending, was a form of service. The borrower was not necessarily a spendthrift. Antonio found himself in Shylock's grip on account of his desire to help Bassanio, but he might himself have borrowed to finance his trade with foreign countries. Not all loans were "distress loans." Nor would it be true to say that, even in those days, every lender was a Shylock. I need not pause to consider the stages between the Italy of Shylock and the typical modern industrial community. The point I wish to emphasise here is that one group—the active group—in the community obtain capital equipment very largely—even mainly—by utilising the savings of another group. It is of no significance, for my

purpose, that many individuals belong to both groups.

Without any further preliminary discussion two facts will be evident. The first is that the capital of a community is now, as in the days of Crusoe and the Swiss Family Robinson, composed of goods that minister, directly or indirectly, to the needs of that community. Such goods include roads, railways, factories, houses, libraries, offices and warehouses, machinery, raw materials, and finished products—in short, anything and everything that may appear on the plate when an instantaneous photograph is taken of economic society, after deducting "consumption" commodities in the hands of their consumers. Some economists exclude human qualities from this category, and such exclusion is defensible for most purposes. But when we are concerned with social problems it is important to remember that the products of educational institutions are the true measure of the ultimate value of such institutions; and that leisure well spent is a social asset. So long as we are conscious of that fact we need not press definitions too far.

The second fact is that capital (in the sense already indicated) is the final form of the savings of individuals. Savings appear, at first, in the form of money, and the total amount of such savings is determined by a vast number of individual decisions, each the result of individual circumstances and inclinations. Crusoe has been split into two, the saver and the creator of social capital. The amount saved by the individual is determined by his power to save and his will to save. His power is determined, in turn, by his income

and current obligations. His will to save is an element which goes to make up his character or personality. Some people discount the future lightly, others heavily. Some will save steadily for some specific purpose, such as a house or a summer holiday; they join a building society or a holiday club. They visualise the future in terms of something definite and concrete. They see the goal and make for it. Others are more seriously influenced by the indefiniteness of the future—its risks and vague possibilities—rather than any specific object that they wish to achieve. Others, again, give the future no place in their lives. They are the spendthrifts—in money if they have any; if not, then spendthrifts in time. The question of will and incentive will call for further consideration when, at a later stage, the effects of interest rates and currency instability are examined.

The savings of individuals become the capital of the community, partly in business undertakings of all kinds, partly in the services of public authorities and partly in the possessions (such as houses) of private individuals. In these various ways savings are normally invested, and the forms of investment are determined by those in control of the undertakings, both private and public. Thus those who provide the savings and those who direct their use (in the sense already indicated) represent two distinct groups, actuated by different motives. Those who supply savings (capital in money form) are governed by their estimate of their own future needs, while those who demand such savings are governed either by the prospect of gain through providing what the public wants or, if they are public authorities, by the need for providing

"collective" services. The stream of savings becomes, later on, the stream of capital goods, but they are divided by a reservoir.

Somehow or other these two streams must be controlled in relation to each other. If the first is too large in relation to the second, the reservoir becomes too full. If the position is reversed, the reservoir runs dry. In actual practice the reservoir is never long at the same level; it slowly rises or falls. When it rises the community tries to enlarge the outlet and when the reservoir falls, it tries to reduce the outlet and at the same time to enlarge the stream of savings. Sometimes the adjustment can be effected without serious difficulty, but there are occasions on which it becomes necessary to take extreme measures. The "economics of saving" I take to mean the study of the two streams and the intermediate reservoir. It is a highly important study. There are many economists who find the root cause of recurring industrial depressions in the relation of one stream to the other. Mr. J. A. Hobson, for example, puts forward the view that the savings stream is too large. The stream of capital goods which the community can absorb is determined by the sum of individual incomes that is not saved but spent in the satisfaction of current needs and wishes. This amount is too small in relation to savings, so that periodically some of the reservoir gates are closed, the capital goods stream runs almost dry and the level of the reservoir is raised. The Austrian economists, on the other hand, attribute periodic depressions to the fact that the savings stream is too small. It becomes necessary, therefore, to reduce the capital goods stream by reducing con-

sumption ; in that way the savings stream is also fed. Mr. J. M. Keynes, too, finds part of the explanation of periodic depressions in the size of the reservoir. The study of the economics of saving includes the study of one important aspect of those alternations of good and bad trade which are frequently known as trade cycles. I shall, therefore, be largely concerned with some of the theories which have been offered in explanation of trade depressions. But it will not be part of my task to examine the "trade cycle" as such.

That, however, is a subject for discussion later. I shall conclude this article by submitting and illustrating one general statement, namely, that voluntary saving and investment—the supply of and demand for capital—cannot be expected to proceed at even approximately the same pace unless the community maintains currency stability. The precise meaning of currency stability need not detain us now ; it is sufficient at this stage to say that it implies the absence of those extremely violent fluctuations in price levels that have been experienced in more than one country since the war.

About twelve years ago Germany was passing through the most extraordinary monetary experiences that the modern world has known. The government had lost all control of the financial situation and was literally pouring an endless stream of currency into the community. Every week prices were appreciably higher than in the previous week, and were rising at an accelerating rate ; in other words, the value of the currency was falling at an increasing pace. The ignorant alone thought of saving in the sense of putting money aside.

Everybody else got rid of his money as quickly as possible. For a time shrewd investors purchased stable foreign currencies, such as dollars and Swiss francs, but when foreigners realised the situation, the supply of such currencies dried up. No one was willing to part with good money for marks that were rapidly becoming worthless. The only alternative open to the Germans was to exchange currency for goods as quickly as possible. The result was an enormous demand for goods and unprecedented business activity which continued so long as the currency was acceptable. Not only did the currency reach mountainous dimensions, but its rapidity of circulation increased to the limit possible in practice. Ultimately it became worthless and a new currency had to be issued under conditions which made impossible a repetition of the process of inflation. It is the recollection of its experience of a paper standard that now causes the German nation to cling tenaciously to the gold standard in spite of the fact that others have linked their currencies to sterling.

During the period of inflation and unprecedented activity it was thought that the Germans had lost the habit of thrift and become a nation of spendthrifts. Such, however, was not the case. Thrift remained, but took another form. Many, realising the futility of thrift of the orthodox type and the uncertainty of the future, thought that nothing remained but to eat, drink and be merry. Restaurants and night clubs were among the flourishing institutions. But others spent their money wisely. They bought linen, pianos and other durable goods—even billiard balls and gramophone records that they could not use. The result was

twofold. Inflation wiped out investments of the old type, destroyed the middle class and drained the country of its circulating capital. But its equipment in the form of goods was not injured to the extent commonly assumed. Railways were neglected—as rates could not be daily revised, they had been run at a serious loss—together with other comparable institutions. But factories were extended, new buildings sprang up and the supply of other durable goods was increased. The effects of the new type of thrift remained.

During the last three years the world has experienced, on a smaller scale, the reverse process—a rapid fall in prices or, in other words, a rapid rise in the value of the currency of nearly every country. Inevitably the demand for the savings of people has fallen—those who might have borrowed to provide capital equipment will not do so while the value of such equipment is likely to fall. The stream of investment has dwindled to a trickle. The accompanying depression has also reduced the stream of savings, but not to the same extent. For this reason the level of the reservoir has steadily risen. Twelve years ago the Germans were crying out against an inflation which they could not prevent. At the present time the world is crying out against a sort of deflation which no country, acting alone, has been able to stem. The final result of the process will be that the investment stream will dry up, the savings stream will become a mere trickle but that trickle will be sufficient to cause a continuous, if slow, rise in the level of the reservoir. The avoidance of these two extremes is a condition of that steady flow of savings which denotes and promotes healthy progress.

Chapter II

Interest and Saving

IN elementary text-books on economics we are told that the price of a commodity is determined by its cost of production. If for any reason the price falls below cost the supply will be reduced and the pressure of demand upon the smaller supply will force up the price once more. If the price rises above cost the supply will be increased and the pressure of the larger supply upon the old demand will force down the price once more. A deviation of price from the cost level calls into play forces which bring it back to the cost level. Price oscillations occur about the cost of production —they are, however, but oscillations. Cost represents the equilibrium level. This simple theory fits most of, though by no means all, the facts of everyday life. Part of the theory may be stated in other words. The supply of a commodity is elastic, that is to say, it varies with variations in the price offered for it. And it is precisely this elasticity in the supply—the responsiveness of supply to changes in price—that causes price to be ultimately determined by cost of production.

The simple theory that I have described in barest outline is applicable to particular uses of land. If a farmer offers a higher price for land than he is now paying he will draw more offers of land from landowners. But the theory is not true of land as a whole. The total supply, as distinguished from

the supply available at a given price for a certain use, is limited and inelastic. Again, the theory is applicable to labour employed in a given occupation or industry. If the wages offered by the industry are raised or reduced the supply is increased or decreased. Workpeople now employed in many of our industries would gladly enter one of the sheltered industries, if that were possible. But it is at least doubtful whether a rise in wages as a whole would result in an increase in the supply of labour. Recent experience suggests that a rising standard of living is more likely to be accompanied by a falling birth-rate and even a decline (after allowing for improved health) in the rate of growth of the population.

The theory is also applicable to individual uses of or markets for capital. The price paid for the use of capital is interest. A rise in the rate of interest offered by a group of borrowers increases the supply which is offered to that group ; in other words, the supply available for any given investment varies with the rate offered by that investment. A given rate attracts a given supply. In the words of economists, capital, in respect of a given investment, has a supply price, meaning by supply price the price which is necessary to attract the requisite amount of capital. The supply is elastic, varying with variations in the price offered for it. We see that statement confirmed every day. Building Societies have attracted a relatively large amount of capital in recent years, but the coal mining industry has failed to attract much. When allowance is made for risk the rate paid by the former is considerably higher than the return paid by the latter.

But there is one important difference between the case of a commodity, with which I started, and

the case of capital to the extent already considered. The commodity is produced in response to the offer of a price; it did not exist previously and would not be brought into existence if the price were not offered or were not satisfactory. But the Building Societies do not necessarily bring fresh savings into existence; they may merely attract to themselves savings that already exist—they may merely divert rather than create. The "cost of production" of capital for any investment is the price that has to be offered in order to attract the requisite supply, but not more than the supply. It is the cost necessary to induce diversion rather than that necessary to induce actual production. In that sense capital—that is to say, particular sections of the total mass of capital—has a supply price, and the supply is elastic.

Can it be said that capital as a whole has a supply price and that the supply is elastic, that is to say, that variations in the price produce variations in the supply? Can it be said that capital as a whole has a cost of production, that is to say, that a certain price must be offered to bring the requisite supply into existence? Can it be said that the rate at which capital is accumulated is affected by the price which is offered for the use of such capital? Can it be said that there is a connection between interest and saving resembling the connection, in the case of steel or cotton, between cost of production and the supply of the commodity?

Orthodox economists of the past argued, and some economists of the present day continue to argue, that the case of capital is roughly parallel to that of other commodities. One writer, for example, divides the discussion of interest into two

parts ; in the first he asks why interest is paid and in the second, what determines the rate of interest. In the first part he introduces an ethical element into the discussion. Capital, he argues, performs a service and, therefore, deserves remuneration. In the second part he states that the actual rate is determined by supply and demand, and oscillates about a normal level which represents cost of production. If that level is not reached the supply of capital will be reduced because people will save less.

That division of the discussion is unscientific. If it is true that the rate of interest is determined by supply and demand, it follows that that statement explains the payment of any interest at all. The first question is therefore superfluous. And since it is true that the rate of interest does depend upon supply and demand (witness the effect of the present lack of demand for capital upon the current rate of interest on gilt-edged securities, which may be regarded as the basic or riskless rate) the ethical consideration is wholly irrelevant. For what is the " ethical " rate as distinguished from the actual rate ? Is it above or below the present market rate of less than one per cent ? A borrower does not offer interest to a lender because the latter provides a service, but because he knows that he cannot attract the loan except by the offer of interest. The circle of demand for capital, without interest, would always, in practice, be greater than the circle of supply ; the former is made to coincide with the latter by the use of interest and the payment of such a rate as to shut-off the excess demand. If capital were available without interest, borrowers would

not feel an obligation, from ethical considerations, to pay for the service rendered. In an individual case the borrower might insist upon paying interest to a friend, the reason being that if he did not do so the friend would be losing interest obtainable by investing the money elsewhere. But if capital were everywhere available without interest the reason for such action would disappear. We may, therefore, dismiss ethical considerations as wholly irrelevant.

Further, I believe the answer to the second question to be only partly true. It is obvious that the actual rate is determined by the play of the market, that is to say, by demand and supply. And in this connection we shall need to consider, at a later stage, the inter-play of old investments and the current investment of current savings. For we shall find that there is one important difference between capital and, say, bread or chocolates. Bread appears and disappears—it is produced and then destroyed in consumption. It passes through the market, never to reappear. Capital is a stock which, like gold, accumulates indefinitely; some is destroyed but the bulk remains. Savings are continually added to that stock. Moreover, savings become an investment in a concern with fluctuating profits, with the result that the original investment must be distinguished from current value or capitalisation. The interplay of supply and demand is far more complex in the case of capital than in that of bread or similar commodities.

I do not, however, share the writer's belief that there is an " equilibrium " level of interest which may be regarded as the cost of production of capital,

that is to say, as the condition of producing a given supply of capital. I do not believe that capital has a supply price, that the supply is elastic. I do not believe that a rise or fall in the rate of interest is followed, as effect follows cause, by a rise or fall in the supply of fresh savings or rate of accumulation of capital. Such supply is, of course, variable—but there is a vast difference between variability and elasticity. At the risk of labouring the obvious, I will endeavour to elaborate this distinction.

It would be generally agreed that a rise in the rate of interest from, say, five per cent. to a hundred per cent., would provide a very strong stimulus to thrift and greatly increase the supply of savings. But in practice such a range of variation would be impossible. Practical discussions are concerned with those variations which history shows. A change of, say, twenty per cent. in the price of a commodity is regarded as an unusually big change, and when economists speak of elasticity in the supply of or demand for a commodity they refer to the response to comparatively small changes in price. A rise from five to six per cent. in the rate of interest is a rise of twenty per cent. in the price paid for the use of capital. It is to changes of that order of magnitude that I now refer.

I have referred, in a previous article, to the fact that the rate of increase in the supply of capital is determined by the power to save and the will to save. When considering the effect of interest upon saving we are obviously concerned with the influence of the rate of interest upon the will to save. I do not believe that many people are influenced by changes in the rate of interest. I have been unable

to discover any individual who is ready to admit that his decision would be influenced by a rise or fall of, say, one or two per cent.—and I have submitted the question to dozens of acquaintances. All agree that their action is determined by much weightier considerations than the prospect of receiving a little more or less in interest. I ask the reader to consider whether his own attitude towards saving has been influenced by the recent reduction in the rate of interest.

There exists in every large community a relatively small group of people whose income is so large that they are unable to spend the whole of it. They cannot help adding to their stock of capital. These may be ignored for the present. For the great majority of people saving implies abstaining from expenditure upon consumable commodities and services which they would have purchased if they had been wealthier. It implies a real choice between two attractive ways of utilising income. Even in the case of such people I have yet to find that in practice the prospect of a higher rate of interest has any real influence.

If any reader disagrees with this view that I have submitted he should not forget the fact that in many cases—perhaps the majority—a variation in the rate of interest produces precisely the opposite effect from that stated by economists of the past. Most of us save in order to make provision for old age or for those in our care. We aim at a certain capital sum or a certain annual income in the future, and we do so largely by means of insurance. The annual premium per £100 paid in respect of insurance is largely governed by the actual and prospective rate of interest—the lower

the interest rate the higher the premium. Many people think in terms of the capital sum, and in such cases the effect of a rise in the rate of interest is to reduce the annual rate of saving. Others think in terms of the annual premium; they pay as much as they feel they can afford to pay, in which case a change in the rate of interest produces no effect upon the rate of saving. It is impossible, in a short article, to enumerate all the motives and objects of saving. The case I have submitted is specified merely for illustrative purposes. In general it seems to me that a rise in the rate of interest is more likely, in the long run, to reduce rather than increase the annual savings of the average individual in receipt of a constant income, and a fall in the rate of interest is likely to stimulate saving. But the influence of other factors is so much more important that the influence of interest may be ignored.

It seems to me, therefore, that the total supply of new capital is not elastic—it does not respond to variations in price. Capital has no supply price. But the supply of capital added to the nation's stock year by year is variable, and it is variable partly because the power to save changes from time to time and partly because our capacity to visualise the future changes. Our habits and our responsibilities change. For this reason I believe that Building Societies can do more to stimulate saving by making a moral appeal to the people than by making a purely financial appeal. By varying the rate of interest they can easily attract or repel existing savings that seek the best avenue of investment, but they do not, in this way, produce any material influence upon the total

amount saved by actual or potential members.

If my view is correct it will be seen that capital differs from both land and ordinary commodities such as bread. It differs from land in that the supply is not fixed; it differs from bread or cotton in that its price is not governed by cost of production—the supply is not elastic. The price of capital—the rate of interest—is determined by demand in relation to a variable supply—an erratic rather than elastic supply.

Many readers will recall that during the later stages of the recent war the Government, in issuing a war loan at five per cent., appealed to the people to economise, or save, on moral grounds. "Patriotism at five per cent." was the comment of cynical observers. It was strongly argued that the rate was too high. There was no free market for capital. New private issues were severely restricted and most forms of activity were controlled. The Government was almost the only borrower; it enjoyed a virtual monopoly, the only effective alternative to investment in government loans being to leave the money on deposit. Why, then, did the Government offer so high a rate as five per cent.? It was partly for the purpose of attracting money from abroad. But that object could have been (and was largely) achieved in other ways. I believe that part of the explanation lies in the fact that the Government advisers clung to the orthodox view that a high rate of interest served as a direct and strong inducement to save. I searched without success for that individual who increased his savings by a single penny on account of the fact that the Government had added one-half per cent. to the rate paid for loans.

Chapter III

Savings and Capital

IT is probable that every economist whose contributions to science are worthy of careful study has experienced difficulty in defining capital in words that satisfy himself. He is compelled, by the nature of his science, to employ familiar terms and to do so, as far as possible, in the way that is familiar to his readers. But the public is not accustomed, in everyday affairs, to the precision of thought and accuracy of expression essential to science. Words are used loosely and acquire a variety of meanings. No words necessarily employed in economic analysis have been more abused, in ordinary conversation, than "wealth" and "capital," nor are there any words which, from the point of view of definition, excited greater controversy among economists of the nineteenth century.

Some economists followed Adam Smith in stressing the income aspect. Capital, they said, is that part of a man's stock from which he derives, or expects to derive, an income. Others, again, stressed the work done by capital. Capital consists of wealth or goods used, or intended to be used, in the production of further wealth. These are not necessarily conflicting views. Capital cannot provide an income unless it be employed in production. But the distinction is useful in that it

reveals the distinction between the individual and social points of view. Those who associate capital with income stress the former while the other group stress the latter.

It will be observed that the first group refer to capital as part of a man's stock, not as consisting of money. The word "stock" was used in the eighteenth century by Adam Smith, who evidently pictured the typical business of his time. It was a one-man undertaking—a small factory or domestic workshop in which comparatively few people were employed. The owner had probably built up the business himself, or inherited it from his father. His savings were invested in the business, only a comparatively small amount being retained in the form of money. If he were asked about his capital he would naturally point to the factory and its contents. He would distinguish between these and the house in which he lived, his household effects and his clothes; and he would probably justify that distinction on the ground that he employed the former as a source of income. His interest in it was that of a producer while his interest in the remainder of his property was that of a consumer.

Economic society is not, however, such a simple affair as is suggested by this illustration. In the first place joint-stock, public utility and public enterprise now plays a vastly more important part than in the eighteenth century. Very few people invest the whole of their savings in their own businesses, while only a comparatively small proportion of producing units are owned and controlled by a single individual who supplies the whole of the necessary capital. The typical

business, if we ignore the professions and retail distribution, is controlled by a joint-stock company. The average individual who saves money invests it, not in his own business, but in some enterprise of which he may or may not share the control. The word capital is now usually employed in relation to a business. We do no think of it as "a man's stock." In ordinary conversation we say that a man is "rich" or "wealthy," not that he possesses a large amount of capital. In the second place, there are some products which seem to lie between "production goods" and "consumption goods," if we distinguish between these on the ground that the former produce an income to the owner. The outstanding illustration of such products is a dwelling house. If the tenant pays rent to an estate company the house is regarded as capital, but if the house is inhabited by the owner it is not usual to regard it in that light. For income tax purposes it is classified as capital irrespective of ownership. But furniture is not placed in the same category, the reason being that although, like a house, it may be hired or rented, it is usually purchased.

There are many cases in which it is almost impossible to avoid the question of ownership. Thus, for example, a billiard table or ping-pong table would form part of the capital of a hotel proprietor by whom it was used as a source of income, but it would not be regarded as capital if it were in a private home and used merely for recreation. In both cases it is used in the same way, and, by the actual users, for the same reason.

The purpose of ownership of such products is a relevant and important consideration. If its

purpose is to secure an income, ownership is associated with business. Hence we find that capital is now a term that is employed in relation to business rather than individuals. We speak of John Smith's wealth or his income or his property, but we speak of the capital of John Smith & Co., bankers or steel manufacturers or housing contractors. It is therefore the income-producing or individual aspect that is stressed in ordinary conversation. The stress upon this aspect is communicated to investment. We do not say that we invest our money when we buy a piano for our drawing-room or parlour—although, seeking consolation in ambiguity, we sometimes comfort ourselves, when buying it, with the thought that it will prove a good "investment," using the word in a special sense. When we say we have invested our money we mean that we have exchanged it for a document which will entitle us either to a fixed rate of interest or to a share of the divisible profits earned by some undertaking.

My purpose in describing, at this stage, the way in which the terms capital and investment are used in ordinary conversation is not to criticise current usage but to draw attention to the need for consistency. In times of severe trade depression, such as the present, the relative merits of "spending" and "saving" inevitably come to be the subject of popular controversy, while the problem of "economy" is at all times among those to which public authorities are expected to give their undivided attention. Proposals to raise the rate of direct taxation are frequently condemned on the ground that the additional taxes would fall upon capital and thereby produce

an injurious effect upon industry. Some of the most important controversies about economic policy have been unnecessarily prolonged by inconsistency in the use of the terms to which I have already referred.

I have stated, in effect, that savings are usually invested outside the owner's business; that a large and growing proportion of business units, whether they produce commodities or provide services of other kinds, are controlled by companies or public authorities, and therefore obtain the necessary funds from widely distributed sources; that the funds so obtained are "invested" by the owners, and that the term capital is associated with business units rather than with individuals. The average individual thus thinks of surplus money as being invested in a business to form the capital of the latter. Capital and investment are terms usually employed in relation to each other and to earning capacity and income.

Before the capital of a business is able to earn income for its owner it must obviously be converted into "stock" of the appropriate kind. The necessary plant and raw materials must be provided. Stocks of the finished products are usually held, and a supply of cash is retained to meet current needs. The plant may have a long life but raw materials and finished products are constantly replenished. For this reason it is customary to divide capital into two or more classes, the most popular classification being fixed and circulating capital. When we speak of fixed or circulating capital we obviously cease to think of the money invested in the business and begin to think of capital as goods of various kinds. But

we continue to look at it from the point of view of its earning or income-producing capacity.

