Volume III

After the Gold Standard, 1931-1999

1931 June

Macmillan Committee Report, 1931: Committee on Finance and Industry. As Britain plunged deep into economic crisis in 1929, the Macmillan Committee, which included John Maynard Keynes among its members, was established to report on the deteriorating financial and industrial situation. The excerpts here discuss the status of the international gold standard and raise the issue of devaluation. They provide a wide-ranging critique of the international monetary system as it had (mal)functioned during the interwar period. While the Committee rejected devaluing the pound as a policy option for a creditor nation, Britain was nevertheless forced off the gold standard two months after the report was issued.

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The recent working of the gold standard

242. Unfortunately, the anticipations of those who were responsible for our return to the gold standard in 1925 have to a large extent not been fulfilled. Whether these anticipations were justified at the time, and what other course was practically possible, are questions on which we do not all agree, but which it would be unfruitful now to discuss. The six years since that act of policy have, for the reasons stated below, proved to be of a very abnormal character and the sacrifices which a return to gold at the old parity involved have not been compensated by the advantages of international price stability which were anticipated.

243. The accomplished fact of the restoration of our currency to the prewar gold parity and its maintenance there for a period of six years creates, however, an entirely new situation; and it by no means follows, even if the view be held, as it is by some of us, that a mistake was made in 1925, that the consequences can be repaired by a reversal of policy in 1931.

244. Apart from the more general considerations relating to the gold standard which we discuss below, there have been two sets of difficulties in the way of its working to advantage in recent years, one of which we may expect, and the other of which we may hope, to be temporary.

245. The first set of difficulties has been caused by the fact that the various gold parities established by the countries returning to the gold standard did not bear by any means the same relation in each case to the existing levels of incomes and costs

in terms of the national currency. For example, Great Britain established a gold parity which meant that her existing level of sterling incomes and costs was relatively too high in terms of gold, so that, failing a downward adjustment, those of her industries which are subject to foreign competition were put at an artificial disadvantage. France and Belgium, on the other hand, somewhat later established a gold parity which, pending an upward adjustment of their wages and other costs in terms of francs, gave an artificial advantage to their export industries. Other countries provide examples of an intermediate character. Thus the distribution of foreign trade, which would correspond to the relative efficiencies of different countries for different purposes, has been seriously disturbed from the equilibrium position corresponding to the normal relations between their costs in terms of gold. This, however, has been a consequence of the manner in which the postwar world groped its way to back to gold, rather than of the permanent characteristics of the gold standard itself when once the equilibrium of relative costs has been re-established, though, even after six years, this is not yet the case.

246. The second set of difficulties has resulted from the international lending power of the creditor countries being redistributed, favourably to two countries, France and the United States, which have used this power only spasmodically, and adversely to the country, Great Britain, which was formerly the leader in this field and has the most highly developed organization for the purpose. This redistribution of lending power has been largely due to the character of the final settlement of the war debts in which this country has acquiesced. For although Great Britain suffered during the war a diminution of her foreign assets of some hundreds of millions, she has agreed to a postwar settlement by which she has resigned her own net creditor claims, with the result, that on a balance of transactions, virtually the whole of the large annual sums due from Germany accrues to the credit of France and of the United States. This has naturally had the effect of greatly increasing the surplus of these two countries, both absolutely and relatively to the surplus of Great Britain. The diminution in Great Britain's international surplus, due to her war sacrifices remaining uncompensated by postwar advantages, has, however, been further aggravated recently by the adverse effect on her visible balance of trade of the first set of difficulties just mentioned, namely, the differing relationships between gold and domestic money-costs on which different countries returned to the gold standard.

247. This redistribution of lending power need not, however, in itself have interfered with the working of the gold standard. The difficulties have arisen through the partial failure of the two recipients, during the last two or three years, to employ the receipts in the way in which Great Britain had always employed hers, namely, either in the purchase of additional imports or in making additional foreign loans on long-term. On the contrary, they have required payment of a large part of their annual surplus either in actual gold or in short-term liquid claims. This

is a contingency which the normal working of the international gold standard does not contemplate and for which it does not provide.

