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Nona Newman

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## ABSTRACT

The role of the Treasury in the formation of British economic policy in the period 1918 to 1925 is one of considerable interest, both because the economic problems which confronted the British Government at this time were many, complex and often without close historical parallel, and because there was a considerable contrast in both the quality and the duration of experience between the Treasury officials and the Chancellors of the Exchequer.

This study begins by studying the structure and nature of the Treasury, and goes on to examine five major areas of policy in which the Treasury was closely concerned. The topics studied include the Cunliffe Committee, whose reports formed the foundation for British post-war financial policy; the problems involved in a return to a peace-time economy, including the 'economy campaign' of mid-1919, in which Treasury advisers played a leading role; the development of inter-Allied debt policy which led up to the publication of the Balfour Note in 1922, in which a Treasury official played a prominent part; and the restructuring of the National Debt during this period carried out by the Treasury. Finally, the Treasury's role in the return to gold is examined.

It is evident throughout that the Treasury's primary concern in the discussion of any policy was its desire to return to the Gold Standard with all possible speed. Further, Treasury officials always advised following historical precedent wherever possible. But it is apparent that there was strong support among informed contemporaries for the Treasury views, nor is there evidence to suggest that the Chancellors would have looked favourably on unorthodox advice had it been offered.

THE ROLE OF THE TREASURY IN THE FORMATION

OF BRITISH ECONOMIC POLICY

1918-1925

Nona Newman

Thesis submitted for the Degree of Doctor of Philosophy

Durham University

1972

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VI	DEBT REDEMPTION AND INTEREST RATE POLICY 1920-1925	270
	Treasury Monetary Policy	271
	The Influence of the Cunliffe Committee	275
	Changes in Attitude during the Post-War Boom	277
	Effects of Treasury Policy	280
	Government Borrowing during and immediately after the War	285
	Debt Redemption and Funding 1920-1925	288
	New National Debt Issues 1920-1925	295
	Interest Rate Policy 1920-1925	299
VII	THE TREASURY AND THE GOLD STANDARD	308
	The Historical Background	310
	The War and Post-War Periods	311
	The Waiting Period, 1920-1924	313
	The Bradbury Committee	320
	The Period of Internal Discussion	326
	The Return to Gold	333
	The Treasury and the Return to Gold	334
VIII	CONCLUSION	339
	Treasury Structure and the Formation of Opinion	341
	The Treasury Officials and their Ministers	349
	The Role of the Treasury	352
	BIOGRAPHICAL APPENDIX ON TREASURY OFFICIALS	355
	STATISTICAL APPENDIX	362
	SELECT BIBLIOGRAPHY	369
	INDEX	377

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LIST OF TABLES

1. Total Government income and expenditure	363
2. Bank Rate 1919-1925	364
3. Floating Debt 1919-1925	365
4. Composition of the National Debt, 1914 and 1919	366
5. Internal Debt Maturing 1921-1930	367
6. National Debt, 1914, 1919 and 1925	368

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CHAPTER ONE

INTRODUCTION

The period between the two World Wars was regarded by those who lived through it as one of the most disturbed in the peace-time history of the modern world. The problems of adjustment to the changed conditions of the twentieth century were considerable. The prosecution of hostilities imposed great reorganisation in industrial and economic life, and involved the decimation of a whole generation in a war of attrition. The situation was aggravated and intensified both by these distortions, and by the inability of both national and international institutions and statesmen to deal adequately with the situation. These problems were particularly apparent in Britain, which was in an especially difficult position. While the manifest economic disasters of the period, in terms of trade depression and unemployment, came mainly after 1929, the roots of the problem are, as far as Britain is concerned, to be found in the years before, and particularly in the period from the end of the war in 1918, until the return to the Gold Standard in 1925. This study sets out to examine the problems of the making of economic policy in Britain in this period, from the viewpoint of the Government Department most deeply involved, the Treasury. The object is to attempt to shed light on the ways in which decisions on matters of economic policy were made, and to isolate the part played by Treasury officials in this process.