It is necessary to emphasise the association, in our minds, of capital with an investment which produces an income to the investor, for it has frequently played a part in determining our attitude in discussions of economic problems. During and on account of the world war the government of every belligerent State was compelled to borrow large sums of money from its own citizens and from foreigners. The money was spent in many ways, but when the war came to an end the supply of goods commonly known as wealth was considerably less in nearly every community than when it started. In the meantime, however, the supply of investment paper had been enormously increased by the issue of war loans—that is to say, the capital of the world, as measured by the sum of individual investments, had been increased. But the loan certificates representing investments by individuals merely represented State debts against which no tangible assets could be set. Shortly after the war Germany inflated her currency to such an extent that all investments bearing fixed rates of interest were rendered worthless. We are frequently told that inflation destroyed the capital of Germany. It is true to say that it destroyed much of the working or floating capital—that is to say, the capital held in the form of cash to meet current needs—but it did not destroy the tangible assets of that country. Individual investors were ruined but the factories and other assets constructed with the money of such investors remained. The net effect of inflation was to redistribute the property

of the citizens and create a revolution in ownership. Incidentally it had the effect, too, of cancelling the debts of the State and local authorities. The existence of war debts shows the danger of measuring the total capital of a nation by the sum total of individual investments.

Let me take another case. A municipality owns and operates a tramway system which, for a long period, provides a considerable surplus available for the reduction of local rates. In due course motor buses, run by a private company, appear on the scene and, by offering better service, attract those who previously used trams. Duplication would be wasteful; in any case the trams represent an obsolete system of transport in the town of my illustration. The local council therefore decides to cut its losses by abolishing the system. The council obtained the capital for constructing the system by issuing a loan to the public, and it may be presumed that part of the loan has not been repaid. Consequently the municipality is saddled with a debt which resembles a war-debt in that it is no longer represented by a tangible and profit-earning asset. The individual investment remains, but it has ceased to represent part of the capital goods of the community.

The third and last illustration has a very important bearing upon current controversies, to which I shall refer in due course. A municipality issues a loan for the purpose of building a new town hall which is admittedly necessary for administrative purposes. The individual investor receives interest regularly, and is paid a rate appropriate to the type of investment. From his point of view the investment differs in no

way from one made in a local loan employed for some other purpose. But the new hall is not, in the narrow sense of the words, an earning asset. It is not a source of direct and immediate profit. The capital and running charges constitute a burden upon the rates. The source of the interest is not a price charged to the consumer, but a compulsory charge made upon the ratepayer. But the hall was admittedly needed. For this reason it is no less desirable, as part of the equipment of the community, than a municipal gas undertaking, which may provide a net revenue available for the reduction of rates. The essential difference between the two cases is in the method of charging for the service rendered. A price is (in theory at least) a voluntary payment in the sense that the individual may avoid payment by not purchasing the service. A local rate is a compulsory payment. A municipal gas undertaking takes the risk of the market (subject to the fact that the rates are the ultimate security for the loan), while a town hall is outside market risks.

This difference in the method of charging shows the importance of seeking a substantial measure of agreement before embarking upon heavy expenditure upon public undertakings of a non-reproductive character. We are now assuming, however, that the community has approved such expenditure. That being so, it is clear that, in its wider or social aspects, the town hall is capital. It provides a service for which the community is willing to pay, and such payment—local rates—provides the fund for the payment of interest.

Early in this article I referred to types of products

which lay on the boundary between "production goods" and "consumption goods." They are durable, and provide service day after day and week after week, for which reason the daily service (as distinguished from the products which provide the service) may be sold by "renting" the products. Houses were quoted as illustrations of such products. Some of these products are owned by the State or by local authorities, and the services that they provide are gratuitous, the cost being met by contributions from public funds. It is well known that social progress has been accompanied by a rapid increase in the importance of durable products in the lives of the people. Further, a large and growing number of such products are owned by public authorities and provide "free" services or services for which the recipient is charged a fee below the actual cost of supply.

The effects of this development upon "thrift" campaigns are already noticeable. Most of the early advocates of thrift emphasised the need for saving in terms of money. Savings would become investments or capital employed in profit-earning business. The State played a comparatively unimportant part in the economic life of the community. The Building Society movement was almost alone in its attitude towards thrift. It was the first to recognise the importance of those products which resembled, yet differed from, both production goods and consumption goods of the ordinary type. It was the first to emphasise differences in quality between different types of expenditure. It was a movement to advocate and assist spending rather than saving—but spending of the right kind. It advocated thrift

and economy, but placed its own, and a new, interpretation upon those words. Its existence actually depended upon its success in persuading individuals to spend upon the approved objects, in advance of their incomes. In that sense it was a pioneer along the route since followed by public authorities. "Selective expenditure" has been the practice of all such authorities in recent times. Roads, schools and other public buildings, reservoirs, cleansing departments—these, to a local authority, are what a house is to a private individual.

I hope I shall not be misunderstood. I am not advocating public expenditure on a larger scale than in the past, or even on the present scale. My purpose in this article is merely to show the need for caution in the use of terms which are apt to be misleading precisely because they are so familiar. One illustration of the need for precision will suffice. Some writers find the major cause of periodic depressions in the fact that we save and invest too much, and thereby cause a glut of production goods; others find it in the fact that we save and invest too little and thereby cause a scarcity of production goods which must be removed by creating a temporary glut of consumption goods. These theories will be examined in due course, but it is obviously important to know the category in which the writers would place those products of the intermediate type to which I have referred.

Chapter IV

Economy

DURING the progress of the world war it was obviously the duty of every citizen to economise to the utmost extent. And economy meant abstinence. Every unnecessary form of expenditure was condemned. The State needed money for financing the war and, if currency inflation was to be avoided, the money had to be found from the current incomes of the people. Only part could be obtained by means of taxation and for the remainder the State was compelled to rely upon the proceeds of loans. If the voluntary savings of the community were not sufficient to provide such loans the State would be forced to create currency.

In theory it is possible for a State to conduct a costly war without inflating the currency, but theory is never borne out by practice. War expenditure on a large scale is incurred very rapidly, while the proceeds of loans and taxes are gathered slowly. The latter are always behind the clock, and the interval has to be filled in. Since bank-loans cannot immediately be transferred from their normal uses, fresh "money" has to be created. But when the transition from a peace economy to a war economy has been completed no further inflation need, or should, occur. The ease and rapidity of transition are determined by the readiness of citizens to economise.

Hardly distinguishable from this argument in support of drastic economy is the argument that economy actually reduces the cost of the war. If the citizens do not economise they compete for the products needed by the State and thereby raise prices, and the higher the prices paid by the State the greater the cost of carrying on the war. It was on these two grounds that the economy campaign was defended in the early stages of the war.

In the later stages, however, the purely monetary aspect of economy was less prominent than other aspects. Not only were prices controlled by the State but finance mattered less than the conservation of human energy. The enrolment of a large proportion of the working population in the fighting forces and the growth in the need for munitions and other necessities of war had reduced the amount of labour available to supply civilian needs. The primary purpose of economy was therefore to release labour urgently needed for other purposes. It was the duty of everybody to work hard and live very simply. The need for conserving energy also stimulated the introduction of machinery wherever possible and the application of devices of all kinds for the purpose of economising human effort.

It became evident, however, that we were in danger of adopting too narrow a view of economy and of sacrificing the near future to the immediate present. A runner in a mile race reserves sufficient energy to enable him to put on a spurt in the final round; if he tried to run at full speed all the way he would quickly fall out of the race. We were engaged in a long war, and it was therefore necessary to

take a long view of "economy." It was found, for example, that long hours of work at high speed were not conducive to efficiency over a long period. It is noteworthy that the post-war emphasis upon the human factor in industrial efficiency was the outcome of the war-time need for increasing output to the practicable limit, and that the National Institute of Industrial Psychology is the successor of departments created by the Minister of Munitions for the purpose of maintaining the highest possible level of efficiency.

It will thus be seen that the term "economy" was used in all its senses during the war. Economy may mean conservation of effort. It may mean refusal to pay an unduly high price for what it is desired to purchase. It may mean abstinence or refusal to spend. Economy includes wise spending as well as saving. Essentially it means the most advantageous use of resources. Hence we find that in controversies about the relative merits of "saving" and "spending" all claim to advocate "economy" and to oppose "extravagance."

In the next article I propose to begin the discussion of such controversies, and it will be an economy of time and space if I indicate broad economic truths which would be universally accepted. In the first place it is clear that there are physical limits to "extravagance." It would be physically impossible for everybody to give up saving. If everyone tried to spend the whole of his income such income would be competing for the existing supply of goods ready or nearly ready for consumption. The rate of supplies could not be increased for, by assumption, there would be no savings or capital available for the erection of new factories or the

preparation of new sources of supply. Existing supplies would therefore be quickly exhausted and many consumers would remain unsatisfied. They would be left with unused and unusable money on their hands. The desire to spend would itself compel people to create fresh appliances of production in order that supplies should be forthcoming. Capital is essential to production and must be supplied if production is to continue and to grow.

I have submitted an extreme case in order to indicate that there are physical limits to extravagance. It will be evident, however, that long before the physical limits are reached the prices of consumption goods rise and that this rise is communicated to raw materials and semi-manufactured products. Moreover, the costs of new equipment increase so that a given amount of money capital does not perform the same amount of work as before. By raising the price level the extravagant habits of the people make it necessary to increase the amount of money needed to produce a given supply of equipment and of consumption goods. This increase in the supply of money is provided by banks and other financial agencies, and the process is known as inflation. We shall find later that one school of economists maintains that this is precisely the sequence of events in the modern world. Periodically the community spends upon consumption goods what it should be saving and investing in capital equipment. The latter can therefore only be provided with the aid of new money specially created for this purpose. Prices rise, inflation takes place until a crisis occurs and depression follows. The community pays the

penalty of its extravagance. It is held, in effect, that economic development during and immediately after the war showed, in exaggerated form, the features that are present during times of peace. In the economic sense the war period was a caricature of modern economic society.

I have stated that there is a physical limit to "extravagance." There is also a physical limit to "abstinence." If everybody decided to live at a bare subsistence level and save the remainder of his income, more than half the people in the community would be unemployed. At first there would be a large mass of idle capital seeking avenues of investment without finding any. But that would only be the first stage. Existing capital equipment would fall into ruin while the money income of the community would steadily diminish. The mass of idle savings would gradually be drawn upon to provide money for current purposes, so that in trying to save to the limit physically possible the community would lose its savings.

The present situation resembles in some respects the hypothetical case that I have described. We have not reached the physical limit of abstinence. The bulk of the community still enjoy comforts and luxuries that they could forego: they still live on a higher standard than was possible during the war. But there are many who are living near the bare subsistence level. Most people are living less luxuriously than in the recent past. The demand for consumption goods has fallen heavily, nor is there much demand for capital for industrial development. This means a large volume of unemployment and a large fund of idle capital in the form of uninvested savings. There are many who wish to

transform the unemployment of the minority into the leisure of all, by reducing the hours of work. This desire is the product of pessimism. It is felt that trade cannot recover within the measureable future. Leisure is regarded as the form of "expenditure upon consumption" which can be most easily spread among the members of the community.

For the time being we possess a large fund of capital or savings awaiting investment. If it is not actually invested it will ultimately melt away. The reservoir which does not feed the stream of investment will not in turn be fed; and a reservoir which neither feeds nor is fed is but a pool of water which will slowly evaporate. The present reservoir of capital has been fed from the savings of the past, when prices were higher, employment was more regular and trade was more profitable. The depression may reach a stage where some people will be encroaching upon past savings to a greater extent than others save from current incomes. If and when it reaches that stage not only will the capital equipment of the community be diminishing but the funds available for investment in new equipment will be dwindling. Money capital, in short, is not something which can be held indefinitely; it must be constantly replenished. Additions are required under ordinary circumstances in order to meet withdrawals for investment; but if there is no investment, unemployment and poverty may be so widespread that the additions are needed to replace the withdrawals of unfortunate sufferers who are compelled, by the depression, to live on their capital.

This aspect of the depression has not received

the attention that it demands, but it is obviously present in the minds of those who argue that a policy of economy, at the present time, should include a policy of capital development by public authorities, which need not and should not be influenced by those considerations which determine policy in private industry and commerce. In due course we shall need to consider all the implications of such a policy. I am merely concerned, for the present, to point out that the fund of savings is not something that can always and necessarily be stored up until required. It is changeable and changing, and when it is itself being reduced we are witnessing a process of deflation.

I have referred to the physical limits of extravagance and of abstinence and indicated some of the features that become prominent before such limits are reached. Somewhere between these limits there is a relationship between saving and spending which maintains a stable and steadily progressing economic society. That relationship, which maintains the maximum of real economy, exists only in theory. In practice we find error and a process of correction. The disturbances from which economic society suffers are said to represent the process and cost of rectifying the error that has been made. Now the fundamental difference between the chief theories or explanations of the undulations in economic progress lies in the fact that they are based upon different assumptions regarding the nature of the error. One school of thought (the Austrian) assumes a persistent tendency on the part of society to spend too freely and to save too little. Capital tends to lag behind requirements, for which reason, long before the physical

limit of extravagance is reached, a corrective is applied. Economic forces compel society to reduce its consumption and thereby enables the supply of capital to overtake social requirements. Economy thus means cutting down, retrenching, deflating currency and credit. The other school (represented by Mr. J. A. Hobson) assumes a persistent tendency on the part of society to save too much. Capital tends to run ahead of requirements, for which reason, long before the physical limit of abstinence is reached, some corrective must be applied. Economic forces compel society to reduce expenditure upon capital equipment and thus enable the latter to be overtaken by social requirements. Economy means expansion of currency and credit, made to circulate by State development schemes. It is agreed, on both sides, that error must be corrected and that there is a persistent tendency to error. According to one, however, the error is "too much," according to the other, "too little." It must be rare to find two explanations of the same sequence of events based upon what appear to be diametrically opposed assumptions. Whether the assumptions are so strongly opposed as they appear to be, is a question that will be considered in due course.

Chapter V

The Future Demand for Capital

THE first condition of progress in any discussion is to know and remember the precise subject that we are discussing. Public attention is now concentrated upon a controversy regarding the policy that should be pursued for the purpose of increasing the volume of employment during the present highly exceptional and world-wide depression in trade. This controversy is of a twofold character. It is held by a large and growing number that the State should embark upon a bold scheme of capital development. The essence of this proposal is that savings should be converted into investment. It is not implied that people should save less than they have been accustomed to save. It is suggested, not that savings should be reduced, but that they should be employed in the creation of social capital. But there are many people who say that for the present individuals should spend more freely and save less of their incomes than they have been in the habit of doing. They advocate a change in individual habits. The first appeal is to public authorities as producers of useful things, or users of money capital, while the second is to individuals as suppliers of money capital. The first is an appeal to use what is produced, the second is an appeal to produce less. These are distinct and separate appeals, and those who endorse the first

do not necessarily endorse the second. They have one element in common—both stress the need for expenditure. But extremists among those who make the second appeal think less of the quality of the things bought than of the effect of purchase upon the volume of employment.

Such is the first of three controversies that call for consideration. The second is concerned with the relation of saving, interest and investment to those recurring fluctuations in industry and trade which are commonly known as trade cycles. It is of a more theoretical character than the first and has been conducted mainly by academic economists. The third controversy is concerned with the future demand for capital irrespective of cyclical fluctuations in industrial activity. It has been suggested that the demand for capital is not likely to be so great in the future as it has been in the past, and that, therefore, the need for saving is likely to be reduced. If, in spite of this change in demand, the community maintains the old rate of saving, it will be unable to find sufficient channels of investment to drain the money saved. By " past " and " future " is meant not a short period of a year or a decade but a long period of years. Broadly speaking, the probable demand for capital during the next half century is compared with the demand for capital during the half century ending with the world war. The remainder of this article will be devoted to a discussion of this suggestion. In the next article I shall endeavour to examine the first controversy, and in subsequent articles I shall be concerned with some of the issues raised in the second controversy, though not with the trade cycle as such.

It is common knowledge that the modern industrial system is of recent origin, being the product of a series of inventions of the eighteenth and early nineteenth centuries. The development of the factory system was made possible by improvements in transport, hence we find that in this country, the birthplace of that system, a large amount of capital was invested in road, canal and rail transport and, at a later stage, in ocean transport. Moreover, the new and larger factories, driven by steam power, necessitated greater expenditure upon fixed capital (i.e. buildings and machinery) than was needed for the smaller factories and workshops of earlier days. During the process of industrialisation there was a large and persistent demand for capital. Alongside this demand there was a rapid growth in those industries which supplied the capital equipment of other industries. Thus, for example, the rapid growth of factory production in the cotton industry of Lancashire was accompanied by a corresponding growth in that section of the engineering industry which supplied textile machinery. During this period of rapid industrialisation there was also a rapid increase in population, with the result that the supply of houses was also increased. Further, the need for warehouses and offices increased. Towns sprang into being, the centres of which were occupied by factories, warehouses and offices. The *process* of industrialisation was one which obviously called for a large stream of savings. I emphasise the word *process* for a reason which I shall give presently.

The necessary supply of capital was provided by the citizens of this country. Manufacturers and merchants invested their profits in the development

of their own businesses. If these were not sufficient they borrowed from neighbours—shopkeepers, merchants, doctors, lawyers, landowners, etc. Joint stock companies, such as the early railway companies, obtained capital from similar sources. As time went on the capital market became more highly organised. Not only were our ancestors able to finance industrial development at home but they were able to export capital and thereby hasten the process of industrialisation in other countries.

The total exports of this country exceeded the total imports, and the difference (representing, over a long period, the amount of new capital invested abroad), was paid for, by other countries, with the borrowed capital. Alongside this outward flow of capital there was an outward flow of goods for which it paid, such goods being, in large measure, the precise commodities (such as engines and rails) which became the capital equipment of foreign enterprises financed by British capital. It is commonly said that trade followed the flag; but it is more fully true to say that British trade and British capital walked hand in hand. Nor is it necessary to pause and discuss which was the guiding hand. Thus the rapidly changing industrial system in this country was able not only to provide the capital necessary for the revolutionary changes within itself but also to assist in providing capital for the industrialisation of other countries.

It is suggested that the period during which these revolutionary changes took place—the transformation of the domestic system of industry into the factory system—represents an epoch in our history, and an epoch which, broadly speaking, has come to an end. Our railway system, the construc-

tion of which absorbed (directly and indirectly) a vast amount of the savings of the community, has long since been completed. The network of roads is almost sufficient for our purpose. The population has almost reached its probable maximum, for which reason our towns will not grow much larger, nor our factories more plentiful. There is room for substitution and improvement but not much for absolute growth. Further—and this is an important consideration—industrial changes have themselves largely changed in character. During the process of industrialisation machinery was substituted for hand labour and factories took the place of workshops. Machinery is now substituted for machinery. Moreover, the new machines are cheaper and more effective than the older and more cumbersome machines. The first industrial revolution meant more roundabout methods; it lengthened the chain of production. The new industrial revolution frequently means cutting out processes—it enables some of the links in the chain to be removed. It achieves not merely an economy of effort in the broad sense but a direct and real economy of capital itself. Just as, in the old days, a machine might displace several men, so now a new machine may displace several machines each more expensive than itself. In the past the introduction of new machinery resulted in unemployment among the workers immediately affected; in the future the substitution of machinery for machinery will mean that less capital will be required than before and that therefore a smaller fund of savings will suffice for the industry concerned.

For these reasons it is held that a lower rate of

saving will be sufficient to satisfy the future requirements of this country. It is further held that the demand of other countries for British capital will fall. In the first place the statement made of this country is applicable, in lesser degree, to others. Over a great part of the world the birth rate is falling. Many countries have practically reached the limit of expenditure upon new railways and roads; they have reached the same stage of industrial development as this country and are, therefore, exposed to the same effects of the substitution of machinery for machinery. Their future demand for capital will therefore probably be, like ours, on a smaller scale than in the past. Moreover, they will be able to satisfy that demand to a greater and growing extent from their own resources. At one time Germany was a borrowing country, but long before the war she had become an exporter of capital. The industries of the United States of America were built up with the aid of British capital, but by 1913 that country was able to finance her industrial development without further external aid. She is now a large exporter of capital. The experience of Germany and the United States is being and will be repeated in other countries. Both at home and abroad, therefore, the demand for the savings of our citizens will be likely to fall during the next half-century.

I do not suppose anyone could have drawn a picture, fifty years ago, of the world as it exists to-day. The only confident prediction that we can make of the world fifty years hence is that it will be vastly different from the world as we now know it. Nevertheless it is worth while considering the arguments that have been adduced in support

of the view that the demand for capital is likely to fall.

(1) In so far as the fall in demand is due to a reduction in the rate of growth of population it would appear at first sight, that it would be offset by a corresponding reduction in supply. But, in the first place, the correspondence is not exact. For a long period of years the adult population would tend to increase more rapidly than the total population, so that if the rate of savings among adults remained constant the total savings of the community would increase more rapidly than the total population. On the other hand, on the assumption made by the advocates of the view now under discussion, the fall in demand would be due more particularly to the reduction in the rate of growth of the adult population rather than that of total population. In the second place, if the satisfaction of elementary needs, such as housing, food and clothing, necessitated greater expenditure of capital than the satisfaction of other needs, the reduction in the total demand for capital would be greater than the reduction in the growth of population. For, on that assumption, the demand for capital is being kept up by the constant flow of people whose elementary needs must be satisfied. For these two reasons it does not necessarily follow that the reduction in the annual supply of savings will correspond to the reduction in demand due to the fall in the rate of growth of population.

(2) It is undoubtedly true that a real economy of capital has recently been achieved, in many industries, by the substitution of machinery for machinerv rather than the direct substitution

of machinery for manual processes. Moreover, it is not improbable that this process will extend in the future. On the other hand it is possible to exaggerate the net economy achieved by the new type of substitution. The new machines may be cheaper, simpler and more effective, but they wear out much more quickly and therefore need to be replaced more frequently.

(3) The volume of demand for capital is largely dependent upon the rapidity of the process of change in the economic system. When new methods are introduced they create a demand for capital. The greater part of our railway system was constructed near the middle of the nineteenth century. During the railway boom the demand for capital was very heavy, interest rates were high and much capital expenditure became prohibitive and had to be postponed. It seems to be assumed, in the view that I have described, that rapid industrial changes on a comparable scale will not take place in the future; its advocates picture the future as a period of consolidation rather than one of fundamental change in technique, the process of consolidation being comparatively slow and steady. But the period of spreading and adapting a new technique is one of great change and therefore one of corresponding demand for capital.

(4) As the new technique is spread and its economies show themselves in lower human costs a higher standard of living becomes possible. When machinery reduced the cost of producing boots and shoes two results followed. In the first place the demand for footwear rapidly increased; tens of thousands of families were well shod for the first time in their lives. In the second place

people who were already well shod were able to spend less on footwear and more on other things. The human effort rendered unnecessary by the use of machinery found outlets in other directions, either in the rapidly growing boot and shoe industry or in the callings which prospered as the result of the change in that industry.