248. But this set of difficulties, too, one may hope, though with less confidence, to be a temporary phenomenon. Should it not prove so, we can scarcely expect the international gold standard to survive in its present form. If for any reason, however plausible from its own point of view, a creditor country, after making all the purchases it desires, is unwilling to lend its remaining surplus to the rest of the world, there can be no solution except the ultimate destruction of the export trade of the country in question through a relative reduction in the gold costs of other countries. If there were no international standard, but each country had its own domestic currency subject to fluctuating exchanges, this solution would come about at once. For in this event the exchanges of France and the United States, for example, would by now have risen to so high a level relatively to the rest of the world that their exporters would have been driven out of business, so that their unlent surplus would have disappeared. According to the classical theory of the gold standard, the same result should ensue, though more slowly and painfully, as a result of movements of gold inflating costs in those countries and deflating costs elsewhere. But in the modern world, where, on the one hand, inflows of gold are liable to be sterilized and prevented from causing an expansion of credit, whilst on the other hand the deflation of credit set up elsewhere is prevented by social causes from transmitting its full effect to money-wages and other costs, it may be that the whole machine will crack before the reaction back to equilibrium has been brought about.

249. Unfortunately upon these two sets of abnormal difficulties there has supervened, starting in the United States, a business slump of a more normal type though of quite unusual dimensions, further aggravated, in the opinion of some, by being associated with the necessity for a transition from the high rates of interest appropriate to the war and postwar period back towards the lower rates which were typical before the war.

250. Naturally the total result leads some people to question the desirability of adhering to an international standard.

<u>The question of an international standard</u>

251. This brings us to the question whether adherence to an international standard may involve the payment of too heavy a price in the shape of domestic instability. Many countries, both today and at former times, have found that such continued adherence involves a strain greater than they can bear. But these are generally debtor countries, the trade of which is concentrated on a narrow range of primary products subject to violent disturbances of prices. If we leave aside the position today, experience does not show that a creditor country with diversified trade is liable to suffer undue domestic strain merely as the result of adherence to

an international standard. We are of opinion, therefore, that we should not be influenced merely by the exigencies of the moment, if there is reason to believe that there may be important countervailing advantages on a longer view. If we need emergency measures to relieve the immediate strain, we should seek them in some other direction.

252. In the particular case of Great Britain we believe that there are such advantages. One of our most valuable sources of income, indeed one of our most important export industries, is the practice of international banking and associated services. Along with our shipping and our staple export industries this has been for a long period past one of our main sources of wealth. It is by no means clear that the possible advantages to our export activities from the fact that a fluctuating exchange would automatically offset the rigidity of money-incomes would balance the unquestionable loss to the first named; and we might be a poorer country on balance. It is not necessary, in order to reach this conclusion, to exaggerate the benefits which accrue to us from our international financial business. They are not so enormous as to outweigh all other considerations. For example, it is not likely that they have gone even a fraction of the way towards compensating the losses of wealth through unemployment in recent years. It is not our case that industry should be sacrificed to finance. It is, rather, that the benefits to industry from a fluctuating exchange would be inadequate to compensate the losses in other directions. For whilst a fluctuating exchange would have undoubted advantages in certain conditions, it would often be merely substituting one form of instability for another. It would not be possible for a country so intricately concerned with the outside world as Great Britain is to escape so simply from the repercussions of instability elsewhere.

253. There is, moreover, a further reason which cannot easily be weighed merely in the balance of our own direct economic advantage and which weighs more heavily with us than any other. There is, perhaps, no more important object within the field of human technique than that the world as a whole should achieve a sound and scientific monetary system. But there can be little or no hope of progress at any early date for the monetary system of the world as a whole, except as the result of a process of evolution starting from the historic gold standard. If, therefore, this country were to cut adrift from the international system with the object of setting up a local standard with a sole regard to our domestic situation, we should be abandoning the larger problem — the solution of which is certainly necessary to a satisfactory solution of the purely domestic problem - just at the moment, maybe, when, if we were able to look a little further forward, the beginnings of general progress would be becoming visible.

254. We conclude, therefore, that we shall best serve the purpose for which we were set up, and have the greatest hope of securing a sufficient general agreement to lead to action, if we base our recommendations on the assumption, which we

hold justified, that the next phase of monetary policy must consist of a wholehearted attempt to make the existing international standard work more satisfactorily. It is possible - though we believe that hard experience will teach them otherwise - that some countries may be unable or may fail to work an international standard in a satisfactory way. But this is not yet proved, and it would be unwise for us, who have so much to gain by it, to give up the attempt to secure a sound international currency.

Devaluation

255. It has been represented to us that, without in any way departing from the principle or the practice of adherence to an international standard, it is desirable for us in the national interest to do now what might have been accomplished with much less difficulty in 1925, namely, to revise the gold parity of sterling. Such a step is urged on the ground that, if we diminished the gold equivalent of the pound sterling by 10 per cent thereby reducing our gold costs automatically by the same percentage, this would restore to our export industries and to the industries which compete with imported goods what they lost by the return to gold at a figure which was inappropriate to the then existing facts, and that it would also have the great advantage of affecting all sterling costs equally, whether or not they were protected by contract.