For some time before the war, Britain had gradually been losing the commercial and financial supremacy in world markets which she had held during the greater part of the nineteenth century. Two important features of her trading position were to have serious consequences after the war. Firstly, the direction of her trade: in 1913, 60% of Britain's exports went to countries other than Canada, the United States and Europe,<sup>1</sup> while only 39% of her imports came from those countries.<sup>2</sup> In addition, of Britain's European customers, Germany was before the war much the most important. In 1913, the value of British exports to Germany was exceeded only by

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1. I. Svernilson, Growth and Stagnation in the European Economy (Geneva: United Nations Economic Commission for Europe, 1954), Table 51, p.176.
  2. Ibid., Table 51, p. 177.

exports to the United States and to India.<sup>1</sup> Thus Britain's foreign trade position was particularly vulnerable to two of the most important features of the world economy between the wars, the slump in the prices of primary products and the extreme dislocation of the German economy.

Secondly, there was an excessive reliance on a few staple commodities in Britain's export trade. The chief of these were textiles, coal and shipbuilding, all of which were commodities in which trade was declining even prior to the First World War.<sup>2</sup> This factor was reinforced by several factors after the war. Notable among these were the development of domestic production of these goods in countries which had been denied them during the war, and the fact that production of these commodities, particularly coal and ships, had had to be expanded virtually without regard to cost or productivity to meet the demands of war, which were in any case considerably in excess of peacetime needs, largely because of the amount of actual destruction of resources in wartime.

The long-term economic problems were exacerbated by the circumstances of the post-war period. The ending of the war in 1918 was followed by a post-war boom, during which large numbers of demobilised ex-servicemen returning to this country were absorbed into employment without much difficulty. However, the boom was largely a speculative and restocking phenomenon, based on the expected shortages in commodities and raw materials, and the sharp rise in prices in the two years after the war were followed by catastrophic falls in succeeding years. The recession which followed the post-war boom saw the emergence of the phenomenon of long-term unemployment on a scale unknown before the war. The whole country did not suffer equally: it has been estimated that the most depressed areas, containing only just over a quarter of the total work force of the United Kingdom, included nearly half the unemployed labour.<sup>3</sup> Modern studies suggest that this problem was largely due

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1. A.W. Kirkaldy (ed.), British Finance 1914-21 (London: Pitman, 1921), pp. 370-373.

2. W.A. Lewis, Economic Survey 1919-1939 (London: George Allen and Unwin, 1949), pp. 78-9.

3. R.I.A.A., Unemployment: an International Problem (Oxford: O.U.P., 1935), p. 60.

to the nature of economic growth in this country between the wars, which involved substantial increases in output per man. This appears to have been partly due to the nature of the industries which were growing fastest; in that they were heavily capital-intensive, and also seem to have made better use of the capital they had by improved methods of organisation, and partly because even those industries which were stagnant in terms of total output saw a growth in productivity and a reduction in the labour force.

Britain's difficulties in the commercial field were to a large extent paralleled by, and to some degree responsible for, difficulties in the financial field. Before the war, the City of London had been the principal financial centre of the world. While Britain's financial importance in the post-war world was still considerable, her position of primacy was being eroded by the United States.<sup>1</sup> Responsibility for this change lies partly with the trade changes, and partly with the war. During the war Britain had liquidated a considerable part of the foreign assets which she had built up during the previous century. She had also lent considerable sums to all her Allies except the United States, which had in turn lent Britain sums totalling about two-thirds of Britain's loans to other Allies. At the end of the financial year 1919-20, the grand total of British loans outstanding was £1,852 million, of which £120 million had been lent to Empire countries, and the remainder to other Allies, of whom France and Russia took more than £500 million each.<sup>2</sup> British borrowing overseas during the war was considerably less than her lending; British debts outstanding at the same date totalled £1,279 million, of which £1,036 million was owed to the United States.<sup>3</sup> Thus the British Government's loans to France and Russia alone were in excess of the British debt to the United States. Much of the financial difficulty of the inter-war years resulted from the unwillingness of the United States to recognise any connection between

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1. S. Pollard, The Development of the British Economy 1914-1950 (London: Edward Arnold, 1962), pp. 185-188.
  2. E.V. Morgan, Studies in British Financial Policy 1914-1925 (London: Macmillan and Co., 1952), p. 317.
  3. Ibid., pp. 320-1.

reparation payments due to her Allies, and their debts to her; and between Allied debt to Britain and British debt to the United States.