Similar results may be expected to follow the substitution of machinery for machinery. Not only will many of the industries directly affected enjoy a new level of prosperity but other forms of economic activity will benefit. The new technique itself creates industrial change and therefore stimulates elsewhere a demand for capital, the use of which it has itself directly economised. An illustration of the direct effect upon the industry concerned is provided by the motor car industry; motor cars, which were once the monopoly of the wealthy are now used by a large public. The indirect effect is illustrated below.

(5) A large proportion of the capital of the community consists of buildings—including factories, warehouses, commercial buildings and dwelling houses. It is true that the supply of these appears to be almost adequate. In a new and rapidly growing community a far greater amount of savings has to be devoted to the construction of such buildings than in an older community with a comparatively stable population. But the buildings do not last for ever; there comes a time when they must be replaced, either because they have become unsafe or unsuitable for their commercial purposes or because the standard of requirement set by the community has been raised. Every reader must have observed that when old buildings are

demolished their successors are larger and better and involve far greater expenditure of capital.

(6) It seems to me that progress along these lines will give rise to far greater capital expenditure in the future than in the recent past, and will be rendered possible, in part measure, by precisely that economy of capital which is achieved through the substitution of machinery for machinery. The rise in the standard of living which is brought within reach by such economy will express itself partly in a higher standard of housing and office accommodation, and a higher level of factory accommodation. When I try to draw a picture of progress during the next half century I cannot exclude the reconstruction of large industrial regions which came into being in Victorian days. In fifty years most of the factories of the nineteenth century will be gone and even the ultra-modern factory of to-day will appear shabby and inefficient. The endless streets of Victorian and Edwardian houses, built by speculative builders, will have sunk below the minimum standards of housing, if not already disappeared. Industrial change includes replacement on a higher standard. In this sphere the demand for capital will undoubtedly increase. For this reason I believe that the Building Society movement may hope not merely to maintain the position that it has already gained but to grow even more important relatively to other institutions in the country. An increasing proportion of the savings of the community will be directed (in the absence of wars) towards the construction of buildings of various kinds. Those who hold the view that I have described seem to me to be concentrating too much attention upon

the use of capital in providing transport and factory equipment.

(7) Apart from the demand for better houses there are many ways already known, in which a higher standard of living will express itself. Most of these will necessitate capital expenditure. Travel, as a recreation, is in its infancy, and is likely to become a far more important factor in the lives of a large section of the community. Not only will holiday resorts increase in number and size, but the means of transport will also be increased. Expenditure on roads and other services provided by public authorities will grow. Ocean travel will become more popular and necessitate an ever-growing supply of ships. Generally speaking one may expect that, in spite of the fact that our railway system is practically complete, transport and communications will make heavy drains upon the future supply of capital. For these reasons I am not impressed by the view that the future demand for capital within the country is likely to diminish or to grow less rapidly than the population.

(8) If what I have said of this country is true, it is likely to be equally true of other countries. It is an observed fact that while industrial development, in its early stages, is assisted and accelerated by capital obtained from abroad, it afterwards enables countries to find sufficient capital within their own borders and thus dispense with external aid. I do not believe, however, that all the countries of the world will approach that stage within the next fifty years. Russia, India and China are vast potential markets for foreign capital, and these are likely to open their doors more widely as the

doors of the industrialised countries of the west are closed. Given peace and orderly economic development it seems to me likely that for the next half century the world outside will continue to be able to absorb as much capital as we care to invest. If it fails to do so the change will be slow enough to enable the domestic situation to be adjusted to the new circumstances. For, after all, capital goes abroad not because, under normal circumstances, it cannot find a market at home, but because the foreign market offers a greater inducement in the form of a higher net rate of interest.

Chapter VI

Expenditure and Public Policy

THE world is passing through the most severe trade depression in modern history, although there is now some evidence of improvement. A world depression is not a new phenomenon. Before the war industry and trade passed through alternating periods of expansion and contraction, of rising and falling prices, increasing and decreasing employment. These fluctuations in industry, prices and employment were so regular, and appeared to be so inevitable that they were termed " cyclical," and a complete " revolution " of trade was termed a " trade cycle." The termination of the war was followed by a boom in trade and a rapid and unprecedented rise in prices, which came to an end in 1920 and was then followed by a severe depression and a rapid fall in prices. The reappearance of those fluctuations which were characteristic of the pre-war economic system stimulated investigation into the features of the " trade cycle," the existence of which was assumed by most writers. The world depression of 1921–22 was described as a cyclical depression, exaggerated by the war and the influences created or released by the war. The recovery of industry and trade outside Europe, after 1922, was not accompanied by a full recovery in Great Britain where, even in 1929 (the most prosperous post-war year) approximately a million workpeople were unemployed.

This persistent depression in British industry was distinguished, by all writers, from a cyclical depression, and was rightly attributed to special causes operating in Great Britain alone. In America and elsewhere the depression of 1921–22 was followed by a rapid recovery which, if we ignore minor recessions, resulted in a trade boom. The trade prosperity of 1928–29 was accompanied by a speculative boom which, in the autumn of 1929 produced the New York Stock Exchange crisis. The collapse of prices on the stock market heralded the depression from which the world is still suffering. This depression was again termed "cyclical" and it was expected that, like previous cyclical depressions, it would generate a check upon its own progress and in due course be followed by recovery. But the recovery which the trade cycle theory led us to expect has not yet appeared, and the theory itself has lost much of its attraction.

The word "cyclical" was used to describe recurring fluctuations in trade for the purpose of showing that they were not "accidental." It was believed that their cause was to be found in some factor or force which was inherent in the economic system and therefore persistent in its operation. They were not due to extraneous influences, such as a war or a failure of the harvest or a change of economic policy by a country or a group of countries. If fluctuations had been wholly due to external and "accidental" influences they would not have been repeated so regularly and faithfully as actual experience had shown. It was true that individual cycles differed in length and in other respects, but their fundamental similarities were more significant than superficial differences. The latter could always

be explained by external and temporary influences, which gave to each cycle its own peculiarity or individuality. Wars, political difficulties, failures of harvests and other external influences might delay or accelerate changes due to inherent forces, but even the war of 1914–18 had failed to destroy the latter. And it is now held that the present world depression is cyclical in the sense that it is essentially the result of forces working within the economic system rather than of external influences brought to bear upon it. The disturbances in the industrial balance due to the war, the erratic movements of gold and capital during the past decade, the financial crises of the last few years, the recent restrictions upon international trade and the political difficulties and strains of the present time—all these have combined to increase the severity of and to prolong the existing depression. But it is held—and I believe rightly held—that even in combination they do not constitute its cause. Sooner or later world industry and trade will resume that wave-like movement which has been its outstanding feature for over a century; the inner and persistent influences will once more predominate.

The pre-war view that the trade cycle was a normal feature of the economic system led to the belief that it might ultimately prove possible, by appropriate action, to prevent the recurrence of depression, and that in the meantime it was possible to mitigate its effects. So long as trade depression was regarded as the result of "accidental," that is to say, of external and usually uncontrollable influences, no serious attempt was made to deal with the problem of unemployment. Public

authorities relieved distress, and frequently instituted "relief works": they provided work irrespective of its real economic value, its main purpose being to provide employment. It was but a degree better than the work test provided in poor law institutions. But the publication of the reports of the Poor Law Commission (1906–9) marked the beginning of a change in the attitude of the Government and of the public towards the problem. The first evidence of change was the provision of a State scheme of insurance against unemployment. The scheme was restricted, for an experimental period, to a few carefully selected industries, but it was obviously intended that its scope should be enlarged and after the war it was actually extended to all industries except those presenting administrative difficulties which could not be overcome. But the proposal which is relevant to my present subject was of a different character.

Cyclical fluctuations were found to occur not only in trade, prices and employment but also in investment. A period of expanding trade and rising prices was also a period of increasing annual investment of capital, and a period of depression and low prices was also one during which the rate of investment was relatively low. One element of the trade cycle was an investment cycle, and the fluctuations in investment were of even greater amplitude than the fluctuations in industry and trade. Moreover, such fluctuations occurred not only in investment as a whole but also in overseas investment and domestic investment, regarded separately. Domestic investment was composed partly of private investment and partly of investment by public authorities, and the latter was growing

in volume and in relative importance. Cyclical fluctuations occurred not only in domestic investment as a whole but also in that part for which public authorities were responsible.

The Poor Law Commission issued two reports, one signed by the majority and the other by a minority. The Minority Report stressed the fact that I have described and made it the basis of a recommendation which was not inconsistent with the recommendations of the majority. It was recommended that public authorities should concentrate expenditure, as far as possible, upon periods of depression. The "cycle" of public expenditure, it was argued, should run counter to the cycle of private expenditure. Thus, for example, post offices should be built during a period of depression rather than one of great activity in private industry. It was held that such a policy would cut off the top of the boom and make the depression more shallow: the hill top would be used to fill up the bottom of the valley and the undulations thereby reduced.

This proposal calls for three comments. In the first place serious practical difficulties would be encountered by any public authority by which it was adopted. Some forms of public expenditure, even on durable goods, cannot be anticipated far in advance or delayed when the need appears. Such a statement would apply to uniforms, to warships and guns, and to office furniture. The proposal would be largely restricted, in practice, to capital expenditure in the form of buildings, capital equipment and roads. Capital expenditure of that type is the subject of close scrutiny by the public, and can only be undertaken, on a large scale, with the

approval of the public. Public opinion is largely influenced by the state of industry and employment. When trade is brisk, prices are high and profits are plentiful, the general public not only recognises the need for many types of expenditure but readily accepts other types which it feels it can afford. That is the time, for example, when a director of education feels that he can most easily persuade the town council to erect a new school. If a building scheme were submitted during a period of depression it would probably be rejected on the ground that the community could not, at that time, afford the expenditure involved. For this reason the director could not submit costly schemes in anticipation of future needs. In any case, it is not his function to dovetail his demand for schools and equipment into the general industrial demand, except in so far as such a course would influence the cost of his schemes. It is his task to frame schemes designed to meet the developing needs of education. The responsibility for adopting, rejecting, anticipating or postponing such schemes rests with the town council or other local authority. This authority alone is able to give a decision upon the main issue. And the policy of the local authority is influenced by public opinion which, in turn, is influenced by the industrial situation. Public opinion is apt to be critical of schemes involving expenditure until unemployment reaches serious dimensions and threatens a substantial increase in the rates for the purpose of providing funds for relieving distress. Since the war the main financial burden due to unemployment has fallen upon the national unemployment insurance fund, towards which no contribution is

made from local rates. Until quite recently the remainder of the burden fell upon State funds so long as the unemployed worker was eligible for ordinary or "transitional" benefit under the insurance scheme. The burden upon local rates did not reflect, so faithfully as in pre-war days, the changes in the industrial situation. It is probably true to state that the national unemployment insurance scheme has tended to reduce the urgency of provision of work by public authorities, both central and local, and therefore tended to delay the adoption of the proposal already described.

Many public undertakings enjoy a revenue which exceeds the cost of providing the service. Such "reproductive" undertakings, including the post office, municipal gas works, electricity supply stations and tramways, are run as "business" concerns, and those in control are judged by the ordinary "business" tests. If the controllers are expected to accept responsibilities from which privately owned undertakings are free they may reasonably claim to be judged by other standards. If a tramway manager is expected to frame a policy with a view to reducing unemployment during a period of depression he cannot, at the same time, be subjected to the usual tests of efficiency. If the controllers of the post office are expected to supply orders for telephones that are not wanted by subscribers or to build post offices at the wrong time, they cannot be blamed for failure to provide a profit or supply an efficient service. Work is a means to an end; if it becomes an end in itself a real conflict may arise.

It will thus be seen that serious difficulties are encountered when an attempt is made to apply the recommendation contained in the Minority Report of the Poor Law Commission. These difficulties obviously restrict the field to which the recommendation can be applied in practice. But they can be reduced by education and by willing co-operation. Public opinion can be influenced, while public authorities may be expected to provide leadership. Nor is the conflict of ends, to which I have referred, so serious as we are sometimes asked to believe. Further, it is often a matter of chance, or of individual opinion, whether a scheme of development is judged to be necessary this year or next. Public departments, which are often bold in conception, are extremely cautious in their procedure. They propose only what they feel will be accepted; they do not willingly risk failure. Thus the influence of public opinion reaches to the heart of administration and affects initiative and suggestion. Finally, the existence of difficulties in applying the recommendation to some departments of public activity does not form an objection to the principle upon which it is based.

The second comment upon the recommendation contained in the Minority Report of the Poor Law Commission is that it does not necessarily involve any net increase in public expenditure by public authorities. It is not suggested, for example, that the post office authorities should build more post offices, but that, having determined their requirements, the scheme of construction should be so designed as to avoid further pressure upon the building trades when these are already

busy and to provide employment when the latter are suffering from depression. Within limits the inconvenience of this scheme is balanced by the money economy achieved. The costs of labour and material are lower during a period of depression than at any other time, so that the total cost of building is reduced. Not only is the total capital cost reduced but capital itself can be borrowed at a lower (permanent) rate of interest. A double economy is therefore enjoyed in respect of capital charges—a lower rate of interest is paid upon a smaller total sum.

It is important to stress the fact that the proposal does not involve any net increase in public expenditure. For it will be evident, to students of the present controversy about public expenditure, that many critics have assumed—and, in spite of repeated contradiction, continue to assume—that the proposal, as now advocated, is to increase public expenditure by embarking upon schemes which would otherwise never mature. Such is not the case. It is suggested, not that a municipal authority should provide a public swimming bath (which is a much quoted illustration), but that if it decides that such a bath is desirable the present is the most appropriate time for its construction. Again, we shall be concerned, in due course, with the theory that the rate of saving is lower than the rate necessary to secure the maximum rate of economic progress over a long period. This theory is sometimes believed to be in essential conflict with the propsal now under consideration. Such is not the case. The proposal is concerned not with the amount of public expenditure but with its distribution in time.

The third comment upon the recommendation or proposal is that, in so far as it is concerned with capital expenditure, the money should be provided from a loan fund. If the money is obtained by means of additional rates or taxes the expenditure takes away as much employment as it gives: it merely substitutes one form of work for another. If John Smith pays £10 in increased taxation, in order to provide his share of public money to be used in rebuilding a bridge across the River Thames, and therefore decides not to buy the new summer clothes that he had intended to buy, the tailor and the host of workers behind him lose what the bridge-builder and those behind him gain. The net result is a transfer of employment, not an increase of employment. If, however, John Smith withdraws £10 from his bank deposits (which have been lying idle for some time and would otherwise continue to lie idle) and lends the money to the Government, the bridge-builder and his followers find employment while John Smith gives orders for the clothes. Employment is increased, not merely diverted. This distinction between the sources of payment is of no importance under normal trade conditions, when savings do not lie idle in banks but are actually invested in industry and provide employment; but it is of the first importance during a period of severe depression, when capital expenditure has fallen and savings remain idle in the form of bank deposits.

There remains one general consideration which has an indirect bearing upon the subject of this article. When a public authority borrows money from the public or any other source it creates

against itself an annual charge for interest and redemption or repayment. The annual charge may ultimately reach an amount greater than the annual average additions to capital expenditure. If therefore the authority, which we may assume to be a town council, could make a fresh start it might be able to proceed without further loans from outside sources. Capital development could be spread evenly over a period of years and the money obtained from rates. The case would correspond roughly to that of a business undertaking which was steadily expanding and financing development from reserves of undistributed profits. This policy is actually being followed, within limits, by municipalities and other public bodies. If a new undertaking is started (such as an electricity supply station) which necessitates heavy initial expenditure upon plant, the funds are obtained through the issue of a public loan. But such undertakings are usually "reproductive," and involve no additional burden upon the rates. Capital expenditure which is not financially self-supporting is usually on a much smaller scale, and may be financed entirely out of the revenue obtained during the year from the rates. Thus, for example, a new school may be built and paid for from the proceeds of rates obtained during the period of construction. If such capital expenditure is spread evenly over a long period the burden on the rates is fairly constant, without being heavier than in the case where the capital expenditure is financed from the proceeds of a loan repayable within a given period.

It will be evidenced that the adoption of the proposal contained in the Minority Report involves

a change of financial policy. If capital development is concentrated upon years of depression and suspended, as far as practicable, in years of trade prosperity, it cannot be financed from rates collected during the period in which the money is spent. Such a policy would defeat its purpose. During the period of depression the annual revenue derived from a given rate per pound is likely to be less than in a period of prosperity, and in such cases a rise in rates is necessary even to provide the old revenue. It follows that if schemes of capital development were financed from current revenue the burden of rates would be very much heavier in a period of depression than in a period of prosperity. Moreover, it has already been shown that if a scheme for providing employment during depression involves additional payment by the public in the form of taxation, the net effect is not to increase but to divert employment. It is an essential part of the proposal under consideration that the scheme of capital development be financed by means of loans. And it follows from the above that provision should be made for repayment within the period covered by the trade cycle, that is to say, that rates during the prosperous years should be sufficient to cover interest and a large sinking fund. In view of the fact that capital development proceeds more rapidly in prosperous than in lean years, and is largely financed from the proceeds of current rates, the time distribution of the financial burden would not be seriously affected by the adoption of the proposal. The total burden would be slightly increased by the increase in interest charges, and this increase may be regarded as an element in the public sacrifice involved in the proposal.

In view, however, of the fact that the rate of interest is relatively low during depression and that other economies (already indicated) become available, the financial sacrifice may be considerably less than the financial gain.

The proposal that I have discussed is essentially the proposal that is now widely advocated as a method of reducing unemployment. Not only is it old but it has long been regarded as " orthodox " political economy. It is the alternative to the " make-work " policy, that is to say, the provision of " relief work " irrespective of its economic value. It is held that in the present emergency public authorities should go even farther. I had intended to include, in this article, a discussion of public expenditure in relation to the present crisis, and an examination of the chief current proposals, but the article is already so long that it must form the subject matter of a separate article.

Chapter VII

Expenditure and Public Policy—*Continued.*

IT is impossible to divide the science of economics into compartments each of which is shut off from the remainder. If we are to deal adequately with any subject we are compelled to show its relation to other subjects and thereby risk the charge of irrelevance or of evading the "plain issues." The subject of these articles is "The Economics of Saving." It carries us to the heart of economic theory and much of the discussion is necessarily abstract and apparently remote from the realities of economic life. But theory is itself largely an interpretation of life. and the life of economic society, like that of the individual, is constantly changing.

In the previous article we were concerned with the relation of investment to cyclical depressions in industry and trade. We saw that even before the war it was widely held that, by adjusting capital expenditure to the state of trade, public authorities would be able to reduce the amplitude of cyclical fluctuations. Since the war the volume of unemployment has never been less, in Great Britain, than that which apparently existed, before the war, during the most intense cyclical depression. Even in 1929, the most prosperous post-war year, more than a million workers were unemployed. In 1928 a report was published, by a group within the Liberal party, under the title *Britain's Industrial*

Future. The authors of the report recommended that the government should embark upon a policy of capital expenditure and thereby provide work for those who were unemployed. Specific schemes of development were afterwards prepared and advocated by the Liberal party. The authors of the main report had apparently adopted and applied the recommendations of the Minority Report of the Poor Law Commission, which were examined in the previous article. But the resemblance between the two reports was merely superficial. Unemployment from 1922 to 1929 was due not to cyclical fluctuations of a world-wide character but to special influences largely confined to Great Britain. It presented a national rather than an international problem. Great Britain was suffering from depression and unemployment at a time when most countries were enjoying a period of prosperity. The recommendations of the Minority Report did not fit the circumstances; they were not meant to deal with persistent unemployment due to special causes.

Since 1929, however, there has been superimposed upon unemployment due to special causes a large volume of unemployment due to a world-wide depression and essentially cyclical in character. The circumstances assumed by the Poor Law Commission have now appeared, although the depression is far more severe than anyone could have anticipated. For this reason the proposals of the Minority Report have been revived. It is strongly urged that the State and local authorities should abandon the policy of the last two years, make up the leeway and anticipate future needs. They should embark upon a bold policy of capital

expenditure and secure the necessary funds by issuing loans to the public. If the present is not a suitable opportunity for such expenditure upon schemes of national development which are admittedly desirable what (it is asked) constitutes a suitable opportunity? Capital is plentiful and cheap; prices are low and wages are not likely to fall below the present level. By providing employment to workers in receipt of unemployment benefit the sums now paid to such workers would be saved. To that extent taxation could be reduced and the spendable income of taxpayers increased. The net financial cost of development would therefore be considerably less at present than at a future date, when the country would be more prosperous and apparently better able to afford such expenditure. Nor would the advantage be confined to those directly and indirectly employed upon the schemes of development. The wages of such workers would naturally be considerably higher than the unemployment benefit which they now receive. The difference between the two sums would represent additional spending power; it would be spent and would therefore give employment to others, who in turn would spend their additional incomes. Employment would breed employment; the effects of government schemes of development would spread outwards, like the ripples caused by dropping a stone into a still pond.

The practical considerations that arise in applying such a policy during a period of cyclical depression were examined in the previous article. I do not propose to repeat what has already been stated, and I shall confine my attention to issues

that have not yet been considered. In defence of my method of treatment it is desirable to emphasise the fact that unemployment and trade depression is not my subject. I am only concerned with the problem of saving and investment in relation to depression, and I shall therefore only deal with those aspects of the problem of depression which are strictly relevant to my subject. If it be urged that in the last resort the two problems are inseparable I shall not disagree with my critic but merely submit that there are varying degrees of relationship. We are all descended from Adam and Eve, but we are content with a shorter family history and are ready to place third and fourth cousins outside the boundaries of our families.

Before proceeding to examine the policy of public expenditure upon capital development it is desirable to point out that five distinct, though related, methods of stimulating trade have been suggested. The first is the method now under consideration. The second is that of increasing private expenditure, and is advocated by many who oppose the first. The third is that of reducing taxation, thereby increasing the purchasing power of all taxpayers. The consequent deficit on the national budget would be met by the issue of Treasury bills (which would ultimately be converted into a long-term loan), or of Exchequer bonds repayable in three or five years. The fourth method is that of stimulating credit expansion by reducing the rate of discount. As the Bank Rate and the market rates of discount are already very low this method, to be effective, would necessitate a reduction in the rate charged by

joint-stock banks for accommodation to business clients. The fifth and last method is that of reducing the value of the currency in terms of other currencies, that is to say, depreciating the exchange. It is held that by this method we could increase our exports, reduce our imports and thereby stimulate trade and initiate that expansion of currency and credit which others seek by the fourth method.

These methods are not necessarily alternatives. It is possible to advocate two or more at the same time. The first three may, indeed, be regarded as not only consistent but actually complementary or supplementary. They are jointly advocated by many who see little scope, in practice, for the fourth, and regard the fifth as rooted in a fallacy. It is, however, important to distinguish between all five methods not only because each may be advocated by people who reject all the others, but also because they attack the problem from different points, and would produce different effects—immediate if not ultimate—upon the relation of "spending" to "saving."