256. We have no hesitation in rejecting this course. It is no doubt true that an essential attribute of a sovereign state is a power at any time to alter the value of its currency for any reasons deemed to be in the national interest, and that legally, therefore, there is nothing to prevent the British Government and Parliament from taking such a step. The same may be said of a measure writing down all debts, including those owed by the state itself, by a prescribed percentage - an expedient which would in fact over a considerable field have precisely the same effect. But, while all things may be lawful, all things are not expedient, and in our opinion the devaluation by any government of a currency standing at its par value suddenly and without notice (as must be the case to prevent foreign creditors removing their property) is emphatically one of those things which are not expedient. International trade, commerce and finance are based on confidence. One of the foundation stones on which that confidence reposes is the general belief that all countries will seek to maintain so far as lies in their power the value of their national currency as it has been fixed by law, and will only give legal recognition to its depreciation when that depreciation has already come about *de facto.* It has frequently been the case -we have numerous examples of recent years - that either through the misfortunes of war, or mistakes of policy, or the collapse or prices, currencies have fallen so far below par that their restoration would involve either great social injustices or national efforts and sacrifices for which no adequate compensation can be expected. The view may be held that our own case in 1925 was of this character. The British currency had been depreciated for some years. It was

obvious to the whole world that it was an open question whether its restoration to par was in the national interest and there is no doubt in our minds as to our absolute freedom at that time to fix it, if it suited us, at a lower par value corresponding to the then existing exchange. But it would be to adopt an entirely new principle, and one which would undoubtedly be an immense shock to the international financial world, if the government of the greatest creditor nation were deliberately and by an act of positive policy to announce one morning that it had reduced by law the value of its currency from the par at which it was standing to some lower value.

257. Moreover, considering the matter from another point of view, in the environment of the present world slump the relief to be obtained from a 10 per cent devaluation might prove to be disappointing. It is not certain that, with world demand at its present low ebb, such a measure would serve by itself to restore our export trades to their former position or to effect a radical cure of unemployment. On the contrary, in the atmosphere of crisis and distress which would inevitably surround such an extreme and sensational measure as the devaluation of sterling, we might well find that the state of affairs immediately ensuing on such an event would be worse than that which had preceded it.

The prospects of the gold standard

258. The course of events in the last two years has had the effect of forcing a number of countries off the gold standard. But these are all debtor countries; and if matters continue as at present, it will be the debtor countries of the world, and not a creditor country such as Great Britain, which will be the first to find the strain unbearable. We consider that the leading creditor countries of the world should consult together to prevent matters from continuing as at present. In order that Great Britain may speak with authority in such discussions, it is essential that her financial strength should be beyond criticism. This largely depends in the near future on an increase of her surplus available for new foreign lending.

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263. It seems probable, therefore, that in spite of the reduction of our surplus, the whole of our *net* purchases of foreign securities have been paid for out of our currently accruing surplus on income account. It is possible, we think, that this surplus may be somewhat larger than the usual estimate.

264. As regards the immediate situation, it is also interesting to note that the trade returns, unsatisfactory though they are, bear out the conclusion that the worst strain of a situation such as the present falls on the raw-material countries. During the first quarter of this year the quantity of our exports fell off by more than 30 per cent, whereas the reduction in the quantity of our imports was only 6 per cent. Nevertheless, as a result of the catastrophic fall of raw-material prices, the visible balance of trade has been actually less adverse to us than in recent years, the net position in terms of money moving £5 million in our favour, so that less of

our surplus under other heads (i.e. from foreign interest, shipping, etc.), is being required today to finance our imports than in 1930 or in 1929.

265. The same point can be strikingly illustrated by what has happened in the case of the single commodity wheat. At the price prevailing in December 1930, the annual cost of our wheat imports would be about £30 million less than it was in 1929, and £60 million less than in 1925. It is obvious what a large contribution this single item represents to the national cost of supporting the present volume of unemployment. It is a great misfortune both for us and for the raw-material countries that we should have a great volume of unemployment through their inability to purchase from us as a result of the fall in the price of their produce. But merely from the point of view of our balance of trade it is not to be overlooked that the latter fact not only balances the former but may even outweigh it. We conclude that the underlying financial facts are more favourable than had been supposed, and that Great Britain's position as a creditor country remains immensely strong.

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***Source*:** *Parliamentary Papers*, 1930-1931, Command 3897