Further dislocation resulted from the inability and unwillingness of the United States to take over Britain's role as the financial centre of the world and the chief creditor nation, together with the responsibilities which this entailed.<sup>1</sup> The much smaller part played in the American economy by overseas trade made her less sensitive to changes in world trading conditions, and it was also less important to her than it had been to Britain to maintain easy and flexible world trading conditions. The Federal Reserve Board was considerably weaker in its control over the American banking system than was the Bank of England in this country. In addition, the absence of institutional intermediaries in the call market on Wall Street did not give the banks in America the same degree of insulation from the effects of speculation on the stock markets as British banks enjoyed.<sup>2</sup> On the Continent, banking stability was not enhanced by the widespread participation of banks in commercial ventures. The virtual absence of a call market in France led many banks, during the 'twenties, to keep call money in London and repatriate it as needed, which increased the 'hot money' strains on the London market, since withdrawals by French banks for purely internal reasons were liable to be construed as constituting a run on the pound and to be followed by further, speculative, outflows.<sup>3</sup>

In many ways, the Governments of the war and post-war periods in Britain did nothing to alleviate and much to exacerbate these problems. The cost of the war was largely financed by borrowing, at inflated rates of interest. Little effort was made to assess realistically the yields which might be obtained from taxation under war-time conditions. The extent to which expenditure was covered by revenue

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1. S. Pollard, The Development of the British Economy 1914-1950, p. 186.
  2. W.A. Brown, Jr., The International Gold Standard Re-interpreted (2 vols; New York: N.B.E.R., 1940), pp. 21-3.
  3. United Nations, International Capital Movements in the Inter-War Period (New York: United Nations, 1949), pp. 21-23.

changed from full cover (indeed often with a small surplus) before the war, to 21.6% cover in 1916-17, the worst year of the war, and 34.5% cover in 1918-19.<sup>1</sup> Over the four years from April, 1914 to April, 1918, it was estimated that revenue amounted to 26.3% of expenditure on average.<sup>2</sup> After the war, however, the Government set its face firmly against further borrowing, and in every year from 1921 to the end of our period achieved a surplus of revenue over expenditure.<sup>3</sup> During the early part of the 'twenties, deflation was deliberately pursued in order to bring down British prices and to strengthen the exchange rate, preparatory to restoring the Gold Standard at the pre-war parity. The chief result was that while a number of other countries, notably the United States, experienced a mild recovery in this period, British industry remained severely depressed, and unemployment was never below 10% of the population - the "intractable million".<sup>4</sup> Industry suffered particularly from the necessity of maintaining high interest rates to counteract the pull of the New York market on money, as did government finance from the consequent high level of debt service, which constituted nearly half of government expenditure during this period.<sup>5</sup>

The impact of the economic and financial policy of the government of the day was enhanced by an increased involvement in the economy. It has been estimated that the proportion of the National Income expended by the Government rose from approximately one twelfth in 1914 to about one half in 1918.<sup>6</sup> Even after the Economy Campaign of 1919, and the Geddes Axe of 1922, Government expenditure relative to the National Income was still about double the pre-war figure.

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1. A.W. Kirkaldy (ed.), British Finance 1914-21 (London: Pitman, 1921), p. 215.
  2. Budget speech 1918; quoted in E.L. Hargreaves, The National Debt (London: Edward Arnold, 1930), p. 246.
  3. See below, Statistical Appendix, Table 1.
  4. A.C. Pigou, Aspects of British Economic History 1918-1925 (London: Macmillan and Co., 1948), pp. 42-55, 221.
  5. U. Hicks, The Finance of British Government 1920-1936 (London: O.U.P., 1938), p. 380, Table 1.
  6. E.V. Morgan, Studies in British Financial Policy 1914-1925, p. 105.

Thus in the period immediately following the First World War, the Government was faced with economic problems of a seriousness and a magnitude with which it had not had to deal before the war, both in the national and the international sphere: and it was more deeply concerned in those problems than governments had customarily been in economic problems before 1914. Further, it had to deal with many new social problems, some of them consequent upon the economic difficulties already outlined.

\* \* \*

These economic and social changes were accompanied by major changes in the political sphere. During the years from 1918-25, there were four General Elections, and five Administrations, a Coalition, three Conservative, and one Labour, held office under four Prime Ministers. Within these Administrations, a number of major Cabinet reorganisations took place, so that in our period no fewer than seven men held the office of Chancellor of the Exchequer, in charge of the Ministry most concerned with these widespread economic changes. Thus the activities of the permanent officials of the Treasury and their relationships with their chief ministers assume considerable importance in this period, first because of the magnitude and novelty of the economic problems with which they had to deal, and because the Chancellor whom they advised was frequently a man inexperienced in the direction of economic policy, so that the civil servants provided a continuity of experience which would otherwise have been absent.