Some critics of the first method (as distinguished from those who argue that the practical difficulties are so serious that its value as an immediate palliative must be very small) point out that it may defeat its own object. Its purpose is to tide the nation over a period of depression. The schemes of development are limited in number and are only able to provide a fixed amount of employment. It is by no means certain that the general trade depression will have passed before they are completed. If, when they have been completed, private industry and trade have not

recovered from the depression the cessation of public orders and the reduction of public demand for labour may produce a state of affairs even worse than that now prevailing. We shall have used up our reserves of public demands and be compelled to await a revival originating in private industry and lacking the stimulus of expenditure by the State and local authorities.

There is but one reply to that argument. Reserves maintained to meet emergencies should be used when the real emergency appears. A reserve which is never used cannot truly be called a reserve. And if and when it is used its use is the outcome of faith based upon knowledge and judgment. Those who, like myself, believe that the State should now throw its reserves of demand into the fight against depression, do so not only because they believe that, in practice, they will not be so jerky in their effect as is assumed by the critics, but also because they believe that they will help to create that momentum which will carry industry and trade back into its normal channels. The issue raised by critics is practical rather than one involving any principle. But I have always believed that what is neglected when opportunity offers is usually left until a crisis threatens, and is then done badly and at great expense.

The second criticism of the policy of State expenditure seems to me far more serious. For the last ten years the industries of this country have been divided into two groups, commonly known as the sheltered and unsheltered industries. The former consists of those which are not subject to foreign competition, and include the public

services, inland transport and the building industries. The latter consists of those which compete with corresponding industries in other countries, and include agriculture, coal-mining, textile manufacture, steel production, engineering and shipbuilding. Ever since the depression of 1921 initiated reductions in the wages of workers employed in unsheltered industries, wage relationships, judged by pre-war relationships, have been abnormal. The standard of living of the sheltered group has been raised at the expense of that of the unsheltered group. Here we find the essence of the criticism of the post-war policy of subsidising the construction of houses intended for wage-earners. The cost of building such houses, at the prevailing wage rates, was so high that the rents would have been prohibitive. Even subsidised houses have usually been too expensive for workers employed in unsheltered industries. And it is broadly true to say that the standard of housing accommodation for such workers is actually lower than in pre-war days.

The critics of the policy now under consideration state that the effect of such a policy would be to perpetuate, and possibly increase, the disparity in the wages of sheltered and unsheltered workers. The former benefit from the policy, which would prevent the adjustment of wage relationships urgently needed in the interests of the unsheltered group. Moreover, the cost of the capital goods produced under the scheme would be so high relatively to the general price level that much of the expenditure would have to be written off as dead loss. In the long run the value of capital goods must be adjusted to the price level. The

experience of the last ten years, during which the value of houses erected shortly after the war has been written down, would be repeated.

That criticism is not one that can be swept aside as merely academic. If we are to be faced with a falling price level during the next decade or so it seems to me to be of the first importance. But the assumption of a falling price level need not be accepted. In terms of sterling the future price level is largely within our control; the mean level around which fluctuations will take place will be determined by government policy in the sphere of currency. The policy which we are now considering may—and, I belief, should—be regarded as part of a wider policy of raising the sterling price level. If it is to be regarded as a self-contained policy irrespective of general currency policy, and advocated even in the face of a downward trend in the sterling price level, it seems to me to be defensible only on the assumption that a substantial reduction is first made in the wages of workers employed in the sheltered industries. On the assumption of a downward trend in prices the working class houses, for example, constructed at the present cost level, under the proposed scheme of development, would be far too expensive for the average wage earner and, like those erected in the past, would actually be occupied by others, while the standard of housing accommodation of the unsheltered workers would be still further depressed. Similarly the public loans employed in other forms of development would represent a burden upon future taxpayers wholly disproportionate to the then value of the roads, buildings and other equipment and

services to be provided under the proposed policy of loan expenditure by the State and local authorities.

Other critics of this proposal argue that the assumption upon which it is based is false. The assumption is that there exists a large supply of idle savings awaiting investment. It is true, they say, that bank reserves are high. They are high, however, not because savings are excessive but because the depression has reduced the demand for capital. Balances lying idle at the banks partly represent commercial capital normally employed in business but, like workers, now suffering from unemployment. When trade revives they will again be needed to finance private trading, and when that time comes it will be found that the supply of capital available for investment, so far from being abundant, is seriously inadequate. For this reason it would be unwise to impose a serious drain upon existing savings by issuing loans for development schemes. Such a policy, by reducing the supply necessary for industrial development, would actually retard the recovery of private industry and trade.

This criticism seems to me partly true and partly false. It is undoubtedly true that many have been misled by the existence of large and apparently unusable balances lying idle in the banks, and by the low rates of interest now offered for public loans and the low yields upon long-term investments of high quality. These are normal features of a cyclical depression which are exaggerated, at present, by government restrictions upon certain types of investment. They are due to a big fall in demand, not to an increase in supply.

The flow of savings is smaller than under normal trade conditions.

Further, this consideration is relevant to the proposal—the second of the list of five already specified—that private individuals should spend freely rather than save. If by that is meant that people should use capital as income, its consequences might be serious. Or again, if it is suggested that they should spend, on perishable goods and services, income that they would normally save, the suggestion is open to serious objection. If, however, it is merely suggested that, like public authorities, they should anticipate their needs in respect of durable goods such as houses and pianos—needs in respect of perishable goods, such as food, or services, such as film plays, cannot be anticipated—and, if necessary, borrow for such purposes, the case is indistinguishable, in practice, from the case now under consideration. There may be a world of difference between "spending" and "wise spending"!

The fact that the existence of large idle balances at the banks is misleading and that the flow of savings is below rather than above the normal flow is not, however, a decisive argument against public expenditure, although it emphasises the need for avoiding unwise or extravagant expenditure. The conclusion of the critics is itself the result of failure to distinguish between a fund of savings (or the bank balances now lying idle) and a flow of savings. In so far as the policy of loan expenditure was successful in stimulating industry and trade it would also tend to increase the flow of savings. The source of savings is the income of the people, for which reason the sums available

for saving increase with incomes. It is important to observe that the supply of savings or capital available for investment is essentially a flow rather than a fund—a stream rather than a reservoir. Variations in the fund are not so important as variations in the flow, except in so far as the former reveal variations in trade activity. On the other side, investment also represents a flow. When trade revives and capital development is resumed on a larger scale in private industry, the demand for investment capital will not be placed suddenly upon the market. It will be a continuing demand, small at first and slowly or rapidly growing. It may quickly become sufficient to drain a large part of the existing fund, or it may start on a small scale and grow but slowly—that is to say, it may run ahead of the supply of current savings or fall short. We have to contemplate and prepare for the former, and for this reason conserve our resources. But it should be observed that in so far as the policy of loan expenditure reduces future demands by public authorities for investment capital the future stream of demand is reduced. The policy would not destroy capital but conserve the use of existing supplies of idle savings, strengthen the flow of current savings and reduce the future demands upon the new stream.

The general conclusion to which these considerations lead is that the public policy advocated in the Minority Report of the Poor Law Commission is not only wise in itself but applicable to present-day conditions. And it should be reinforced by private policy of the same type. The proposed scheme of co-operation between building societies

and public authorities provides one important method of enabling individuals to apply that policy in ordering their own lives. But this general conclusion is subject to two conditions. One is that the currency policy of the Government should be such as to promote a substantial rise in the general price level and to protect the higher level when it has been reached. In that way it will be possible to restore an equitable relationship between sheltèred and unsheltered wages by raising the latter, and thereby to prevent a future reduction in the value of houses and other capital goods.

The second condition is that the policy should be cautiously administered. It should be confined to the production of capital goods in the broad sense of the words. But, by increasing employment and therefore the spendable incomes of a large number of workers now idle, it would also result in an increase in expenditure upon consumption goods—food, clothing and recreation. This raises the question whether the policy under consideration results in a better balanced development than the other policies in the list already given, which are submitted by some observers as alternatives to those already considered. Is it better to press forward with capital development schemes and to await their reaction upon industries not immediately affected, than to seek a solution by assisting the latter industries and await their reaction upon those connected with capital development? That industries do not fall into two mutually exclusive groups (as would appear to be here implied) is not of serious significance. There are two separate methods of attacking the problem, one by directly stimulating the industries

primarily engaged in supplying capital goods, the other by stimulating miscellaneous industries. The consideration of these alternatives, which we shall begin in the next article, raises issues that are the subject of controversy among economists.

Chapter VIII

Methods of Restoring Prosperity

IN the seventh article of this series I stated that five distinct, though related, methods of restoring trade had been suggested. These may be summarised as follows: (1) Capital expenditure by public authorities, both central and local; (2) an increase in private expenditure; (3) a reduction in taxation; (4) expansion of bank credit and (5) exchange depreciation. In the present article I propose to continue the discussion of the group of suggestions and to attempt a form of classification which will serve as an introduction to a discussion of existing theories relating to the part played by savings and capital in economic development. It will be convenient to assume, for the present, that we are dealing with a self-contained community, and to reserve the case of exchange depreciation until the next article.

The first and second methods have already been examined at some length, and at this stage I desire merely to recall one general observation about the first. It seeks to employ idle capital and to stimulate those industries which are engaged in the production of capital goods. The method would provide direct employment in the construction of roads, bridges, buildings and other forms of capital, but it would also increase the demand for materials required in carrying out the many schemes that have been suggested. Such

industries as those providing road and building materials, the products of the engineering and allied industries, and intermediate commodities such as steel and coal, would, therefore benefit by such a policy. The capital employed in applying this method of expansion would be spent in the payment of wages, salaries and other costs, and would thus be spent by the recipients in the purchase of consumption goods that they cannot at present afford. At this later stage, therefore, the industries engaged in providing such goods would benefit. Employment would be further increased, and this would be followed by a further increase in demand. The growth in the activity of such industries would lead to capital development in private industry and trade and at that stage the depression would have disappeared.*

The third method differs materially from the first. It is suggested that the Government should deliberately create a budget deficit, not necessarily by increasing expenditure on capital development or on current services, but by reducing taxation without reducing current expenditure. It is held that the additional money left in the pockets of taxpayers would be spent upon the ordinary comforts and luxuries of life and would thereby stimulate the industries engaged in supplying the goods and services concerned. It is assumed that

* I have already pointed out that it is of the essence of the policy of capital expenditure by the State and local authorities that such expenditure should be financed by means of borrowed money. If it were financed by an increase in central or local taxation the net effect would be not an increase in employment but a transfer. Private expenditure would be contracted, to the extent that the additional taxes and rates did not reduce private saving, to meet the increase in public expenditure.

the taxes to be reduced would be those paid by the average citizen, including income tax and indirect taxes upon such commodities as beer and tea. If the reductions only occurred in, say, super-taxes and death duties they might merely have the the effect of increasing the supply of savings, and if the budget deficit were covered by the issue of a loan the Government might be receiving, as loan, sums which it might have been receiving as taxation. The purpose of the method now under discussion is to set free money which would be freely spent—to bring to an end that form and degree of economy enforced by heavy taxation. It is held that the government should meet the budget deficit either by issuing a loan or by causing the necessary amount of paper money to be printed. We are told that at a time when all countries are suffering from budget deficits we need not fear the effect of such a policy upon the credit of the nation. No distinction is drawn between an accidental deficit, regarded by the victim as an evil to be overcome as quickly as possible, and a deficit deliberately sought as an object worth achieving and, when achieved, regarded as a virtue.

As we are not concerned, at this stage, with the effects of deliberate, undisguised and far-reaching inflation of currency we may confine our attention to those who suggest that the budget deficit should be met by the issue of a loan.*

* By reducing the sinking fund and making no provision for the interest element in our debt payments to the United States we have already proceeded some distance along the line suggested by this group. And if the amount in suspense is not made up when the world depression passes away the case will be analogous to the one now under consideration.

The net effect of the scheme would be the employment of capital as income. For it may be assumed, for the purpose of this discussion, that Government income from taxation is employed in meeting expenditure other than capital expenditure. Even if the proceeds of taxation are normally employed to meet capital expenditure within the same year the net effect of the scheme would be to reduce the amount so used, for which reason my general observation would still be relevant. The observation is that the effect of such a method of procedure would be to stimulate those industries which supply consumption goods and services. And in so far as capital was being employed as income the stimulus would be provided at the expense of savings. It is, indeed, the purpose of the advocates of the method to provide such a stimulus, while some such advocates deliberately seek to do so at the expense of savings.

Those who advocate the fourth method, namely, an expansion of credit as a means of stimulating trade and employment, fall into two main groups. Both groups state that the banks should make available a large supply of credit at a low rate of discount or interest. The amount which the joint-stock banks can supply is determined by their reserves at the Bank of England, so that the ultimate responsibility for banking policy rests upon the shoulders of the central institution.

The Bank of England should not only maintain a low rate of discount but also, by means of open-market operations, create and maintain a large supply of credit. By this statement is meant that the Bank should purchase securities in the market. The securities would be paid for by

cheques drawn upon itself; such cheques would be placed by the sellers to the credit of their accounts at joint-stock banks, with the result that the reserves of the latter at the Bank of England would be correspondingly increased. The increase in such reserves would enable the joint-stock banks to provide a larger supply of loans or credit to their customers than would otherwise be possible. Thus credit would be plentiful and cheap.

But the existence of a plentiful supply of cheap credit does not itself constitute a guarantee that it will be used. During the past year the rate of discount has been relatively low and the deposits of the joint-stock banks relatively high, but this state of the credit market does not appear to have produced the desired result. The theory assumes a latent demand for credit which has been prevented from becoming active by the scarcity or high price (or both) of credit. How, then, does the policy of increasing the supply and reducing the price of credit produce the desired result?

One of the two groups to which I have referred argues as follows. A low Bank Rate is accompanied by a low rate of interest on bank deposits. For this reason depositors will reduce their deposits and invest the proceeds in securities, with the result that the prices of securities will rise. Moreover, a low Bank Rate is accompanied by a low rate of interest for short loans made by joint-stock banks, for which reason there will be a greater demand for such loans by members of the Stock Exchange. These loans will be employed in the purchase of securities by professional dealers,

whose action will strengthen the effect of purchases both by the Bank of England itself and by those customers of joint-stock banks who have withdrawn their deposits in order to seek a higher return upon their savings.

The net effect, therefore, of the policy of the Bank of England will be to raise the average prices of securities, or in other words, to reduce the average rate of interest upon long-term investment. The fall in the rate of interest will stimulate the issue of new securities, that is to say, will stimulate capital development in private industry and trade. New enterprises will be started which would have been unremunerative at a relatively high rate of interest but promise to be "economic" at a relatively low rate of interest. The demand for investment capital is assumed to be elastic. The stimulus to industry and trade is thus felt first by those industries (such as engineering and building) which supply capital goods or equipment, and afterwards, through the distribution of the capital among the workers employed in and through those industries, by the industries supplying consumption goods, such as necessaries and luxuries.

The second of the two groups argue, in effect, that the immediate consequences of a policy of credit expansion are likely to be found, not in the industries connected with capital development, but in those which supply consumption goods. During the early stages of a general depression in trade wholesale dealers and other middlemen are burdened with surplus stocks and therefore reduce their purchases from manufacturers. Their action, though necessary,

intensifies the depression in manufacturing industry and the fall in prices. In due course stocks are reduced, but middlemen only purchase sufficient for current requirements. They are not prepared to accept the risk involved in building up stocks for future requirements. If, at that stage, the Bank Rate is reduced and the supply of credit is increased, the middlemen, who are the generating force in industry, assume that the fall in prices has come to an end and that if they wish to enjoy the full benefit of the rise that is imminent they should replenish their stocks. For this reason their demand from manufacturing industry is increased and the promised rise in prices actually occurs. Even if the rise does not take place immediately it becomes profitable to hold stocks with money borrowed at a relatively low rate of interest which could not be held without loss at a relatively high rate of interest. A small difference in the rate of interest is of real significance in commerce, as distinguished from manufacture. The demand for credit among middlemen is elastic.

Middlemen are not alone in being influenced by future prospects. Although a large proportion of the supply of commodities is produced under contract the remainder is produced in anticipation of demand. It is held that a low rate of discount stimulates speculative production. In this case the cheapness of credit is not itself the significant factor in the sense that it materially influences the cost of supply. For in such industries production necessitates heavy expenditure on fixed capital, and that is already in existence. The cost of bank credit is usually an insignificant

factor. Moreover, such credit is usually obtained by means of an overdraft on current account, and the rate upon overdraft does not fall below a conventional minimum even when the Bank Rate and the market rates of discount are extremely low. It is, of course, true that producers are able to take advantage of low rates by employing bills of exchange instead of overdrafts as a means of financing current business. In practice, however, such a change is not usually made. Moreover, in a large proportion of cases producers need less credit during a depression than in a period of prosperity. Some of the capital of the business is held in liquid form, and this may be sufficient to finance current trade; it is only when the volume of trade increases and the price and cost levels rise that the producers need additional liquid capital and obtain it by means of bank overdrafts. For these reasons the direct effect of a low rate of discount upon speculative production may be negligible. But the indirect effect, it is held, may be important. The policy of the banking community creates the belief that prices have ceased, or will quickly cease, to fall and that an improvement in trade is within sight. Producers therefore believe that they will be justified in making preparations for a revival and begin to increase their stocks for the speculative market.

The views of the second group call for two observations. In the first place the group attach chief importance to the psychological effect of a low rate of discount. In the case of merchants, who may purchase most of their stocks with money borrowed for short periods from the banks, a low

rate of discount, by reducing the cost of holding stocks, will probably produce a direct effect upon the amount held. But even in such cases this effect is not likely to be so pronounced as that produced by the expectation of a rise in prices. If the expected psychological effect is achieved the bank policy proves successful. Merchants increase their stocks and thereby stimulate production in those industries from which they buy. Producers who produce in anticipation of demand also increase their output. Thus a revival of trade sets in. Employment is increased and the total sums distributed among wage earners and others grow larger. The demand for goods increases and prices rise. Trade begets trade and the policy of the speculators is justified. If, on the other hand, the low rate of discount does not produce the expected psychological effect, it will not provide a lasting stimulus to trade. But it is held by some members of the group that if money rates are reduced to sufficiently low levels and maintained at such levels they cannot fail to provide the necessary stimulus.

The second observation upon the views of the second group is more closely related to the subject of these articles. The revival in trade is expected to affect first those industries which supply consumption goods, such as necessaries and luxuries. The improvement in the industries providing capital goods appears at a later stage in economic recovery, and when such industries are fully employed the depression has been converted into a trade boom. In this respect the views of the second group differ from those of the first. When the first argue that a low rate of discount stimulates

capital development they also argue that the revival of industry and trade starts in those industries which provide capital goods. When the second argue that a low rate of discount enlarges the volume of bank credit by stimulative activity among merchants and speculative producers they also argue that the revival starts in those industries which supply consumption goods. We are here faced with a question of fact upon which industrial statistics might be expected to throw considerable light, but, unfortunately, even the available statistical data have not yet been analysed with sufficient care and minuteness to justify any generalisation.

We have now examined four cases. In the first two cases a revival of trade was sought through State action, and in the third and fourth cases it was sought through bank action. In the first case the State, by embarking upon schemes of capital development, was expected to create direct employment in the constructional trades and to stimulate employment in industries providing capital goods. In the second case the State, by reducing taxation, was expected to stimulate demand from and employment in those industries which supply consumption goods. In the third case the policy of the banks was expected to reduce the rate of interest upon long-term investment and thereby stimulate capital development and increase employment in the private constructional trades and in industries providing capital goods. In the fourth case the policy of the banks was expected to stimulate demand from and employment in industries supplying consumption goods. Thus in the first and third cases

the attack upon the depression is made by stimulating the constructional trades and the industries supplying capital goods ; in the second and fourth cases it is made by stimulating the industries supplying consumption goods.

This twofold classification must be regarded as very general. It is impossible to divide industries into separate compartments. The coal-mining industry, for example, supplies coal both for household consumption and for consumption in the production of steel and engineering products : it supplies both consumption goods and capital goods, and would directly benefit from any one of the four stimuli under consideration. Nor is it to be assumed that those who attack the depression at one point of the industrial system believe that the effects will only be visible at that point. It is recognised that an improvement in one branch of industry may be expected to spread rapidly to other branches.

Nevertheless the classification is useful in that, as I shall try to show later, it helps to bring out what is implied in theories relating to capital and the influence of saving upon economic progress. Those who stress the importance of stimulating saving, for example, would naturally regard with suspicion a proposal to stimulate expenditure by reducing taxation and thereby create a budget deficit. Some would be prepared to admit that such a method might be employed in certain circumstances provided the deficit were covered by a loan to be repaid within a short period. But even they would condemn a scheme to cover the deficit by a special issue of notes. Forced inflation of this character would create an artificial

rise in prices and reduce the value, in terms of commodities, of the existing supply of money capital. This, in turn, would lead to further inflation in order to provide the means of creating capital goods in the future. It is held that "forced" saving, of this kind, would ultimately lead to a financial crisis and an industrial collapse. Such a stimulus would be unnatural and bound to produce a violent reaction.

Chapter IX
Stocktaking

IN the summer of 1931, before we suspended gold payment, the pound was worth approximately 4·86 dollars and also worth 125 francs. Each of these sums was exchangeable for the same amount of gold: they were therefore equal in value. When the gold standard was suspended, the value of the pound fell in terms of those currencies which were still attached to gold. The effect upon the direction of world trade soon became obvious. A pound's worth of British goods, which was previously sold for 125 francs (or its equivalent in other countries), could be sold, with equal profit, for much less than 125 francs. Similarly imports from France, valued at 125 francs, and previously sold for a pound, could only be sold in this country for a larger sum in our currency. Exports were stimulated and imports checked, with the result that trade appeared to improve. For this reason the gold standard became unpopular and currency depreciation was regarded by some people as a remedy for the depression. By currency depreciation was meant a reduction in the external value of the pound without any change in internal conditions such reduction being effected by the sale of currency or, in other words, the export of liquid capital.