The Treasury which had to deal with these complex and far-reaching changes in the economy was itself going through a period of change. In the years before the First World War, following the effective introduction of open competition for posts in the First Division of the Civil Service, what is now the Administrative Class, many of the best graduates of the Universities of Oxford and Cambridge had been recruited to that Division. As the most prestigious of the Departments of

State, the Treasury was able to take the best of these highly able men. Since by modern standards it was then a very small Department, numbering around forty in the First Division, the Treasury had by 1914 acquired the characteristics of a closely-knit elite, advising Ministers on policy-making with an authority which was not easily ignored. This was the more so since at that time there was no unified Civil Service promotion system, and the senior Treasury officials were for the most part men who had spent their whole working lives in that Department.

Despite the influx of new staff during the war (the numbers in the Higher Division more than doubled by 1919) the situation was not greatly altered. Partly this was because the newcomers were of substantially the same class and educational background as the 'regular' Treasury men; partly it was because many of the newcomers were temporary Civil Servants, with jobs to return to at the end of the war; finally, the fact that many of them were employed in two new, and temporary, divisions of the Treasury, one of which was headed by J.M. Keynes, himself a temporary official, must have tended to isolate many of these men from their permanent colleagues. But there seems to have been some breaking down of traditional reserve, and in particular there was an increased recognition of the value of the work of the clerks in the Second Division, and of the invidious nature of many of the distinctions between the two Divisions.

More considerable changes came after the war, when in accordance with the recommendations of the Haldane Committee,<sup>1</sup> the importance of a unified Service with a properly staffed Establishments Division at the Treasury was recognised. As a result, the numbers of Treasury staff declined very little after the war, although of course considerable changes in personnel took place as the temporary officials left to return to their normal occupations. Thus those in what became in September 1919 the Administrative Class, the old First or Higher Division, still numbered about eighty in the Treasury of the late 'twenties and early 'thirties.

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1. Cd. 9230, Ministry of Reconstruction, Report of the Machinery of Government Committee, 1918.

Under the reorganisation scheme of 1919, the six divisions of the pre-war Treasury were increased to nine and later to eleven, with a special 'Financial Enquiries' division. These were divided into three sections, each under a Controller with the rank of Permanent Secretary, and with a Permanent Secretary, later designated 'Head of the Civil Service', over the whole. The section primarily concerned with economic policy was Finance, which incorporated the pre-war Home and Foreign Finance divisions, and Financial Enquiries. The fact that many of the war-time entrants to the Treasury had been temporary appointments meant that the new personnel needed to staff the expansion of the Establishments work had largely to come, not from existing Treasury staff transferred from war work, but from other Departments. This was in accordance with the views of Sir Warren Fisher, appointed Permanent Secretary the month after the reorganisation of September 1919. But these changes affected the Finance section to a much smaller extent than the other sections.<sup>1</sup>

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So the picture that emerges at the end of the war is of a Treasury undergoing major changes and expansion; but despite this the divisions of the Treasury most deeply concerned in policy-making and advice to Ministers still constituted the small, closely knit, highly educated and able elite that they had been before the war. The aim of this study is to examine the structure of the Treasury in the years immediately after the war in some detail, paying closest attention to the divisions most closely concerned with policy-making, in order to identify the role of the Treasury in the formation of economic policy in Britain in the early years of the inter-war period.

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1. See below, Ch. II passim.

The first stage in this process will take the form of an examination of the structure and development of the Departmental Treasury during our period, and of the personalities involved, both at the official and the Ministerial level. It will become evident that the economic activities of the Treasury in this period can be divided into three main categories. One area covers the management of government securities and the National Debt. Another concerns budgetary policy, and Treasury control over public expenditure. A third concerns international financial relations, and in particular policy on German reparations, and on inter-Allied debts. Each area tends to overlap the others: some issues have implications for more than one area. In particular the question of the Gold Standard, which was of paramount importance in economic policy in our period, has an impact in all three areas, and is in a sense in a category of its own. But the classification is a valid and a valuable one for the purpose of this work.