It quickly became evident, however, that

currency depreciation merely enabled us to secure a larger share of the total trade of the world; it was merely a competitive device that enabled us to benefit at the expense of others. So far from stimulating world trade it intensified the depression elsewhere, thereby creating an unfavourable psychological reaction. Moreover, it was found that competitive depreciation was a device that might be (and was) adopted by other countries. When some of the latter joined in the new game its futility became so evident that it lost its temporary popularity in this country, although it is still advocated in the United States of America, the latest convert. It is, of course, true that British trade is better and employment greater than it would have been (other things being equal) at the 1930 rate of exchange. But it cannot be affirmed that it is better than it would have been, in 1933, if we had not been forced off the gold standard by circumstances beyond our control.*

Currency depreciation, in the sense already employed, means a fall in the external value of a currency without any internal change, that is to say, a fall in the external value relatively to the internal value or purchasing power. It is, however, possible, by means of inflation, to depreciate it internally. It has been suggested that depreciation of this kind would stimulate

* My own opinion, for what it is worth, is that the state not only of world trade but also of British trade is considerably worse than it would have been if we had been able to escape the actual crisis of 1931 and to remain on the gold standard. On the other hand, the abandonment of gold has provided an opportunity for the reconstruction of a gold standard which will be more favourable to economic progress.

not only the trade of the country concerned, but also the trade of other countries. If the currency were inflated, some of the additional money (it is argued) would be spent in the purchase of imports. The consequent revival of trade in the exporting countries would lead to an increase in demand from the first country, whose exports would therefore be stimulated by the process of inflation. This argument, however, ignores the immediate effect of inflation upon the rate of exchange. Recent American experience confirms the evidence supplied by the post-war history of other countries. The mere prospect or danger of inflation is sufficient to cause the rate of exchange to fall. Moreover, so long as the currency of a country is being inflated, external depreciation not merely persists but even increases. Its external value falls more rapidly than its internal value or purchasing power. As in the first case exports are stimulated and imports checked. World trade is redirected but not increased. If such a policy of inflation is to be effective (within its own limits) it must be an agreed policy simultaneously pursued by several countries. If it is confined to one country its effect upon world trade appears to be the same as in the first case. It merely becomes a method of initiating "competitive depreciation." Whether inflation of the type postulated in this proposal would be likely to promote economic progress in a self-contained community is a subject that will call for consideration in due course.

We have now reached the end of the first stage of our discussion of the Economics of Saving and in the remaining articles of this series I shall endeavour to describe, in the simplest possible

terms, the essential features of the modern controversy about the influence of the rate of saving and the rate of interest upon economic progress. Before I embark upon this task it seems desirable to submit a brief summary of the discussion so far as it has gone.

Capital is essential in every form of economic organisation known to mankind. A man living alone on an island provides his own capital. Saving takes the form of effort devoted to the production of such capital as distinguished from effort devoted to the satisfaction of immediate needs. Nor is the situation materially changed if two or more people live together as a family, that is to say, as a communistic group which employs no money. But modern communities do not live in that fashion. They not only employ money, but also live and work under the system of private enterprise or economic freedom. The discussion of the economics of saving is based upon that assumption. If every nation adopted, in its complete form, the system which, in a modified form, now prevails in Russia, the theories and descriptions contained in these articles would not be relevant. The State would direct all forms of economic activity and determine how much expenditure of current effort should be devoted to the production of capital goods and how much to the satisfaction of immediate needs. Private saving and private investment would not, and could not, exist.

In modern society saving takes the form of setting apart a portion of income, the remainder being used to satisfy current needs. Usually the amount saved is invested in a form such that

its actual use is controlled by some other individual or by a firm or other institution. The stream of savings normally becomes a stream of investment; the money capital of the individual saver and investor is used to provide the capital goods, such as factories and houses, that are required by society for the purpose of providing goods for current consumption, including current services. While, therefore, saving in the individual sense means abstinence, in the wider sense it means expenditure upon capital goods or equipment. This expenditure may be termed, for our present purpose, real investment. The adjective "real" is useful for the reason that an individual may invest his savings by purchasing an existing security from a seller who either leaves the money on deposit at a bank or even hoards it. In such a case there may be no fresh or real investment. Under normal conditions, however, the stream of savings is converted into new securities representing additional capital goods or real investment. The relation between the two streams, and the conditions under which they do not correspond, will be considered in due course.

The individual investor receives, or expects to receive, a return upon his investment. If the money is invested in a security such as a loan issued by a public authority the owner receives interest. A loan issued by the government represents the most perfect type of security; not only is it free from risk but it may be sold at any time on the market. The interest earned by money so invested may be regarded as the net rate of interest, or payment for the use of capital after eliminating all payments due to

risk and inconvenience. Interest emerges because, without interest, there would be no inducement to invest or lend savings; the demand for fresh capital would be greater than the supply. Ethical considerations do not arise.

Capital, like all other commodities, is subject to the law of demand. The demand for capital at a given price (i.e. rate of interest) is greater than it would have been at a higher price, and less than it would have been at a lower price. It should be observed that I am making no comparisons involving the time element. I have not said that a rise (or fall) in the price, or rate of interest, is followed by a fall (or rise) in the demand for capital. I have merely compared the demands at different rates of interest under precisely the same objective conditions. Now the variation in demand at different rates of interest may be due to the effects of interest either upon the number of investments of the same quality or upon the quality of the investments. Thus, for example, a low rate of interest may mean either that more people will build new houses for themselves or that the same number will build better houses than would be the case at a high rate of interest. In practice these results may be combined. The apparent conclusion is that a relatively high rate of saving, maintaining a relatively low rate of interest, also favours the accumulation of capital goods (that is to say, secures a high rate of investment) and thereby accelerates economic progress. But that conclusion, we shall find, is itself the subject of controversy. It will, indeed, form the starting point of the theoretical discussion in the remaining

articles of this series. My own view is given below.

That controversy, however, has no direct bearing upon the view that the relative need for capital in the future will not be less than in the past. Reference has already been made to the suggestion that, over the next fifty years, technological progress and other forms of economic progress will not call for so large a stream of savings as in the days when progress was based upon railway development and necessitated the multiplication of large factories to house heavy and expensive machinery. Before the war the world had to be filled up with new capital goods. A reservoir had to be created, whereas in future it will only need to be fed, and its level raised. I need not repeat the reasons that I have given for dissenting from that view.

It is theoretically possible for a community, through its members, to save too much. If everybody decided to live on the margin of subsistence and save the balance of the money income, the savings would be invested in capital goods that no one wished to use. The need and demand for capital is a function of the standard of living; and the aim of society is to make that as high as possible, having regard to the claims of both present and future. Again it is theoretically possible for a community to save too little. If everybody decided to spend total income in the satisfaction of current desires, and to ignore the claims of the future, society would quickly be reduced to a state of chaos. It would be literally impossible, through lack of capital equipment, to satisfy all desires. Thus, for example, there

would not be sufficient chocolate factories to meet the demand for chocolates. Somehow or other saving would have to be forced upon the community in order that more chocolate factories might be erected.

These are extreme cases, which are submitted to show that the rate of accumulation of capital may be a cause of disturbance in economic society. Now it is theoretically possible for the rate of saving to fit so nicely into the demand for capital as to produce a real balance or equilibrium. By this statement I mean that the demand of the community for current goods and services grows in exactly the same proportion as the supply of capital equipment necessary to supply such current needs. What is spent on such equipment requires precisely the amount that is saved. Such a balance between saving and spending would cause no disturbance. The stream of savings would become an equivalent stream of investment and the latter would be precisely the stream necessary to supply the additional goods and services required by society to satisfy current demands.

Under such conditions the rate of saving would not itself be a cause of disturbance. They are, however, imaginary conditions that are not realised in practice. But here we are faced with a real difficulty. I have described two extreme cases in which the rate of accumulation of capital creates a real disturbance and indicated an intermediate position in which there is no disturbance due to the rate of saving or accumulation. This intermediate position of equilibrium suggests a particular rate of saving intermediate between the two extreme rates. But this conclusion does

not follow inevitably from the previous statements. There may be several rates any one of which would maintain equilibrium, or a constant rate of progress.

This statement may become clear if I use a simple illustration. Houses form part of the capital of a community. Now the community may prefer a low standard of housing and greater expenditure upon perishable goods to a high standard of housing and less expenditure upon perishable goods. In the former case equilibrium will be maintained at a lower permanent rate of saving than in the latter case. The rate of interest need not be the same in the two cases, nor is it possible to say which would produce the higher rate. For in this case it is a voluntary decision between saving and spending; the demand for good houses is inelastic. The community would be sacrificing future gain for immediate need. The loss would be in quality rather than quantity of the national income. For, by assumption, the community saves sufficient capital to provide all that it needs—it prefers perishable goods to good houses, not merely at a given moment but for an indefinite period. If the community were persuaded that good houses were preferable to semi-luxuries of a perishable nature it would need to endure an interval during which it was without either. The houses would need to be built and the money saved to pay for such houses. During this interval the rate of interest would be raised, but the higher rate would not necessarily be maintained beyond the period of transition. After the interval a new equilibrium would be restored, at a rate of interest which might be

higher or lower than the original rate.

While, however, a position of equilibrium may be maintained at more than one rate of interest, the rate of economic progress is not the same in all cases. We know, from experience, that the most efficient methods of production, and the highest standards of housing are usually those which involve proportionately greater expenditure of capital. The more we sacrifice in the present the greater (proportionately) will be the future return in consumption goods and services. And, as already stated, the lower the rate of interest the greater will be the inducement to employ capital, that is to say, to employ more efficient instruments of production. It is here that we find the ultimate benefit to society of the saving and investment that takes place in society. It may therefore be stated that although several rates of interest might maintain economic equilibrium it is the lowest of those rates that secures the maximum rate of economic and social progress. Herein lies the theoretical justification of all efforts to stimulate saving and investment.

In the foregoing summary of previous articles I have assumed no *change* either in the rate of saving or in the demand for capital. The discussion has been concerned with the significance of any given relation between supply and demand, and I have suggested that a state of equilibrium may be maintained at more than one rate of interest. We know, however, that such equilibrium is not maintained in practice. Trade and employment ebb and flow, and with trade the demand for capital and the rate of interest. The relation between the supply of and demand for capital

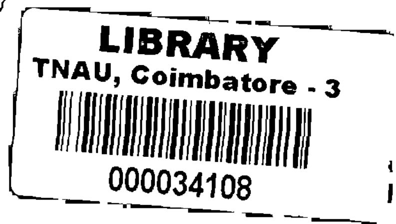
changes in the course of a trade cycle, which tends to cover a period of eight or nine years.* It will immediately be evident that the change in the relation of the rate of saving to the rate of investment may, in theory, be either the cause of fluctuations or the result of fluctuations due to other causes. The controversy that will be examined in the remaining articles of this series is primarily concerned with this relationship. It is held, for example, that the normal relationship between saving and spending is such as to produce disequilibrium in the form of cyclical booms and depressions.

Accepting the existence of the trade cycle I then examined the proposal that public expenditure upon capital development should be concentrated, as far as possible, within periods of depression, instead of being either spread evenly over a long period or largely concentrated within a period of prosperity. The point that I urged in that connection was that such a proposal did not necessarily involve any change in the long-term relationship between saving and spending; it merely aimed at changing the time-distribution of public investment, and thereby secured a closer connection between the savings stream and the investment stream and a more steady flow of employment. Moreover, in the discussion of other proposals for stimulating trade at the present time, I distinguished between

* I do not ask the reader to accept this estimate as strictly accurate. Other writers submit other estimates, but I do not agree with their methods of measuring the length of a trade cycle, which is to measure the time from the peak of one boom to the peak of the next. I have tried to show, in the second edition of *The Economics of Private Enterprise*, that trade cycles are more regular than previous writers have assumed.

them according to whether they were intended to stimulate investment first or last.

We are now ready to enter upon the discussion of the controversy *relating to the effect of the* relation of spending, saving and real investment to those movements of industry and trade which are known as trade cycles. It is one of the most difficult subjects in the science of economics. I shall begin by examining the view that trade depression is due to lack of "purchasing power" in the hands of consumers. But I wish to emphasise the fact that the "trade cycle" is not the subject of this series of articles, and will not be examined as a special problem. I shall merely be concerned with one aspect of that problem.



Chapter X

The Hobson Theory of Over-Saving

THE path of progress is strewn with discarded ideas and theories. What is discarded by one generation, however, may be taken up by the next or some later generation and re-examined in the light of new circumstances and fresh knowledge. Often it is found that a theory which had previously been rejected as false contains an important element of truth. Even when it is rooted in fallacy it may appear to afford an explanation of the difficulties experienced by society at a later stage of development and is therefore welcomed as a new and correct interpretation. An illustration of the revival of old ideas is to be found in the American theory of technocracy. When technocrats argue that recent advances in invention and organisation have so increased the producing capacity of economic society as to make it impossible to re-absorb the displaced labour without reducing the hours of work, they add little to the cry of the hand-loom weaver and others when, more than a century ago, the spread of the power loom and other types of machinery caused an immediate displacement of labour and a considerable amount of "technological unemployment."

We shall be concerned, in the present article, with a theory which, like technocracy, is as old as the modern factory system, namely, the theory

of "over-saving." This theory has been mainly associated, in recent years, with the name of Mr. J. A. Hobson, one of the most persuasive of recent writers on economic and social problems. I shall not quote from any of Mr. Hobson's books. Even when a short quotation is not misleading in the sense that, removed from its context, it may convey a meaning not intended by the author, it is almost inevitably concerned with one aspect, under immediate discussion, of a wider problem, and is therefore apt to be unjust to the author. It is probably true to say that few writers have suffered more from this type of quotation than Mr. Hobson. As I have myself frequently suffered from such quotations I know how difficult it is to correct the impression conveyed to the readers. I shall therefore endeavour to indicate, in the simplest possible terms, the essential features of the theory expounded by Mr. Hobson and his followers.

There are many who defend, not merely the competitive system, but also the degree of inequality in the distribution of income with which that system was once associated. This association is one of historical fact, not of economic inevitability; and I am now concerned only with inequalities of income—the question of wealth and poverty. It has been held that if the income of the community were not largely concentrated in the hands of relatively few people there would be no guarantee, or even reasonable prospect, of a sufficient flow of savings to provide for future economic development. Present inequality is the price paid for continuity. Without such continuity (conditioned by inequality) the future standard of living even

of the relatively poor would be lower than under a system of greater equality in the distribution of current income. The rate of saving necessary to progress can only be maintained by allowing a comparatively small number to receive surpluses beyond their capacity to consume. Saving cannot be left to the voluntary action of individuals in receipt of moderate incomes: much of it must be forced upon society through inequality. Luxurious expenditure by the rich is a social cost incurred in providing an adequate flow of savings, for it does not absorb the whole of their incomes. The danger confronting society is scarcity of capital, for which reason society cannot afford such a distribution of income as would appear, at first sight, more consistent with popular ideas of justice. I merely state this point of view, without either defending or attacking it; but I may add that since, in recent years, there has been a marked decrease in the inequalities of the final distribution of spendable incomes, it is a theory which is being subjected to the test of experience.

Mr. Hobson approaches the problem as one who is acutely conscious of the fact and consequences of inequalities in the distribution of the national income. He sees, on the one side, ample leisure and the growth of luxury; on the other, long hours, fatigue, periodic unemployment and a low standard of living. Like every public-spirited citizen he asks himself whether such inequalities are inevitable, and if not, to what avoidable causes they are due. He is led to deny (by implication) the truth of the doctrine that I have briefly described. He reaches the conclusion

that the evil from which society is suffering is not that it saves, or may save, too little, but that it saves too much, and that it saves too much because wealth and income are too unequally distributed. It is in this fact that he finds the explanation of periodic booms and depressions.

Before proceeding any farther it should be noted that on one point Mr. Hobson, by implication, agrees with those who defend recent inequalities in the distribution of income. His view implies that if income were less unequally distributed the relatively poor would enjoy a higher standard of living, not by saving and investing their additional incomes, but by spending them upon the comforts of life. It might be argued that the relatively wealthy section of the community instead of saving and investing less of their smaller incomes, would spend less upon luxuries, so that the rate of saving would not be reduced. But that is not part of Mr. Hobson's argument which, in effect, is that society saves too much, and that over-saving, and its evil consequences, would disappear if incomes were less unequal. Thus both sides agree that saving is increased by concentration and reduced by a wide diffusion of incomes. Moreover, they agree that the ultimate objective is to maintain the highest possible standard of living for the great mass of the people over a long period.

Mr. Hobson's argument, as I understand it, may be summed up as follows. The purpose of all work is to provide the commodities and services that contribute to human welfare. Some of these contribute directly and immediately to such welfare and are called consumption goods. The remainder,

which may be termed capital goods or production goods, contribute indirectly to welfare in so far as they assist in the production of consumption goods that are in effective demand. Such production goods, including factories, transport agencies and other well-known forms of capital equipment, are provided out of the savings of the community. The income that is not saved represents the effective demand for consumption goods.

Now it is agreed that, in theory, the total income of the community may be divided into saved income and consumed income in such a way as to make the effective demand for consumption goods equal to that flow of such goods which is made possible by the investment, in production goods, of the amount of income that is saved. Such a ratio between saving and spending is ideal; it maintains equilibrium, secures continuity of employment and provides the highest continuing standard of living that is possible, regarding the community as a unit.

In this connection it should be pointed out that such a state of affairs would not necessarily be regarded by Mr. Hobson as ideal. For it is clear that (on Mr. Hobson's assumption, which will presently be developed) such a state of equilibrium in production would be reached and maintained if the relatively wealthy people spent a larger proportion of their incomes upon consumption goods and saved less. Inequalities in incomes would not be reduced; luxurious expenditure would be increased while the standard of living of the relatively poor would not be raised. The problems of poverty—inequalities in the distribution of income—forms a more compre-

hensive subject of discussion than the one with which we are now concerned. Mr. Hobson deals with the subject of our present discussion only as part of a wider problem. Nor should it be assumed that if his analysis of saving and spending is false the remainder of his treatment of the problem of wealth distribution is also necessarily false. We are concerned not with Mr. Hobson's views as a whole, but only with his theory of "under-consumption" or "over-saving." I venture to emphasise this point, for I believe that his contributions to economic study have not received the recognition that they deserve, and that the cause is to be found in the fact that critics, by attacking the less convincing parts of his analysis, have conveyed a false impression of the value of his work as a whole.

Reference has been made to the view that, in theory, there exists a ratio between saving and spending which would maintain equilibrium between production and effective demand for consumption. In practice, however, this ratio is not maintained. Mr. Hobson points out that investment, or the production of production goods, is itself a long process. Savings are thus slowly transformed, through investment, into a mass of factories and other forms of capital equipment. These, however, are mere instruments for the production of consumption goods, and when they are ready for use it is found that they cannot be used to advantage. The income spent upon consumption goods is so small that the new supplies made possible by the new appliances cannot be absorbed. Then follows a fall in prices and trade depression. The evil is over-investment

and under-consumption. The failure of demand is due to the poverty of the relatively poor; the excess of investment is due to the superfluous wealth of the relatively wealthy.

The immediate remedy is to spend more and save less. For reasons of a different character, the increased expenditure should be upon the comforts for the relatively poor, not upon further luxuries for the relatively wealthy.

When depression enters and prices fall the burden falls most heavily upon the industries connected with capital development. The community is overloaded with invested capital or capital goods. There is no prospect of a return upon new investments, no inducement to invest. Society is more or less compelled to wait until consumption overtakes the supply of equipment; this waiting period is depression and represents waste. It is characterised by a fall in the rate of interest, for which reason investment income falls. In spite of a fall in wages the ratio of investment to consumption is altered in a favourable manner, though not for all time. For savings accumulate even during depression, and these are ready to be added to new savings when the growth of consumption favours some addition to investment. Thus a new cycle is started and the process is repeated. Until the change in the ratio of saving (or investment) to expenditure upon consumption goods is made permanent the cycle of trade will continue. Such a change can only be made permanent by a permanent change in the distribution of wealth and income. Again, the existence of long periods of unemployment in the industries immediately dependent upon

investment means that such industries are wastefully employed. If they were reduced to a smaller scale and worked continuously they might produce an equal amount of capital goods and set free a large body of workers available for increasing the national income of goods and services immediately available for consumption. Such waste represents the social cost of maintaining existing inequalities and is an aspect of over-saving.

It is not surprising that many who accept Mr. Hobson's analysis of the trade cycle should favour monetary expansion as a method of dealing with the present depression of trade. But we should be careful not to assume that such a policy of expansion is bound up with his theory of over-saving or under-consumption. It is possible, without inconsistency, to accept the analysis while rejecting the view that a policy of monetary expansion is desirable. For, in the first place, such a policy might lead to further capital development. What is needed, if the analysis is correct, is less rather than more development of that kind. In the second place if (as is likely) such expansion led to an increase in consumption, the revival of industry would again cause an increase in saving and investment. The cause of instability would not be removed. Monetary expansion would not change the long-period ratio between saving and spending. The analysis which has been submitted points to the conclusion that the industries producing consumption goods should be expanded relatively to the investment industries; and that this end can only be achieved by a permanent change in the distribution of wealth and income.

Moreover, the theory expounded by Mr. Hobson should be distinguished from the cruder theories of under-consumption and inflation now so prevalent both in this country and in America. We are frequently told that the present depression is due to lack of "purchasing power" and that the remedy is to be found in an increase of purchasing power in the hands of consumers. Circumstantial evidence suggests that the policy of the United States has been influenced by this theory. An attempt is now being made in that country to increase employment by raising wages. But the theory that depression can be overcome by a monetary policy which aims at increasing consumers' income is not connected with the theory that cyclical booms and depressions are due to over-saving and over-investment. The former is merely concerned with the method of increasing the volume of employment at the moment. It is not concerned with the economics of saving, and for that reason does not fall within the scope of this discussion.

Let me repeat that Mr. Hobson's theory is that economic society is suffering from the fact that the rate of saving is too high. It is not concerned with the effects of changes in the rate of saving. If the rate were suddenly changed—if we all suddenly became misers or spendthrifts—industrial equilibrium would be destroyed. But the effects of changes in the rate of saving constitute a different problem from the effects of a given rate of saving. Mr. Hobson holds that there is a persistent rate in excess of that which is desirable; and that the excess is due to inequalities in the distribution of income. The difficulty created by

such excess is not that of converting savings into investment. Savings are in fact so converted, and because they are converted into investment society is supplied with more producing capacity than is needed to supply the consumption goods demanded by consumers. The result of this lack of balance is seen in the recurrence of general trade booms—the periods of over-investment—and depressions—the periods during which the lack of effective demand from consumers becomes evident. Before commenting further upon this theory it is desirable to describe a theory which has recently attracted considerable attention and is based upon the assumption that society tends to spend, not too little, but too much upon consumption goods. This theory will be the subject of the next article.

Chapter XI

The Theory of Under-Saving

DURING the last few years economists have been largely concerned with the relation of saving, investment and the rate of interest to those fluctuations in industry and trade which are usually termed "cyclical." Their discussion is not only highly theoretical, but also almost unintelligible to those not acquainted with technical economics. While this may be admitted it is, however, necessary to emphasise the ultimate practical importance of the issues that are raised by such economists. There appears to be a very close connection between the trade cycle and the rates of investment and saving, nor is it unlikely that the most valuable contributions to the practical study of the trade cycle will include those supplied by abstract theory.

It is necessary, in the present article, to skirt the boundaries of this theoretical discussion; but I venture once more to emphasise the fact that I am not concerned with the theory of the trade cycle as such. In the previous article I examined the view of those who hold that society saves too much, and showed that, in the opinion of such writers, the fact of over-saving was revealed in the recurrence of cyclical booms and slumps in industry. In the present article I shall endeavour to examine the views of those who believe that, in one sense, society saves too little,

and that the scarcity of voluntary savings is shown in the recurrence of booms and slumps. In the one case the trade cycle is associated with over-saving or "under-consumption," in the other with under-saving or over-consumption as a persistent tendency in economic society. These views are obviously in conflict, but a full examination of this conflict would necessitate a discussion of trade cycle theory, which is beyond the scope of these articles. I hope that what I have to say will be intelligible (though it may not be easy) to those who do not claim to understand technical economics. I shall proceed with the analysis by stages and assume the existence of an isolated community, thus avoiding the complications created by trade between communities that have reached different stages of economic development.