The three categories outlined comprise the three main kinds of economic activity with which the Treasury was concerned. These activities can also be viewed in terms of the kind of approach which the Treasury took to particular problems. Again, there are three main divisions to be considered. Firstly, some kinds of activity, although having an economic impact and being the concern of members of the Administrative Class, were not strictly concerned with the making of policy. Much of the activity of the Establishments and Supply Divisions was of this kind, since they acted at one remove, as it were, through and with other government departments. Secondly, there were areas in which Treasury officials acted in an initiatory role, but in which the issues were of so complex a nature technically that, although sometimes quite important matters of policy were at stake, consultation with Ministers was kept to a minimum, and official advice usually accepted by Ministers with little demur. Thirdly, there were areas of less technical difficulty, but with perhaps stronger political overtones, which concerned Ministers closely, and where the Minister took his own decision, occasionally

against official advice. Again, the three categories overlap, nor are they entirely exhaustive, but they provide some insight into the way Treasury activity evolved.

The second stage in this study of Treasury policy-making takes the form of an examination in detail of four problems in which the Treasury was deeply concerned. Each of these studies illustrates a different aspect of the Treasury's work, and a problem from each of the three areas outlined has been included. Each study also shows a fresh aspect of the Treasury approach to policy problems. As we have seen, financial and economic policy was the province of the Finance section of the Treasury, under a Controller, who was responsible directly to the Chancellor of the Exchequer, but whose Departmental superior was the Permanent Secretary. Treasury business was so organised that the need for a policy decision might originate as a reaction to events from outside, which required a decision; this category includes matters raised initially at Ministerial level, for instance in Cabinet, and passed on for the attention of the Chancellor and his officials. Or on occasion an original policy proposal might come from within the Treasury. Some problems required the co-operation of other Departments, such as the Board of Trade, or the Inland Revenue, or with outside but closely related bodies like the Committee of Clearing Bankers, or, most particularly, the Bank of England. All these points contributed to the choice of the four topics which are examined in detail: as did a consideration of chronology, since many of the most pressing problems which confronted the Treasury during our period continued to be important throughout the inter-war period, and could not be meaningfully treated within the chosen time-span.

The first problem examined concerns the discussions and decisions of the Committee on Currency and Foreign Exchange after the War, appointed in 1918 with Lord Cunliffe, late Governor of the Bank of England, and its chairman. It was this Committee which recommended without reservation that Britain should restore the Gold Standard, with the pound at the old parity, as soon as possible after the end

of the war: and by accepting the Reports of the Cunliffe Committee in December 1919, the Government committed itself to the return to the Gold Standard. The Treasury member of the Cunliffe Committee for most of its life was Sir John Bradbury, then Joint Permanent Secretary to the Treasury (this was prior to the post-war reorganisation). Bradbury had spent nearly all of his working life in the Treasury, broken only by a short period of secondment to the National Insurance Commission; he had been thoroughly steeped in traditional Treasury views, and while a brilliant and much admired man, he was impeccably orthodox in his opinions.<sup>1</sup> He and Cunliffe were primarily responsible for the conclusions of the Committee, and the Minutes of the Committee's proceedings present a fascinating and informative picture of the views of a very senior Treasury official, and their impact on the production of a document of outstanding importance in post-war British financial and economic policy. This study is also illustrative of the relationship between the Treasury and the Bank of England; it shows, too, the development of Treasury reactions in a situation in which the initial impetus, that is for the setting up of the Committee, came from outside the Treasury. Partly because of this last fact, and partly because of the technical nature of the problem, this is also an example of the taking of a decision in which the advice of officials was apparently accepted by the responsible Minister without formal discussion or debate, despite the fact that the setting up of the Committee had been a Ministerial initiative. The Treasury and the Bank of England therefore were effectively allowed to commit Britain to a particular international and internal monetary policy without formal Ministerial discussion at Cabinet level.

The second special area of study concerns the relaxation of economic controls after the war. In the sense that it covers the return from wartime to peacetime conditions in the economy, the problem is atypical of Treasury work; but it covers the re-establishment of Treasury Control after the wartime expedients of Votes of

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1. For a definition of the term 'orthodox' as used in this work, see below, p.p. 42, 88-90.