(*a*) Let us first assume a simple community, with a stationary population and fixed habits of life and methods of work. Provided adequate provision is made for repairs and replacement of capital it is clear that no further saving on the part of the community is necessary. The industries providing capital equipment will be large enough to maintain the existing supply of capital goods, but will not be larger than is necessary for that purpose. The remainder of the working population will be utilising such equipment in ministering to the immediate needs of the community; in other words, they will be supplying consumption goods and services.

In the next place, let us assume that, while habits of life and methods of work remain unchanged, the population is slowly increasing. The additional population will require capital instru-

ments of the same kind as the original inhabitants, and these will need to be provided by the latter. For this reason the community will need to save, and their savings will be invested in the industries providing such instruments of production. Until the additional members of the community start to work, these industries will be larger and will employ more people than in the first case, while the industries supplying consumption goods will be smaller and will employ fewer people than before. The community will always be preparing for its growth—i.e. for the *next* increase in population—for which reason its standard of living (upon the assumptions already specified) will be lower than it would have been if the population had remained stationary. In its essential features this case resembles that of a family containing a number of growing children. As the latter must be fed, clothed and educated, the standard of material comfort of the parents will necessarily be lower than it would have been if they had had fewer children. The community may, indeed, be regarded as a family with more children than are necessary merely to maintain a stationary population. These must be given sustenance, provided with schools, etc., and supplied with capital goods for the time when they, too, will be able to pull their weight as workers. All these requirements—invested savings—represent a drain upon the community and reduce the degree of material comfort that would otherwise have been possible.

In the case described in the last paragraph I assumed that habits and methods were fixed and that the population was increasing. Let us now suppose that the population remains fixed, but

that new inventions are periodically discovered and adopted, and new and better methods of organisation devised, and that these necessitate greater use of capital than the older methods. The provision made for repair and replacement will no longer be sufficient; additional savings will be required, which will be invested in the industries providing capital equipment. These industries will be larger than before and will absorb a greater proportion of the working population. The industries providing consumption goods and services will employ fewer people and, for a time, will supply fewer products. The standard of material comfort will temporarily be reduced. But this case differs from the previous one in that the reduction in the standard of comfort will not be permanent. The new methods of production are more efficient than the old ones; they effect a real economy of human effort, with the result that the supply of consumption goods and services will ultimately be increased. To-day's gain is the outcome of yesterday's sacrifice; to-day's sacrifice will be to-morrow's gain. Nevertheless the sacrifice, like the gain, is real and always present. To-day's gain and to-day's sacrifice are so closely interwoven as (in practice) to be indistinguishable. One melts into the other as the present melts into the future. Saving means doing without that which we might have secured; it emphasises the sacrifice while investment emphasises the gain.

In the next place let us assume both that methods of production undergo change and that population is increasing. We now appear to have a double temporary sacrifice, followed by a continuing gain

from the first condition that we assumed and a continuing sacrifice from the second. It should not be forgotten, however, that the growth of population may provide a strong incentive to invention and improvement in organisation and may even, in some cases, make the latter possible. For it is well-known that division of labour and specialisation are limited by the extent of the market, that is to say, by the size of the community. Mass production in the motor-car industry, for example, would not be possible in an isolated community of 10,000 people. Subject, however, to this factor, it is true to say that growth of population imposes a continuing sacrifice represented by the industries that have to be maintained for the purpose of supplying the additional capital goods required by the additional population.

(*b*) In the above discussion I have implicitly assumed that the community acts as a unit, deciding how much it will save in money and invest in the form of capital goods. Such is not the case. The community acts through individuals and the latter enjoy freedom of choice. Both saving and investment represent the action of individuals or business units—either private firms or public bodies. Investment follows the belief of business units that their action will bring an adequate money return. Such units "demand" or bid for savings or capital because they believe that they will be able to make a profit through its employment, and the prospect of success will be partly determined by the price charged for capital, or rate of interest. The total demand of the community is the sum of individual demands and will therefore be partly determined by the rate

of interest. Saving, which provides the supply of capital, is also individual ; it represents a preference for future goods and services over those available for immediate consumption. The saving of the community, which represents the total supply of money available for investment, is the sum of individual savings.

Earlier in this series of articles I stated that it was at least doubtful whether the flow of individual savings—and therefore the total flow of savings—was influenced by the price offered for their use—the rate of interest. It is immaterial for our present purpose, however, whether the rate of interest actually reacts upon the supply of savings. In either case such a rate of interest will tend to be established as to make the demand for capital equal to the flow of savings, *provided there is no disturbing influence at work*. It is with this disturbing influence that we shall presently be concerned. It is important, in passing, to remind ourselves of the distinction between the existing stock of capital, in the form of factories, houses, etc., and the flow of new investment in the form of additions to this stock. By the demand for capital is meant the demand for new savings for the purpose of providing such additions ; by the supply of savings is meant the supply of new savings from current income. These are the two items that are made to balance by the rate of interest.

(*c*) At this stage it is necessary to introduce a complicating factor, namely, the monetary system. Let us first assume that (i) the supply of money is fixed ; (ii) the population is stationary ; (iii) the habits of life and methods of work are fixed. In

such a stationary state the business firms would provide for repairs and renewals; their cost would appear in the cost of producing goods and prices would be equal to the cost of production. There would be no interest element in cost; there would be neither saving nor remuneration (interest) for the use of savings.

Let us next suppose that (iii), but only (iii), is changed, that is to say, that inventions are applied and new and better methods of production devised from time to time. New capital will be required and the latent desire to save will be given an opportunity of expressing itself. Those who want to employ new devices will compete for the flow of savings and this competition will establish such a rate of interest as will shut off that demand which is in excess of the supply. The potential investments that offer the best prospects will capture the existing flow of savings.

Now two statements may be made without further explanation. The first is that the use of the new inventions, etc., will reduce the costs (including in such costs the new element representing interest on capital) and, without any changes in wages and salaries, reduce prices to the consumer. For if costs were not reduced there would be no incentive to introduce the new methods. The second statement is that the rate of technical progress is determined by the rate of interest which, in turn, is determined by the flow of savings. Within limits the extent of future gain is determined by the degree of present sacrifice.*

* The Hobson theory of underconsumption, which was examined in the previous article states, in effect, that these limits are actually exceeded in practice.

If the flow of savings is small only the outstanding inventions, etc., can be utilised. The impatient desire of business units to make profits is held in check.

It is desirable, at this stage, to draw attention to the danger of confusing two distinct and separate issues. I am assuming a given rate of saving without any sudden change in that rate. If everybody suddenly decided, for example, to save twice as much as before, industrial equilibrium would be destroyed for a period which might be long or short. I am throughout assuming not a disturbing change, but an unchanging condition, either of a high rate of saving or of a low rate.

Under such stable conditions, with a low rate of saving, interest rates will be high, the growth of the income of goods and services in the community will be slow, and the high rates of interest will give owners of capital a relatively large share of that income of goods and services. If, on the other hand, the rate of saving is high, interest rates will be relatively low, the growth of national income of goods and services will be rapid, and the low rates of interest will only give the owners of capital a relatively small share of that income of goods and services.

(*d*) We have hitherto assumed that the supply of money in the community is fixed, so that the growth in the supply of goods and services (made possible by invention, etc.) is necessarily accompanied by a general fall in money costs and prices. Let us next assume that the supply of money can be increased by the banks, and that such banks are willing to increase that supply and to lend the

new supply to business firms. The latter want money to pay for capital goods, and are now able to obtain it from either of two sources, current savings of individuals and firms or new bank money. The rate of interest likely to be established under such conditions, provided demand is keen, is clearly below that rate which would prevail if new investment could only be financed, as in (*c*), from current savings. The first rate may be termed the actual rate of interest and the latter the natural or equilibrium rate, i.e. the rate which establishes and maintains an equality between saving and investment demand.

We have now reached the heart of the theory which is the subject of the present article, and as the theory has been pronounced difficult even by serious students of economics, I offer no apology for elaborating my introductory remarks. So long as the supply of money was fixed, investment was necessarily financed from current savings—it could not run ahead of the latter. The rate of investment was made equal to the rate of saving by the rate of interest, which was thus the equilibrium rate. Saving meant abstaining from expenditure upon consumption goods, while investing meant utilising, in the production of capital goods, the forces thus released. Continuous investment, by economising human effort, also meant a continuing increase in the sum total of goods produced and a continuing fall in prices.

When, however, the supply of money has been made elastic, it becomes possible for the rate of investment to exceed the rate of voluntary or spontaneous saving. The supply of money can be increased to the extent of the deficiency.

What is the result ? Human effort is economised no less than in the first case, but prices will not fall proportionately to the economy of effort. They may even rise. The community continues to spend at least as much money as before upon consumption goods, but the supply of the latter does not increase so rapidly as would otherwise have been the case. For, by assumption, investment is accelerated by the withdrawal of resources from the production of consumption goods and services. The capital goods industries and the consumption of goods industries compete for the available supply of labour, and as the former gains the latter obviously loses—during the same interval. Thus, when voluntary saving proves insufficient to finance new investment, a form of compulsory saving is introduced through an increase in the supply of money. But that is not the whole story. The deficiency in savings is a continuing deficiency which must be made good by a continuing increase in money. If the flow of new money is stopped and the supply again becomes inelastic, the rate of investment will need to be restored to the level permitted by the rate of voluntary or spontaneous saving, and this will be done (in theory) by the restoration of the equilibrium rate of interest.

(*e*) The theory of under-saving may now be briefly stated. It is held by the Austrian School of economists that there is a persistent tendency in society for investment to outrun voluntary saving. Both business units and consumers are " impatient "; the former are normally eager to use more money than the latter are prepared to save. Under certain conditions—in other words, when industrial

prospects are favourable—the banking system provides an additional flow of money to business units, and this additional supply maintains a rate of interest below that rate—the equilibrium rate—which would have prevailed if voluntary savings alone had been available for investment. What is clearly a theoretical possibility is more than a mere possibility; it is precisely that which tends to occur in practice. But it cannot continue indefinitely. There is an obvious limit to the power of the banking system to create new money, the limit being fixed by the banking reserve. If the banks decided to continue their policy indefinitely the community would be reduced to the state of Germany when, after the war, the currency of that country was made worthless by fantastic inflation. When the reserve falls the banks either refuse to lend or raise their rates of interest above the equilibrium rate and thereby discourage new investment by business units. This change of policy, by reducing demand from the industries supplying capital goods, initiates a depression which becomes general and may be regarded as a cleansing process.

It is impossible to follow this analysis farther without entering into a discussion of trade cycle theory. But it is important to stress the central statement in the Austrian theory. It is not suggested that, in the absolute sense, society saves too little and ought to save more. Nor is it suggested that society invests too much and ought to invest less. Both interpretations are erroneous. Broadly speaking, the theory is that relatively to the amount actually invested the flow of savings is too small or, alternatively, that relatively to the amount actually

saved the flow of investment is too large. What is wrong is the relation of the one to the other, not the size of either when considered separately.

It is true that some exponents of the theory take a more extreme view and argue that society saves too little in the absolute sense, but in doing so they introduce an element that is not essential to the theory.

This error is made possible by the maintenance of a rate of interest below the equilibrium rate, and this, in turn, is made possible by the injection of, or willingness to inject, new money into the system. The error generates its own correcting influence in the manner already indicated.

(*f*) We have now described two theories of saving, the Hobson theory that society saves too much, and the Austrian theory that society tends to save too little in relation to actual investment demand. These theories, though conflicting, are not diametrically opposed; one is not the negation of the other. The Hobson theory states that, in the absolute sense, society saves too much and should save less. People should spend more upon consumption goods and services. The Austrian theory states that, if society wants to invest on the scale customary in practice, it should save more, and that if it does not wish to save more it should reduce the rate of investment. By trying to make the best of both worlds it fails to enjoy the good in either. Which of the two alternatives it should select is a matter for its own judgment, not a question to which economics can supply an answer. Society cannot, however, both eat its cake and have it.

Both schools of thought describe theoretical possibilities. It is possible for society, like an

individual, to spend too much or to save too much. In either case excess brings its own punishment. One form of punishment from which society suffers is excessive fluctuation in industry and trade, which undoubtedly retards social progress. The two conflicting theories that I have described have been put forward as illustrating, in each case, the sins for which excessive trade fluctuation is the punishment. They have been elaborated in relation to the trade cycle, and for this reason they cannot easily be compared in general terms and without reference to the phenomenon which, in different ways they seek to explain. But it is noteworthy that both ignore the influence of international trade and investment, which cannot be dismissed as irrelevant or unimportant.

Chapter XII

Conclusion

IN the tenth and eleventh articles I was concerned with two conflicting theories or views; one being that society saves too much, the other that, relatively to investment, society tends to save too little, or, alternatively, that relatively to current saving, society tends to invest too much. According to the first view the income of society is so unequally divided that the great majority of the people are compelled to live at a low standard; the fortunate minority, on the other hand, are unable to spend more than a small part of their combined income. The remainder of the income is saved and invested in capital goods. These capital goods, however, cannot be fruitfully employed on account of the poverty of the relatively poor. Hence we find periods of rapid investment and activity in the investment industries followed by depressions that are particularly intense in such industries. A period of depression represents a period of waiting until the requirements of society overtake the investments that were made during the previous period of industrial activity.

According to the other theory investment tends to run ahead of saving; the gap is filled for the time being by the provision of bank money, that is to say, by inflation of credit. In due course inflation brings its punishment in the form of credit restriction and industrial depression, the

period of depression representing a period of waiting until saving again overtakes investment.

It is clear that each of these views indicates a possibility. If everybody in society decided to live at or near the margin of subsistence, the rate of profitable investment of capital would obviously be enormously reduced, in which case society would be clogged with savings. Such a state of affairs could not continue indefinitely; ultimately a balance would be struck through a reduction in the volume of employment, such reduction expressing itself in vastly increased leisure for everybody. Again, it is clear that if every individual decided to spend the whole of his income upon necessaries and luxuries to be immediately consumed, the capital goods that would be necessary for the production of such luxuries would not be forthcoming without some form of forced saving; compulsion in this connection would take the form of credit inflation, and this, in turn, would be followed by a collapse of the credit system and a severe industrial depression. While agreeing that each of these conflicting views states a theoretical possibility, it is not part of my task, in the present series of articles, to suggest which, or whether either, may be accepted as a true interpretation of actual tendencies. Each is put forward as an explanation, or part explanation, of cyclical movements in trade activity and employment. As I have already stated, the trade cycle does not form part of our subject of discussion. On the other hand, although put forward as an explanation of the trade cycle, the first view is in conflict with the views that I have expressed in the present series of articles. It is immaterial to our enquiry whether

over-saving is due to inequalities in the distribution of the national income or to some other factor; if, in fact, society is saving too much it is clearly desirable that it should save less and spend more upon consumption goods. As I am not here concerned with the trade cycle as an economic phenomenon, I must content myself with an expression of opinion, which is that the theory of over-saving does not offer an explanation of cyclical movements in industry and trade. Nor do I believe that the trade cycle is fully explained by the theory of under-saving; on the other hand, this theory is not in conflict with the statements contained in these articles.

Again, I have said nothing about a theory recently expounded by Mr. J. M. Keynes. This theory, like the others to which I have referred, is offered as an explanation of the trade cycle; it is not a theory of saving but a theory which refers to the relation between saving and investment. It does not state that society saves too little or too much or that it invests too little or too much. It is not a theory that can be explained in a paragraph; not only is it difficult in itself, but its difficulty has been increased by the fact that Mr. Keynes employs the terms "saving" and "investment" in a sense that is useful for the purpose of his own analysis but differs from the sense in which the terms are commonly employed. In so far as Mr. Keynes' theory may be reduced to simple terms it may be stated in the following words, in which I use the terms "saving" and "investment" in the ordinary senses. Both saving and investment represent a flow or stream; if the saving stream became automatically the invest-

ment stream, industry and trade would not be subjected to those violent cyclical interruptions from which they now suffer. But there is no necessary or inevitable connection between the two streams ; the size of the one is based upon the desire and the power of individuals to save for the future ; the size of the other is based upon the demand of industry for capital goods. There is no necessary connection between these two factors. Sometimes investment lags behind saving ; at others, saving lags behind investment. When saving lags behind investment the gap is filled by an issue of bank credit ; when investment lags behind saving society suffers from industrial depressions. Trade booms and slumps therefore represent failure to correlate the rate of investment with the rate of saving. In his analysis Mr. Keynes emphasises the time lag in investment, the reason presumably being that he was more concerned with explaining a period of depression and endeavouring to stimulate investment and accelerate trade recovery. But his theory is more than a theory of depression ; it is a theory of the trade cycle.

For our present purpose it is only necessary to submit two observations. In the first place, the theory of the trade cycle to which I now refer should be distinguished from the views (to which reference has already been made in previous articles) expressed by many people, and apparently shared by Mr. Keynes, to the effect that the future demand for capital is likely to be relatively less than in the past. The second observation is that the trade cycle theory expounded by Mr. Keynes differs from the theory of under-saving. The former does not assume a tendency on the part

of society to save too little in relation to the trend of investment demand for capital. Nor, on the other hand, does it assume a tendency on the part of society to save too much. It emphasises the importance of the investment industries and their fluctuations in the general fluctuations of industry and trade. But, unlike the others, it stresses the irregularity of investment demand relatively to the supply of savings. Being a theory of the trade cycle it is beyond the scope of the present series of articles, and the only further observation that it is necessary to submit is that it is not inconsistent with any of the statements made in previous articles or with any of the further statements that are made below.

. . . .

In the present series of articles I have attempted to state, in simple language, the function of capital in economic society and the economic effects of saving. I have made no reference to the effect upon the individual of the habit of thrift and of the knowledge that he possesses reserves of capital upon which he may draw in time of need. It will be universally agreed that the possession of such a reserve adds to the peace of mind of the individual and inspires confidence in dealing with the rest of the world.

Debt, or even the absence of a reserve, is a constant source of anxiety to a sensitive individual; it preys upon his mind; it tends to destroy confidence in himself and to create a feeling of inferiority in his dealings with others. That side of the problem of saving I leave, however, to others, or for other occasions. I have been concerned

only with the wider aspect of the problem, and I now venture to recall those truths which, though frequently forgotten, are as important as they are elementary.

Capital may be considered from either the individual or the social point of view. To the individual it means either money or something that can easily be converted into money. To society it means an accumulation of instruments for supplying current needs; and such needs may be in the form of tangible commodities (such as food and clothing), transport, shelter or such pleasures as are derived from playing the piano, attending cinemas or listening to lectures. These instruments, or capital goods, are increased by the investment of current savings. From the individual standpoint saving means abstaining from expenditure upon consumption goods; from the point of view of society saving actually means the creation of instrumental goods. There is therefore no essential "conflict" between saving and employment; saving normally represents a choice of employment.

In modern society saving takes many forms. Many people become depositors, or take shares, in social institutions such as building societies and savings banks, or purchase National Savings certificates. Many save through the medium of insurance. Again, business firms set aside a proportion of profits as a reserve for development, and until it is needed invest the money in securities. Thus society is provided with a stream of savings available for investment. But the demand of the people who use that stream is largely determined by considerations other than the size of the stream.

We have already seen that the stream of supply is not necessarily equal to the stream of demand, and that when the two are unequal industrial equilibrium is disturbed and there may be either an inflationary boom or a depression in trade. But these periodic disturbances should not blind us to more fundamental aspects of saving and investment.

Other things being equal, the greater the supply of savings the lower is the rate of interest, and the lower the rate of interest the more rapid is the rate of social progress. For, as I have already tried to show, a low rate of interest makes it possible to use instrumental goods more freely than would be possible at a high rate of interest. Houses have already been cited as an illustration of this statement. No greater enemy of housing development can be found than a high rate of interest, no better friend than a low rate of interest. I have already stated that the demand for savings is largely determined by considerations other than the supply of savings; but it is also partly determined by the supply, for the latter influences the rate of interest. The two streams are no more likely to be unequal (thereby disturbing industrial equilibrium) when the supply stream is large than when it is small, that is to say, when the mean rate of interest is low than when it is high. For that reason the controversies about the relation of saving and investment to the trade cycle do not seriously affect those deeper considerations with which these articles have been concerned. The trade cycle theory that is most closely connected with our main discussion is the Hobson theory of over-saving; but if (on Mr. Hobson's theory) the national income were more equally

divided and the standard of living of the relatively poor thereby raised, and if, moreover, the rise in the standard took the form of better housing conditions, the net result would be not less investment but the substitution of one form of investment for another.

. . . .

I have reached the end of my task. Although I cannot hope to have made the issues clear to all my readers no one can doubt the importance of a discussion of those issues at the present time. The user of capital is welcomed as a benefactor, because he obviously provides employment. The thrifty individual, on the other hand, is unpopular; it is presumed that he deprives people of employment. Nor is his unpopularity merely the consequence of the present depression of trade. For at least a decade writers, both in America and in this country, have been preaching the doctrine that unemployment is due to "lack of purchasing power," and that high money wages, by "creating purchasing power," stimulate employment. We are being told that depression is the product of "lack of demand for consumption goods." Saving is denounced as being inimical to industrial prosperity.

And yet the world needs capital for development. Four years of warfare have been followed by fifteen years of arrested progress in many countries. The rate of saving (after allowing for changes in the value of money, or price level) in this country since the war has been consistently below the pre-war rate, nor is there any evidence that other European countries have fared much

better. Interest rates remained far above pre-war rates until the advent of depression, and in many countries they are still so high as to make investment almost prohibitive. Even allowing for the element of risk it is highly probable that such rates signify a real need for a larger stream of savings. The re-establishment of peace and goodwill on the continent, accompanied by a rapid improvement in trade, may be followed by so great a demand for capital as to show, through a rise in the rate of interest, that current savings are seriously inadequate to meet the needs of the world. We should not be misled by the present state of the capital market in this country. I firmly believe that, in so far as savings institutions quicken the sense of saving and stimulate the supply of fresh savings, either (as in the case of building societies) by encouraging house-ownership (a house being a form of investment) or by creating deposits or issuing share certificates, their work is even more important to-day than at any time during the nineteenth century. For more than one reason the pre-war inequalities of retained incomes have been materially reduced, and society will henceforth be compelled to draw a larger proportion of its savings from the great mass of the people. If it fails to do so, economic forces will defeat social reformers and restore those inequalities of retained incomes that are necessary to provide the requisite supply of savings. For this reason we are justified in restoring individual thrift to its old place as an instrument of social progress and claiming for those institutions which promote thrift a place among the most important institutions for social reform.

THE ECONOMIC SIGNIFICANCE OF THE INTERNATIONAL THRIFT AND HOME OWNERSHIP MOVEMENT.*

IT will be known to the audience that I am acting as a substitute for a distinguished American who had expected to be able to attend this international conference. When the National Association did me the honour of inviting me to address its annual conference at Bournemouth last year I accepted the invitation with a feeling of deep appreciation and real pleasure. But I confess that I rejoiced still more when I received a telegram asking me to take the place of the Hon. Charles O'Connor Hennessy. For I regarded that request as something more than an invitation to an economist: it seemed to be a token of friendship. We do not command strangers, or even nodding acquaintances, by telegram! But the fact that the ill-wind has actually blown me good does not prevent me from sharing your regret at the inability of Mr. Hennessy to be present to deliver his address. The majority present are residents in this island. We who live here are apt to think in terms of our own institutions and experience. We cover the same ground over and over again; we sometimes feel that our ideas are growing stale and that our work counts for

* Paper read before the International Congress of Building Societies, London, June, 1933.

less than we had once hoped. It would have been a stimulating experience to hear a visitor from another country address himself to the fundamental issues with which your movement is concerned, particularly a visitor from a country where, we are sometimes told, the virtue of saving is so heavily discounted that among its most active bodies are associations which invite individuals to pledge incomes which they hope to receive by spending money in advance upon things that are immediately consumed and therefore disappear long before they are paid for. They represent the debased coins of your movement, and are assumed at first to possess the same intrinsic value as the good coins. But time has already shown the difference between the two. To have heard Mr. Hennessy on the subject would have been not only stimulating but inspiring.

I am intrigued by the wording of the title. The first glance made me feel very uneasy. I wondered whether there was in being, or in prospect, some international organisation of which I knew nothing and which differed from an international congress. But I had read the title too hastily. A movement may be international in the sense that it is not confined to any one country. I afterwards saw—at least I hope I have seen—the real meaning of the words. But I still felt uneasy about the words "economic significance." The word "economic" is frequently employed in a narrow sense, and when an economist refers to moral and political factors he is told to stick to his last. But individual character and political conditions are among the most potent of economic influences, so I took comfort in the thought that I should not be irrelevant

if I referred to the moral influence of your movement.

For, after all, the final value of that or any other movement is to be measured not in pounds, dollars, marks or francs, but in those intangibles which always defy quantitative measurement and frequently even escape recognition. They fall among the things taken for granted among decent people. I have just read the balance sheet of a school, and it makes depressing reading. The deficit has grown considerably since last year. But it is not a true balance sheet, for it omits the most valuable asset—the institution and what it stands for.

I offer no apology for stressing this aspect at the beginning of my address. One of my earliest recollections is that of a small building society in a suburb of Swansea—the Landore Building Society. The officials met, I believe, every alternate Friday evening, in the schoolroom of a Congregational chapel not without fame in South Wales. I believe my uncle was a director—in the days of unpaid directors. As boys of ten or thereabouts my companions and I used to peep round the door, and gaze in awe at the small group of officials collecting, in semi-darkness, what seemed to be a vast sum of money. Often one of them would get up and start towards us. We knew no more: we scuttled to safety. Later I grew to understand what it all meant, and in that village it meant a great deal. In the nineties of last century the village, like many others in that region, was almost ruined by the McKinley tariff, which practically destroyed the local steel and tinplate works. What happened? Many of the workers went to America—to Pittsburg and Scranton—there to establish industries which

are now among the most important in that country. Others apparently went to Russia, yet others to western Germany and to France—all bent on the same task of finding a livelihood. They were the type that belonged to the local society, and it would be interesting and valuable to know the part played by that society in the rebuilding of the lives of the people of those days. Will anyone say that the statements of accounts of such a society—and this is but one illustration—told the whole story? "Sheer sentiment," someone may say. "No, mere economics," is my reply. When a building society ceases to be anything more than a business organisation it also ceases to be a building society in the old sense of the word. If the American and Continental societies lack that element of which I have spoken, they are no true descendants of the British movement of the nineteenth century.

The movement in this country is at present faced with many interesting and important internal problems that are essentially economic problems. Is there an ideal size at which societies should aim? If so, what is it? Does the ideal differ according to differences in objective conditions? The amalgamation movement and the geographic distribution of activities are subjects that call for serious consideration, particularly in the light of twentieth century developments in banking organisation. Those developments involved sacrifices, and it is for your movement to consider whether similar sacrifices would be called for in your case and, if so, whether they would be justified. In that connection you will inevitably decide between the merits of local monopoly and those of local competition between societies with nation-wide

ramifications. You will examine the many types of business organisation and control, such as holding companies and various kinds of operating companies. In recent years the funds that you control have increased to such an extent that you cannot ignore the situation in the investment and credit markets of this and other countries, or the effects of your policy upon that situation. Irrespective of your own wishes you are compelled to live and play your part in what is called the world of high finance, and to accept obligations corresponding to your new status. What is already true of the British movement may quickly become true, too, of the movement in other countries.

These and allied problems of policy are not, however, the subject upon which I have been invited to speak. My subject is the economic significance of the movement as a whole, not the internal economic problems with which it is faced in one country or another. Nevertheless the significance of the movement must depend largely upon the way in which it is carried on, so that it would be impossible to do justice to the subject without some reference to problems of organisation and policy. That such reference is of the scantiest character is due to the fact that it would be impossible, in a single address, to do justice to the subject.

The need for your movement arises from the fundamental need of society, which is to provide the requirements of existence. The characteristic feature of society is the continuity of its life. It slowly changes in form and gradually acquires new characteristics. But it continues to exist. Individuals enter and pass out, but the community

of which they form part goes on and on, generation after generation. Not only is the community, to all intents and purposes, permanent but, amid all its changes in detail—and important detail—the economic system is continuous in that it always rests upon a foundation of capital. Individual items change: houses, factories and ships come and go, but the community of capital goods remains. The stock of capital goods that we now possess is part of our inheritance, and it is the duty of each generation to hand on that legacy not merely unimpaired but strengthened, to add to rather than drain away the resources of the future. The future begins now, and now is always. The economic significance of your movement is measured by the extent to which it improves, and goes on improving, the community's bequest to the future. We should bequeath better houses than we have inherited, which means that we should be building better houses now, and continuing to do so in the future. But it is possible to do this by neglecting other and equally valuable contributions. The full measure of your significance is not to be found in the houses that you make it possible to build.

Let us look at the matter more closely, and from every side. The thrifty individual who is reasonably well off divides his weekly or monthly income into two parts, one of which he sets aside for the time being, and the other he spends upon food, clothing, houseroom and recreation. The part set aside may be used in various ways. At infrequent intervals he may buy durable goods—a piano, furniture, or even a house. Briefly, he makes a specific contribution to the community's stock of durable goods. The remainder of his income he saves, and he either

invests his savings in securities, pays an insurance premium with it or leaves it on deposit in an appropriate institution. The insurance company uses the premium income to meet claims (which are usually invested in securities) and invests the balance in securities. The institution which receives the balance of the individual's savings likewise invests the money in securities. This statement is crude, but the essentials are so obvious that I need not labour minor distinctions between the purchase of securities and investment in private business undertakings. The point of my statement is that the income stream of an individual splits up into two streams, the stream representing current expenditure and the savings stream. They are money streams, and the latter runs into the investment market, using the words in the broadest possible sense.

When we look at the matter from the point of view of the community we find that its income is not a money stream but a stream of commodities and services, and that this stream also splits up into two parts, the stream of consumption goods and the stream of capital goods. The standard of living now possible is determined by the former, while the standard of living in the future is partly determined by the present stream of capital goods, by which I mean, and shall continue to mean, not only factories and warehouses, railways and ships, but also such durable goods as houses and even pianos. Running between the two main streams we find tiny rivulets, which some say belong to one main stream, others to the other. But we need not seek an accuracy of definition which is not essential to our present discussion. I shall

always include houses in the main stream of capital goods.

It will immediately be obvious that when we discuss such questions as saving and spending from the social point of view we move away from the question of money. By saving we mean adding to the nation's stock of capital goods; by spending we mean providing and consuming consumption goods. What is spent of a man's income gives rise to one type of economic activity; what is saved gives rise to another type of activity. Savings are ultimately transformed into capital goods—unless, that is, the owner is misled, and innocently lends his money to facilitate a rake's progress. And the rake may be, not an individual, but a government.

It will also be evident that if the great mass of a self-contained community suddenly changed its habits the two types of economic activity to which I have referred would be affected. If we all suddenly became spendthrifts the industries directly supplying consumption goods would enjoy a boom, while the others would find themselves in a dilemma. On the one side the boom in the former would cause greater need for capital goods required for extensions, while the supply of savings available for investment would be reduced. Somehow or other the gap in savings would need to be filled, and in practice it is filled by what is politely called credit expansion and less politely called inflation. In the meantime, however, people's energies would have been to some extent diverted to the object of supplying the new and extravagant demands, and these would have to be redirected to the production of capital goods. In such a case a strain would be imposed upon the

community. Now we know that industry and trade fluctuate—they pass through depression to boom and boom to depression. These alternations affect your movement in more than one way, and in view of its recent growth their influence has become far more serious than at any time in the past. I venture to submit that your movement might with advantage investigate the question whether there exists any connection between such fluctuations and the relationship between the two money streams to which I have referred. I promise you—or perhaps I should say, I warn you—that such an investigation would be a serious undertaking, and would only be worth while if you were content to wait patiently for possible results.

But I am not primarily concerned, in this address, with the problem to which I have pointed with the aid of a single illustration. I must retrace my steps and return to the point at which I stated that from the social point of view the savings stream is a stream, not of money, but of capital goods. The process of saving is a process of production or a form of activity. The money stream represented by individual savings is linked up with the stream of capital goods by what may broadly be called investment. Through investment saving becomes expenditure ; the savings of one individual become the expenditure of another individual (or the same individual) or a firm or, it may be, a public authority. The former supplies savings and the latter demands savings.

It is, of course, a truism that the price of a commodity is determined by the supply of it in relation to the demand for it. If the supply runs short the price rises, and if it increases the price

falls. It is also a truism that if the price of a commodity rises relatively to the prices of other things the demand for the former tends to fall. Either we do without it altogether or we buy an inferior quality. If the prices or rents of houses, for example, rise relatively to other things either people seek smaller houses or two or more families escape some of the burden by sharing a house.

In these respects capital resembles other things. The price of capital is determined by supply in relation to demand; in other words, the rate of interest is determined by the relation of the savings stream to the investment stream or stream of capital goods. If the former is relatively small the rate of interest will be high; if it is relatively large the rate will be low. But the investment stream will be influenced, in turn, by the rate of interest. As in the case of other things, the demand will tend to fall. The users, or potential users, will economise. Thus, for example, those who might otherwise have installed machinery may continue to do without it by directly employing more labour, even though, taking a long view, the latter method involves greater expenditure of human effort and thereby retards social progress.

There is one obvious effect of a relatively high rate of interest which is apt to be ignored, possibly because it is so obvious. I refer to the quality of our buildings and other forms of social capital judged both from the æsthetic point of view and from that of use. Now it is well known that fluctuations in the rate of interest largely determine the time at which investment demands for capital become effective. Many borrowers or users of savings or capital, to whom fractional differences in

interest rates are important, are likely to postpone their demands when interest rates are high and to press forward when interest rates are low. In that respect capital resembles other commodities. Such fluctuations, however, influence the time distribution of demand rather than the quality of capital goods produced. The latter is determined by the mean level of interest around which the actual rate fluctuates. If the mean level or average rate of interest is high, economy is exercised in the use of capital. Such economy takes the form of meagre houses, meaner public buildings, uglier factories—in short, a less satisfactory collection of capital goods.

Other things being equal a low average rate of interest is a highly favourable factor in social progress. I venture to emphasise the proviso "other things being equal," for, in recent years, the conditions under which interest rates are low, *have been conditions under which progress is slow.* But I cannot, in a paragraph or two, follow this proviso into a region of difficult controversy. Nor is it necessary to do so in this address. The general conclusion is beyond controversy. A low average rate of interest stimulates the use of valuable and efficient equipment; it encourages users of capital to pay attention to those externals which, though not essential to technical efficiency, make the world more pleasant. It enables public authorities to maintain better roads and encourages them to supply social amenities. Finally it enables people to build and maintain better houses and establishments. I therefore submit that a moral precept follows naturally upon a simple economic analysis. It is the duty of the community to maintain those

conditions which are favourable to the increase of capital goods of the highest quality. One condition is the maintenance of a favourable mean level in the rate of interest, this level being maintained, not by introducing a check upon capital development which would defeat the purpose of that condition, but by fostering the habit of saving, broadly interpreted. If it is the duty of a community to hand on its inheritance, increased and improved by its own contribution, it is also clearly its duty to maintain an adequate rate of saving.

Let us examine the matter more closely. One element in determining the rate of interest is the size of the stream of savings. This in turn is determined (relatively to population) by the power to save and the will to save. Power and will are two different things, and both are essential. Power is determined by the amount of individual income, or in other words, by the amount and the distribution of the national income expressed in terms of money. I believe I am right in stating that in Great Britain there has been, since the war, an important change in the final distribution of the national income. Broadly speaking and allowing for changes in the value of money, the wealthy have become less wealthy and the employed workers have enjoyed a larger share. Death duties have imposed heavy burdens upon accumulated wealth and property, while income tax and super-tax have seriously reduced the retained incomes of those in receipt of large incomes. Health insurance and other social measures have materially increased the relative real incomes of wage earners. There has therefore been a considerable change in the distribution of the power to save. A greater burden of responsi-

bility to posterity now rests upon a large proportion of the community. The stream of savings will have to be fed, to a greater extent than in the pre-war past, by those in receipt of wages and relatively small salaries. How this redistribution of power to save is likely to influence the stream of savings is a question of real importance to the nation. I say nothing of other countries because I do not know how the war and subsequent events have influenced the distribution of wealth and income in any of them.

It seems to me highly important that we should do all that lies in our power to stimulate and strengthen the will to save both among those who still enjoy large incomes and among those whose responsibility has been increased by the rise in real wages. At a time when interest rates are abnormally low, when the joint-stock banks appear to be suffering from a glut of savings, when there appear to be no fresh avenues of investment and when "spending" campaigns are being conducted in most parts of the country, it is not easy to convince people that saving—using the word in its wider and true sense—remains a necessity as well as a virtue. Nevertheless it is true. Appearances are deceptive. The rate of accumulation has fallen during the depression of the last two years. The existence of large idle balances is due to a still heavier fall in the demand for capital, and this, in turn, is partly due to the policy of the Government. If the investment demand increased quickly to the rate which is characteristic of a period of normal trade activity we might easily experience a real scarcity of capital available for investment. The present depression has created a situation, in

the capital market, which is so abnormal as to call for the utmost caution on the part of those in control of policy, which should be determined by long-term considerations.

If, instead of concentrating attention upon the conditions prevailing during the present depression, we extend our survey over the last decade, we are forced to the conclusion that we have not made satisfactory provision for the future. The statistics available to the public are so scrappy that no scientist would agree that an adequate statistical analysis is at present possible. But such information as we possess suggests that we have not restored and maintained the pre-war rate of saving. In terms of money we, in this country, have increased our annual savings, but the proportionate addition is considerably less than the rise in the price level. When the available official statistics and unofficial estimates are adjusted to the 1913 price level they suggest that the post-war rate of saving has not been greater than two-thirds the pre-war rate. I attach no importance to this fraction, which is not based upon sufficiently precise and trustworthy data to justify any arithmetical estimate. But we must all attach importance to the fact that available evidence shows that, since the war, we have not discharged our obligation to the future.

In this respect it is doubtful whether the leeway has been made up by the world outside Great Britain. A large proportion of our pre-war savings were invested abroad. Part of the British money stream of savings became, through investment, a stream of capital goods in other countries, such as Argentina and Canada. The latter stream has been partly maintained by this country, but only

with the assistance of a money stream of savings from France, America and some of the smaller countries of Europe. Much of the American money stream has been directed towards Germany. The international situation has been so complicated by the converging and diverging of streams within and between different countries—partly representing payments of various kinds arising out of the war—that it is at present impossible to make any estimate of the degree to which the post-war world has failed—or, indeed, whether it has actually failed—to maintain the pre-war rate of saving. I cannot help feeling, however, that the world as a whole has not been maintaining that rate of accumulation of capital which it should have done in the interests of social progress.

I cannot pursue the discussion farther along this line in a short address. I shall therefore content myself with a single observation which seems to me of the utmost significance to your movement. The market for capital is international. The savings of each country represent a contribution to the need for capital in the world as a whole. Part of the stream in some countries will flow to other countries. The rate of interest in each country will be largely determined by the rates prevailing outside that country. It is appropriate, at an international congress of this character, to stress the fact that the national movements here represented are parts of a wider movement to facilitate the progress of the world as a whole. It is also appropriate to stress the importance, in determining policy in any country, of giving full weight to the influence of international factors upon the mean level of interest in that country.

The economic barriers erected in recent years have maintained artificial conditions in the capital market. When these become less formidable we may witness a material change in the situation.

There is one serious barrier which has become even more formidable during the last couple of years, and that is fear. Fear has had a twofold effect. Investors have been unwilling to invest capital in long-term securities in other countries. The psychological element in the risk factor has grown in importance, and partly for this reason, long-term interest rates have differed materially in different countries. An illustration of what I mean is to be found in the difference between the yields of British Government dollar loans in the United States and British Government sterling loans in this country, or in the difference between the yields of the American and British portions of the Dawes loan. The other effect of the element of fear, and of the reluctance of owners of capital to invest their money in long-term securities, is to be found in the existence of an abnormally large fund of money capital, quick to move from one country to another on the slightest provocation, thereby destroying the security for which it is always searching. It has been a disturbing element in the capital and credit markets of many countries, and has materially affected the position of your own movement. But in due course this element of fear will lose its present importance. Sooner or later the world will be restored to sanity and confidence will return. When that time comes investors will be more ready to invest in long-term securities while credit and investment rates will be more closely adjusted between different countries.

The influence of world rates upon the rates of each country will be more pronounced. Not until then shall we be able to speak with confidence about the trend in the long-term rate of interest upon British or American capital or the capital of any other country.

I have tried to show that the rate of interest is determined by the stream of savings and the demand for capital ; that the stream is a world stream and the rate of interest a world rate, and that the post-war stream has not been so large, when adjusted to the 1913 price level, as in pre-war times. The post-war interest rates have been high, and have varied between different countries. To what extent the average level of interest throughout the world has been influenced by the fall in savings it is extremely difficult to say, but it is clear that risk has been an important factor in the rates prevailing in a number of countries. I have also tried to show that the stream of savings is determined by the power to save and the will to save. The power to save is determined by the national income (in terms of money) and the manner of its distribution. In Great Britain the national income has been affected by twelve years of persistent depression, which has reduced the power to save. Moreover, the power of individuals to save has been materially influenced by the changes that have taken place in the distribution of the national income. The surplus of the relatively wealthy has been reduced while the standard of living of the majority of employed workers has been raised.

The thesis that I have submitted to you so far may be stated, then, in the following words. It is our duty to maintain and strengthen those elements

upon which the standard of living in the future will rest. Just as we should preserve and add to the literature and inventions of the past so, too, we should add to the stock of capital goods of such kinds as plant and equipment, roads, houses and public buildings. Not otherwise will it be possible to retain what has already been won. The rise in the standard of living will not be maintained if the redistribution of the power to save results in a weakening of the will to save.

It is precisely at this point that I see the real economic significance of your movement. The value of the movement is to be measured largely by its influence upon the will to save. I do not deny value to any institution which brings borrower and lender together. That function is important. Nor is it a function which, in respect of long-term loans, should be performed by joint-stock banks. Moreover, the history of your movement during the last few years shows that the average building society is called upon to perform that function to an increasing extent, and that it has consequently been faced with new and difficult problems in the sphere of organisation and policy. For reasons that I need not elaborate—they are well-known to all present—the movement has attracted the relatively wealthy investor and a type of borrower who, at one time, sought a private mortgage loan through a solicitor. For a long period of years, too, the scarcity of middle-class houses was so pronounced that those who needed houses were unable to secure leases and were compelled to purchase with the aid of loans. I believe I am right in saying that, since the war, a larger proportion of building society loans have been

used to buy existing houses, and a smaller proportion to build new houses, than in earlier times. In so far as the movement facilitates the transfer of ownership it is doing extremely useful work. And the method of repayment that you adopt is a real convenience to the borrower, and may even stimulate saving. For it compels the borrower to provide, at regular intervals, a sum representing repayment of capital, when otherwise he might be inclined to flirt with the thief of time. Procrastination is difficult for everybody under your system. I do not wish to under-rate or understate the value of the movement in this sphere of activity.

But the movement would not have enlisted the sympathy and secured the enthusiastic support of social reformers if it had not been more than a convenient "employment exchange" for investment capital. If it had had no other value it would have been placed, by economists, in that category which includes joint-stock banks, investment trusts and other organisations that justify their existence in the economic system but, because they are merely "business" organisations, never capture the imagination. In view of the scope and financial importance of its activities your movement will henceforth actually be included with such business organisations when economists examine the capital market and its problems. Sooner or later someone will write an article comparing the building society with the investment trust, and another comparing it with an investment bank. Your movement, in its present form, has become an interesting subject of study to those mainly interested in financial organisation.

But it is more—much more—than a financial

movement. Its purpose is to exercise moral influence upon the community. It was and, if it is to be worthy of its past, must remain one of those social agencies which in every community help to strengthen the character of the individual. It works upon the will to save and thereby helps to build a better future for the community in which it finds its home. It emphasises to-morrow's claims; it supports the struggle of the known and unknown needs of the future against the known desires of the present.

The will to save is a peculiar thing which I cannot easily express because I do not fully understand it. I am not a psychologist, and someone who is may laugh at my remarks about it. Will is more than casual and evanescent desire; it is not the vapour emitted by emotion; it is not an average or a residue produced by cancelling out conflicting desires of a passing kind. It is the product partly of intellect and imagination, and partly of opportunity, but not wholly of these. It represents a determination, based upon deliberate judgment, and a readiness to accept obligations which will serve as a protection against any future weakening of that determination.

The will to save is partly a product of the opportunity to invest savings. Early in the nineteenth century the thrifty individual in humble surroundings frequently placed his savings in the proverbial stocking, and in its infancy your movement undoubtedly stimulated saving by offering safety along with interest. But that aspect has lost its importance. Everybody is now aware that savings may be deposited with at least three separate institutions—building societies, savings banks and

the post office, or invested in national savings certificates. I still believe, however, that the existence of local societies or of local branches of these institutions produce an effect upon the habits of the people, particularly if and when they are active and wisely led. There is ample scope for leadership, and even for healthy rivalry between institutions that are working in the same cause.