Credit, and it also illustrates some aspects of the nature of Treasury relations with other Departments. The principal Treasury figure in this study is the Permanent Secretary, Sir Warren Fisher. Fisher took very little part or even interest in the day-to-day work of the Finance Divisions; but occasionally he would make a sudden, swift and devastating foray into this complex world, followed by a speedy withdrawal into the Establishments work with which he was primarily concerned during his tenure of office. On this occasion the instigator was Lloyd George, then Prime Minister in the Coalition Government, who became during the summer of 1919 increasingly anxious about state spending, and public, Press and Parliamentary allegations of government extravagance. Lloyd George wrote to Fisher, urging him to make a thorough investigation: Fisher, anxious to complete the re-establishment of Treasury Control, and with the chance of being instrumental in abolishing altogether the Departments of war-time creation, which were financed largely through undifferentiated Votes of Credit, seized the opportunity with alacrity. It provides an example of a problem which was raised directly by the Prime Minister, and in which the Treasury official effectively by-passed his Chancellor to advise the Prime Minister direct.

The third study is concerned with one aspect of the international financial situation, the negotiations over the British war debt to the United States, culminating in the publication of the Balfour Note in August, 1922, and the funding of the American debt by Baldwin in 1923. In much of this study the principal Treasury man is Sir Basil Blackett, Controller of Finance from 1918 to 1922. Blackett, although a life-time Treasury official, had a brilliant and original mind, and was a friend and later disciple of Keynes. The study is primarily concerned with a proposal made by Blackett for the solution of the inter-Allied debt problem, a plan which because of its generosity became known as the 'Beau Geste', and which represented a largely original attempt at a real and lasting solution of this intractable problem. Despite the enthusiastic support of Sir Austen Chamberlain and Lord Curzon, the Plan was defeated by the combined efforts

of Winston Churchill and Lloyd George, and the policy set out in the Balfour Note adopted instead. But while Blackett's policy was never approved by the Cabinet, it is very revealing of the originality and imagination of which at any rate one Treasury official was capable when confronted with a new problem, without constricting historical precedent: and it represents a genuine policy initiative by an official, as distinct from a necessary reaction along stereotyped lines to a problem pressing for solution. It is also an example of a problem which was otherwise approached in what tends to be thought of as the 'normal' way for policy decisions to be made, that is the official advised his Minister how to deal with the problem, the Chancellor took this advice and his own views to the Cabinet for decision and discussion, and passed the decision back to his official for appropriate action to be taken.

The fourth study concerns the Treasury's policy with regard to the funding and redemption of government debt, and in particular the floating debt, in the period up to 1925. In these years the substantial Ways and Means Advances obtained from the Bank of England during the war were repaid, and a substantial part of the large volume of Treasury Bills outstanding at the end of the war was funded or redeemed, but at considerable cost in terms of the deflationary impact on the economy, a problem of which the officials concerned seem to have been insufficiently aware. The officials concerned at the senior level were Sir Basil Blackett and his deputy, Sir Otto Niemeyer, who succeeded Blackett as Controller in 1922. This study examines a part of the third facet of Treasury activity, the management of the National Debt; it also shows how the officials behaved in a situation in which the problems were of so technical a nature that on the whole the Chancellor allowed them complete freedom of action. The main exception to this occurred at the beginning of the period examined, when the officials were urging a rise in the Treasury Bill rate; since these Bills were then available on tap, this would have an impact analagous to a rise in Bank Rate before the war. Since Bank Rate was the responsibility of the Bank of England, not of the Treasury,

such a decision had no parallel in Treasury experience, and a great deal of written evidence was presented to the Chancellor to help him decide. These papers were collected together by Keynes while at the Treasury during the Second World War, and provide an unusually complete record of Treasury advice on a particular problem.

These four studies together present a number of different aspects of the Treasury's role in the formation of economic policy on a variety of different issues. The final study attempts to look at the Treasury's policy-making role as a whole, by examining, as a case-study, the return to the Gold Standard in 1925. This episode is of prime importance for a number of reasons; further, it displays to an unusual extent the way in which Treasury men tended to think on central issues. Its first claim to importance is the extent to which it dominated policy decisions on other topics: the likely effect of a particular decision on the policy of restoring the Gold Standard as soon as possible was always a major factor in deciding its acceptance or rejection. From the point of view of a study of the Treasury, the Gold Standard is important in itself. But there are other factors: one is that the decision was debated for so long that a considerable body of Treasury opinion is available on the subject, from more junior officials as well as those close to the Chancellor. Another is that, owing to Winston Churchill's unwillingness to accept advice without questioning, there is a much larger body of information about the way in which the decision was reached than is usual in Treasury archives. Further, this episode is one of the few occasions during the early 'twenties when there was a possibility of a serious difference of opinion between the Chancellor and his officials. Finally, the Treasury approach to this question brings together several strands of thought and attitudes which are common to many topics, and represent in some sense the Treasury orthodoxy of the day; this is the more so since all the senior officials in the Finance section were involved in giving advice on the problem, in close conjunction with the Bank of England.