But your movement differs from the others in that it is essentially a movement to promote a particular form of spending. It has shown that saving and spending are not necessarily conflicting processes but are capable of being united. Expenditure of one kind is investment and investment is saving. The average individual usually has an object in view when he saves, and he will not save until he is confident that he can achieve his object. Among the possible objects is the ownership of his house. But in the absence of your movement ownership would be beyond the reach of the average wage-earner while he was still young enough to enjoy it. He wants a house of his own to live in, not to die in. You have brought ownership within reach at the time when he desires it most keenly, that is to say, when he has reached maturity, his children, if any, are young, and his love of home has deepened. If you do not believe me I would ask you whether bachelor borrowers without family ties form a large proportion of the total number of borrowers! By bringing ownership within reach of the comparatively young you are performing a valuable social service. And in doing so you produce three results other than the actual enjoyment and pride of ownership. In the first place you probably

cause the borrower to save more than he would otherwise have saved. At the end of the period of repayment he owns the house. If he had not utilised the service that you provide it is extremely unlikely that he would have saved and invested an amount equal to the value of his property. You have influenced the direction of his expenditure for a long period of years—so long that he is likely to persist in the habit that he has formed. In the second place, when he decides to become a borrower he probably aims at a better house than he would be content to occupy as a tenant. He is fixing a standard for the greater part of his life, and prepares for future needs. The movement therefore tends directly to raise the standard of housing among the class from which borrowers are mainly drawn. Even if the borrower is not very optimistic about the future, the house that he selects is more carefully looked after than one which is occupied by a tenant. The former is nursed as though it were a cricket bat; the latter is sometimes treated like a football—which is the property of the club. In the third place I believe I am right in saying that, in some districts, children acquire the habit from their parents and become depositors or shareholders at an early age. In the days of my boyhood it was a common practice for parents to open deposit accounts for their children and to hand them as presents as soon as the latter began to earn. I do not suppose that that custom has disappeared.

It seems to me, therefore, that the movement has brought ownership within the reach of many thousands of borrowers. It has raised the standard of housing among borrowers and thereby set higher

standards for others. It has stimulated saving and directed expenditure along lines dictated by wise choice. It has enabled each generation to make a valuable contribution to future welfare. The moral influence of the movement among borrowers, depositors, shareholders and the outside community is such that the movement may be associated with insurance and education as the most beneficial among all social movements of the past century.

It is a trite remark that your movement, in this country, has entered upon a new epoch. You now appeal to a new investing class which seeks an avenue of safe and remunerative investment in a world where such avenues are difficult to find. You also lend money to a new type of borrower, who may be less likely to buy an old house than to build a new one, particularly at a time when building costs, expressed in terms of wheat, coal, steel, and many other products, are extremely high. This new development creates many new problems. But before I refer briefly to these, I venture to express the hope that the new developments will not destroy the old features of the movement. Not only do these remain valuable in themselves, but they are the features that have created the goodwill now enjoyed by the movement and made possible the new developments. The movement has acquired new economic significance, but it must not lose its old significance. And if the building societies of other countries are to learn from ours and to claim kinship with ours it must be by creating and maintaining the tradition built up in the nineteeth century, though still, I hope and believe, jealously guarded.

I venture to suggest to your American guests that they should cease to refer to their movement as a " loan movement " and always apply the time-honoured title, " building society movement." A " loan movement," in Great Britain as well as in America, may mean many things, some less desirable than your movement.

In an address to an International Congress, it would not be appropriate to discuss in detail the special problems with which the British movement is confronted. Nevertheless, I may be permitted to submit a few observations which are so general that they may be partly applicable to the movement in other countries. I shall not quote many figures. In 1931, Mr. James Brace read a paper to the Royal Statistical Society, entitled " A Statistical Analysis of Building Societies," and the paper, which gave the results of pioneer work in this field, is published in the Journal of the Society. In March of the present year, an article by Sir Harold Bellman on some economic aspects of Building Societies was published in *The Economic Journal*, and I am glad to find that this has now been issued as a separate pamphlet. Those who love to juggle with figures will find much of what they want in those publications. The latter is peculiarly interesting and valuable at the present time, in that it contains an analysis of statistics relating to the activities of a single society, and, therefore, points the way to a sample investigation.

It is natural that, since the war, the smaller societies should have operated on a larger scale than in earlier years. Apart from the fact that success itself is usually accompanied by growth,

the value of money fell during and after the war. Prices, wages and salaries rose, with the result that the unit of saving, when expressed in terms of money, expanded. It would have been surprising as well as disappointing if a society of a given size did not handle a larger income and lend larger amounts. For this reason it is easy to misinterpret statistics and to assume growth where none has taken place. Comparisons of pre-war and post-war statistics are always difficult and often dangerous.

A general survey of existing statistics, particularly those presented in Sir Harold Bellman's pamphlet, suggest three broad conclusions. In the first place a much larger proportion of building society advances than in pre-war days is now used by borrowers to purchase already existing property than to build new houses. In view of the enormous increase in total advances this is not merely natural but inevitable. But it also seems to be the case that the number of new houses built with the aid of mortgage loans has increased.

In the second place, the classes of borrowers have not changed to any appreciable extent. As of old the vast majority of new borrowers have been drawn from the relatively poor—the wage-earners, the recipients of comparatively small professional and other salaries, and the small shopkeepers and independent workers and traders. In 1911, approximately seventy per cent. of the total mortgage balances was in respect of properties up to £1,000 in value, but in spite of the rise in prices the proportion in 1930 had actually increased to nearly eighty-two per cent. This provides ample evidence that the building societies have

used their vast post-war incomes in the same way as they had used their modest pre-war incomes, and thus maintained their tradition. In his pamphlet, Sir Harold Bellman submits a sample analysis of the purchase price of the property upon which advances were granted last year.

The table shows that 84.4 per cent. of the number of advances were made upon property up to £1,000 in value. In 1930 the *national* average advance was £469 upon property up to £1,000 in value and £1,824 upon the remainder. Assuming these averages to be true of the *sample*, the 84.4 per cent. of borrowers, representing the owners of small property, received less than sixty per cent. of the total advances. This deviation from the national average of 1930 in the share advanced to the relatively poor may be explained, however, partly by the financial situation and the consequent reduction in the amount of construction and purchase of small properties and increase in share income, and partly by the policy pursued, under such conditions, by the societies. It should not be regarded as evidence of a permanent change in the policy of the movement.

Before stating the third and final broad conclusion it may be useful to submit a few leading figures based upon Abbey Road statistics. In 1913, the total amount standing at credit of share accounts was £582,128, while in 1932, at head office, the total amount was £23,458,162. Having given the absolute totals, I can indicate the features by means of percentage figures. I shall divide the individual accounts into three classes, Class I being those up to £500, Class II those above £500 and up to £1,000, and Class III those above £1,000. Between

1913 and 1932 the number in Class I fell from 97.95 to 90.7 per cent. of the total—a fairly significant fall—but the total share accounts fell from 77 to 41.8 per cent. of the total—a highly significant fall. The number in Class II increased from 1.7 to 6.2 per cent. of the total, and the share accounts increased from 15.3 to 25.9 per cent., of the total. The number in Class III increased from 0.35 to 3.1 per cent., while the share accounts increased from 7.7 to 32.3 per cent. of the total. More briefly, the joint contribution of share accounts individually above £500 increased from 23 per cent. to 58.2 per cent. of the total. In absolute amounts, the contributions of Class I increased from £448,888 to £9,810,946, while those of Classes II and III increased from £133,240 to 13,647,216.

These figures may not be typical, in detail, of what has occurred in every society, but they are sufficiently representative to justify, in association with those previously given, the third and last general observation that I shall offer. Comparable statistics would show that the growth in the share accounts of the relatively poor has been far more rapid than the growth of savings invested or deposited with other institutions, including, since the war, the national savings movement. Nevertheless, the increase in the income of your societies has been due mainly to the vast increase in the share accounts of the relatively wealthy. But these have been attracted by the financial inducements that the societies have offered, not by any suddenly conceived affection for their purpose. The persistent depression since 1921 has reduced the remuneration of capital and choked the avenues of investment. Your movement

has offered safety together with a higher rate of remuneration. Broadly speaking, therefore, you have attracted the capital of the relatively wealthy to provide houses for the relatively poor. Since the world depression started (in 1929) you have offered a refuge not merely for the current surpluses of the relatively wealthy, but also for funds normally employed in business as circulating capital.

You will agree, I think, that a large part of your income in recent years has consisted of more mobile capital or more restless savings than in the past. So far you have not been bothered much by withdrawals—there have been no comparable avenues of investment. So persistent is the demand for shares that you have recently even reduced the strength of your inducement. Sooner or later, however, this country will pass out of the depression and enter upon a period of good trade, rising prices and increasing profits. New avenues of investment will then appear and it is at least possible that they will be more remunerative than your shares.

It is, of course, easy to exaggerate the importance of this consideration. You have used the money of the relatively wealthy to finance the provision of houses for the relatively poor. In so far as the latter purchased existing property the transaction merely represented a transfer of funds; in locking up your income you released money for the sellers of the property, so that you did not reduce the sums available for investment. In any case, whether the advances to borrowers were used to build new houses or purchase existing property, those borrowers are steadily repaying the loans. Among the borrowing group—the relatively poor—

you have undoubtedly stimulated saving, so that in the long run the net result will be a net increase in houses and a desired transfer of ownership of existing property together with the replacement of the capital advanced for this purpose through the steady flow of new savings, representing repayment of loans. You have, in short, employed idle savings both to stimulate building and to stimulate savings for future use.

It it far from my intention, therefore, to exaggerate the danger to which your movement is exposed. But it is not a negligible danger. It is certainly possible that the nation will soon be faced with a big demand for industrial capital and an appreciable rise in the rate of interest. *In that event you may be faced with the danger of* large-scale withdrawals. If such withdrawals are in fact made, your income from outside sources (the relatively wealthy investors) will also dwindle; your income from the loan repayments will be partly needed to meet withdrawals, and your advances to fresh borrowers will need to be seriously curtailed. I do not say that you will describe the circle: there is no danger of shrinkage to your former size. You are doomed—or, if you prefer it, predestined—to bigness, just as in the past you were foreordained to greatness. You have penetrated fresh communities of investors and punctured the boundaries of new classes. But there is a limit to the size even of your societies.

I am confident that you will face your problems boldly and handle them wisely. The statesmanlike addresses of your President and the balanced contributions of Mr. Walter Harvey and others to the columns of your *Gazette*, along with the

articles to which I have already referred, show that leadership, in research as well as in policy, is not lacking. Your movement has acquired fresh economic significance since the War. But in concluding my hastily-prepared address I venture once more to express the hope that in developing along the lines that appeal to the interest of the economist you will not weaken in those things that have fired the imagination and secured the enthusiastic support of thousands of humble members and hundreds of leaders up and down the country and have made the movement worth copying in other parts of the world.

THE FUTURE OF INTEREST RATES*

AT gatherings of business men at the present time no subject arouses greater interest or excites more interesting controversy than the future of the rate of interest. When the Conversion Loan of 1932 was issued at three-and-a-half per cent. it was felt that the Treasury was taking serious risks. It represented a thirty per cent. reduction in the rate paid by Government. It was universally agreed that a rate of five per cent. was far too high in relation to current economic conditions and probable development, but practically everybody assumed that the rate for the new Conversion Loan would be approximately four per cent. The Treasury venture proved so successful that people now wonder whether the new loan might not even have been issued at a rate of three per cent. Many competent observers hold the view that a rate of three-and-a-half per cent. now represents a peak and that in the future there will be a gradual downward trend, and as evidence in support of this view they point to the margin that still exists between the long-term rates and the market rate for short loans. If this view proves to be correct the policy of those institutions, such as Building Societies, that are mainly concerned with long-term investments, is bound to be influenced by the fact. It is therefore worth while examining the influences that contribute to the recent fall in the rate of interest

* An article reprinted from *The Building Societies' Gazette* for (April, 1934).

and to consider whether these are likely to be exerted in the same direction in the future.

In the absence of any special reason to the contrary, such as a financial crisis, both discount rates and long-term rates of interest tend to be low during periods of depression. For, in the first place, the amount needed as commercial capital is reduced below the amount needed for financing current trade under normal conditions. In some cases the money needed to finance current trade is obtained by means of overdrafts upon banking accounts. As the result of the depression a large proportion of such overdrafts have been either cancelled or materially reduced. Again, many firms finance current trade transactions from their own liquid resources. The depression has reduced the amount needed from such resources and the unused balance either remains on deposit at the bank or is employed in the purchase of long-term securities that are easily marketable and can therefore be realised quickly when the need for money again increases. Even the money which is paid for such security is likely to be left by the seller, or some subsequent seller, on deposit at the bank. For this reason such cash deposits at the bank tend to increase to the same extent as the demand for trade capital diminishes. Finally, those firms that are engaged in the export trade finance current trade requirements partly by discounting bills supplied by foreign purchasers of commodities. With the fall in the export trade the supply of such bills is reduced and is accompanied by a corresponding reduction in the demand for money from discount houses and a consequent fall in the demand for money by the

discount houses from the joint stock banks. For this reason the depression results in a fall in the demand for short loans upon the money market. It will thus be seen that the depression results in a reduction in the demand for loans and for advances and discounts as well as in an increase in deposits at the joint stock banks. But that is by no means the only factor in the situation during a period of depression.

It is well known that during a period of improving trade the investment demand for capital goods, or in other words, the demand for investment capital, increases more rapidly than trade in general; that during a boom in trade the investment demand reaches its maximum and that during the subsequent depression it falls more rapidly than the fall in general trade. The fall in the demand for investment capital is accompanied by a fall in the rate of saving. It is hardly necessary to point out that the capacity to save is smaller during a period of depression than during a period of normal trade activity. It is true that the reduction in the capacity to save may in turn be accompanied by an increase in the desire to save. During a period of depression a new element of uncertainty enters into the life and estimates even of those people who do not feel the depression to any great extent, either through a substantial fall in profits or through unemployment. Such people feel that they may be the next to suffer and they make as much preparation as is possible to meet the storm that threatens. They postpone avoidable expenditure and tend to save more, relatively to their own incomes, than under ordinary trade conditions. Even when full

allowance is made for this factor; it is, however, undoubtedly true that the flow of savings diminishes with the advent of depression and continues to diminish as the depression proceeds on its course. But the fall in the rate of saving is a function of the general depression, not of the fall in the demand for investment capital; it is considerably less than the latter, with the result that savings during a depression are always in excess of capital expenditure. The unabsorbed surplus is thus added to the mass of idle money to which reference has already been made.

The third factor in the situation is the policy of the Bank of England. By purchasing securities the Bank is always able to increase bank cash, that is to say, the reserves of the joint stock banks. The Bank of England pays for such securities by means of cheques drawn upon itself; the recipients, or sellers of securities, pay the cheques into their own accounts at the joint stock banks and the latter, in turn, pass them on to the Bank of England, which credits their accounts with the specified sums. The joint stock banks are able to use the additional reserves or sums standing to their credit at the Bank of England, for the purpose of lending to customers who need money; and if they cannot find borrowers they have to choose between allowing the money to remain idle, when it brings no return, and using it to purchase securities of the type that they are accustomed to hold. During the past two years the Bank of England has pursued this open-market policy (the term by which the operation that I have indicated is known) and thereby substantially increased the amount of liquid capital in the money market.

These are the three main factors accounting for the existence, at the present time, of a mass of unusable money and the consequent fall in the rate for short loans on the money market. Other influences, of a more elusive character, have also been at work. The first is the restriction of foreign issues and the second the influx of funds from foreign countries. I have no desire to over-rate the contribution of these phenomena to the present excess of loanable money. Before the war the investment of British capital in other countries amounted, in the main, to a reinvestment of interest upon accumulated loans of the past. If at that time such interest had completely disappeared, our capacity to invest would also have practically disappeared, and it is conceivable that an embargo upon foreign issues under such conditions would not have substantially increased the amount of idle money in the money market. Since the war a considerable part of our foreign investment has been financed by short-term loans or the import of funds from abroad ; and it is impossible, without adequate information upon many important details, to indicate the effect that has been produced by the embargo that was placed upon foreign issues in 1931, in consequence of the financial crisis of that year.

Again, it is impossible to indicate the precise effect upon the money market of the influx of funds that was resumed after the financial crisis had passed. When funds from other countries are used to purchase sterling, somebody surrenders sterling in return for such funds. We know that the Exchange Equalisation Fund has been employed to counteract the effect of the movement towards this country

of foreign funds during the past two years. The result has been partly an import of gold and partly the purchase of foreign currencies. For these reasons it is possible, as already stated, to exaggerate the influence upon the money market both of the restriction of foreign issues and of the importation of foreign funds. But it is probably true to say that the net effect has been to increase, to some extent, the amount of money in this country available for investment.

But the first three factors have been sufficiently important in themselves to produce a superabundance of money. Nor should it be forgotten that this money is owned by people who are anxious, if possible, to use it profitably and are ready to seize an opportunity for profitable investment. For this reason it is used, not to finance new issues (these being extremely rare) but, as far as possible, to purchase existing securities. While the money lies on deposit it earns little or no interest; on the other hand, in the present uncertain state of industry and trade most of the owners shun securities that contain an element of risk or are not easily marketable. The demand for securities from the owners of such funds is largely concentrated upon those of the highest class, which entail no risk and can be realised on the market at any time.

But the owners of such securities are clearly not anxious to convert them into money that will lie idle and produce no return. They do not desire to surrender the prizes that they now hold. For this reason the supply of securities available for purchase is extremely small; the market for securities is an extremely narrow one. This intense competition of an extremely large supply of funds for the small

available supply of securities has pushed up the price of the latter to such a height as to produce an extremely low yield; in other words, the rate of interest obtainable upon riskless long-term investments has been reduced. The margin between short and long-term rates has become narrower during the course of the depression.

It is held by many observers that this fall in the rate of interest is likely to prove permanent and that, as already stated, the future trend is likely to be downwards. I do not believe, however, that the present situation provides any indication of the future course of interest rates, and I shall endeavour to supply the reasons for my belief.

In the first place, when trade recovers, there will be an increase in the demand for overdrafts and discounts, while those firms which finance their trade from their own resources will re-employ those resources that are now in the money market in order to finance their recovering or recovered trade. In the second place, when trade recovers it will be largely on account of the growth of the demand for investment capital; if there is no such growth, trade cannot hope to recover. Past experience shows that when the recovery takes place the increase in capital development is more rapid than the increase in savings, the latter being determined by the rate of increase of trade in general; at such a time the reverse of the present process is witnessed.

In the third place, while banking policy may affect the available supply of money for a short time, it cannot influence the supply over a long period. The open market policy of the Bank of England is able to influence the momentary situation in the money market, but it cannot influence the

long-term trend. It would be possible for the Bank to continue to purchase securities, thereby increasing the amount of reserves at the joint stock banks and the amount that such banks would therefore be able to lend. But if such a policy were continued when trade had recovered it would constitute inflation on a serious scale and this, in turn, could only be met by a change of policy and the introduction of strong deflationary measures, including an extremely high bank rate.

In the long run, the rate of interest upon long-term securities must be governed, not by stocks of money accumulated from the past, but by the current flow of savings in relation to the current flow of demand for investment capital. When these two factors are examined they do not justify the statement that the rate of interest is almost bound to show a downward trend. In the series of articles on the Economics of Saving I tried to show, on the one side, that there was no reason to expect the future demand for capital to be less than the demand of the past, and on the other side that, for reasons indicated in those articles, the post-war rate of saving had been substantially below the pre-war rate and was in danger of continuing at the lower rate unless active measures were taken to stimulate saving in the community.

There is another factor in the situation that appears to have been ignored by most observers, namely, the differences now existing between long-term rates of interest in different countries. The fall in the rate since 1929 has been far greater in some countries than in others; judged by the conditions prevailing before the depression, the present rate in Great Britain is low relatively to the

average rate prevailing in the world outside. This state of affairs will not continue indefinitely. Sooner or later the British rate will be drawn closer towards the rates prevailing in other countries. For the present the variation in rates is due largely to currency instability and to differences in the immediate prospects, in the spheres of currency and trade, of different countries. But these differences will tend to diminish rather than increase. I see no evidence to justify confidence in predicting a downward trend in the net rate of interest outside Great Britain during the next few years; and if such is the case, it would be unwise to assume a downward trend in the British rate.

It is generally assumed that so long as countries are off the gold standard and employ independent and isolated currencies, any one may control the rate of interest within its own border independently of events in other countries. It is assumed that if we, for example, employed a managed currency system and endeavoured also to maintain a stable price level, we should be able to control the money market in such a way as to establish and maintain a low rate of interest independently of the course of events in other countries. Such a view seems to me entirely erroneous. The sympathy in interest rates of different countries is not the product of an international currency standard and cannot be destroyed by the maintenance of independent local currencies. The sympathy in interest rates is the product of deeper influences, and will be restored, independently of the nature of the currency system, when financial crises disappear and the element of risk is reduced.

It seems to me that, if we are to envisage a

consistent downward movement in interest rates from the present standard of three-and-a-half per cent., we must also envisage a downward trend in the price level and the persistence of the present depression for an indefinite period. But even if the depression continued, at its present intensity, for another four or five years, it would merely produce a reaction that would express itself as much in interest rates as in any other factor in the economic system. I see but one factor likely to produce a downward trend in interest at the same time as trade improves, and that is a substantial increase in the rate of saving. Unless that is forthcoming those institutions that are concerned with the employment of the savings of the people will be wise to adopt a cautious policy and to work upon the assumption, not that interest rates are likely to show a downward trend, but that the present rate reflects a state of depression and is likely to be followed by higher rates when trade recovers and capital development is resumed. But that is not to say that we shall return to the rate prevailing before the issue of the three-and-a-half per cent. Conversion Loan, nor is it suggested that the rate may not fall farther before the next rise occurs. The present restrictions upon international trade, which are delaying the recovery of world trade, are also delaying the "recovery" of interest rates in this country.

AGRICULTURAL COLLEGE AND RESEARCH INSTITUTE
No. 34108
30 JAN
COIMBATORE

The Building Societies' Gazette

ESTABLISHED 1869

An Illustrated Monthly Journal devoted to the interests of Building Societies.

Indispensable to all interested in the activities of Building Societies, including Accountants, Solicitors, Surveyors, Estate Agents, Auctioneers and Builders. It contains from month to month the latest details of Building Society progress throughout the country, and includes special articles written by experts. Specimen copy will be sent post free.

Prepaid Subscription Rate, 15/- Per Annum, Post Free.

REED & CO.,

37, Cursitor Street, LONDON, E.C.4.

Telephone: Holborn 3284.

LAW
OF
MODERN BUILDING SOCIETIES

By J. LEONARD CROUCH,
of Gray's Inn, Barrister-at-Law.

The law relating to the birth, life and death of a Building Society, the law of mortgages, arbitration and other law incidentally arising has been passed in the form of question and answer throughout. This method greatly facilitates the work of mastering the principles of this important subject and will, it is hoped, be of particular interest to those students who are preparing to sit for examination.

Containing the whole of the BUILDING SOCIETIES ACTS and a set of MODEL RULES.

272 Pages, Crown 8vo. Bound in full blue cloth, stiff covers.

Price 12/6 Net.

REED & CO., 37, Cursitor Street, LONDON, E.C.4

The Building Societies' Year Book

OFFICIAL HANDBOOK OF THE NATIONAL ASSOCIATION OF BUILDING SOCIETIES

THE STANDARD WORK OF REFERENCE ON BUILDING SOCIETIES

PUBLISHED IN JULY OF EACH YEAR.

Contains Alphabetical and Geographical List of the 380 principal Building Societies in the country, names of Directors and Officials, and chief figures from the last balance sheets; and details of Building Societies in other parts of the world.

PRICE 7/6 *NET*

REED & CO., 37, CURSITOR STREET, LONDON, E.C.4.

Telephone: Holborn 3284.