The process by which Britain returned to the Gold Standard, from the deliberations of the Cunliffe Committee in 1918 to the announcement of the removal of the gold export prohibition in the Budget of 1925, thus represents a unique demonstration of Treasury policy-making activity in our period. Its importance as a decision, the amount of evidence available, and Winston Churchill's 'exercise', all contribute to making the decision atypical in itself; but there is every reason to believe that the way in which the decision was made is largely representative of the processes involved in other, less well-documented decisions. Because this is so, the return to the Gold Standard is examined in some detail, not in an attempt to duplicate the work of others, but as a case-study of Treasury decision-making, set in the context of an analysis of the role of the Treasury in the formation of economic policy in general.<sup>1</sup>

The aim of the study as a whole is, therefore, to examine the process by which the Treasury advised Ministers on economic policy, and the impact of that advice on decision-making. The first step in this analysis is to outline the organisation and staffing of the Treasury during the period after 1918, in order to establish a general foundation on which to base the more specific studies of Treasury advice and action in particular areas. It is to this examination of the structure of the Treasury in our period that we must now turn.

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1. The most important study in this sphere is D.J. Moggridge, The Return to Gold 1925 (Cambridge: C.U.P., 1969). On the whole, the present author concurs in Moggridge's conclusions: a further discussion will be found in Chapter VII below.

CHAPTER TWO

THE ORGANISATION AND STRUCTURE OF THE TREASURY

Sir Thomas Heath, joint Permanent Secretary to the Treasury during the First World War, has described the Treasury as:

"...the Department which, subject to the control of the executive and to the authority of Parliament, is responsible for the administration of the public finances of the country ... it is the one permanent institution which stands between the country and national bankruptcy."<sup>1</sup>

The Treasury officials during our period, therefore, saw their role primarily as guardians of the national finances, and as members of an administrative and executive Department. The lack of any perception of the impact which that administration might have on the economy, the absence of any idea of the macro-economic implications of their actions, is one feature of the Treasury in our period which strikes the observer most strongly. Another important feature is the fact that the department was a small and friendly one; in 1914 the total Treasury establishment in the Higher Division numbered only about forty men. These men shared a commonality of background, education and ideals that tended to produce homogeneity and conformity in advice and practice. There were, of course, internecine squabbles, but the general impression is one of harmony and close co-operation. During the 1914-18 war, the Treasury was greatly expanded, but much of the old atmosphere remained, particularly in the Finance sections of the Treasury, which were the most closely concerned with policy making and with the giving of advice to Ministers. The purpose of this chapter is to examine these factors and to try to identify the way in which they and the personalities of those concerned affected the role and running of the Treasury.

### Treasury Structure

Following the introduction of open competition for positions in the Home Civil Service, which gradually became effective during the last quarter of the nineteenth century,<sup>2</sup> the Higher Division, as it was then known, became a focus for the ambition of many of the most brilliant of the young men who graduated from

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1. Sir Thomas Heath, The Treasury (London: G. Putnam's Sons, 1927), p. 1.
  2. G.K. Fry, Statesmen in Disguise (London: Macmillan and Co., 1969), pp. 34-5.

Oxford and Cambridge each year. It is hard to realise how limited were the opportunities for such men in the period before and after the First War. For those without a vocation for the Church, or family connections in the Armed forces, or a private income to maintain them through the first meagre years of law practice, an academic career was the only alternative to public service, and that only for the most gifted. Industry had not yet begun to recruit graduates either in research or for management; many of the fields in which graduates are now employed, such as the social services, barely existed; the salary and status of the teacher compared poorly with the Civil Service. Thus by the early 'twenties of this century, the Service had come to be staffed in the Administrative Class (the old Higher Division) by men who had obtained excellent degrees at Oxford or Cambridge, most often in classical subjects, having come for the most part from grammar schools of the kind which would now mainly be 'Direct Grant' schools. Often they came from quite poor homes, and had only been able to continue their education by means of Open Scholarships.<sup>1</sup> Some idea of the level of competition, can be gained from the fact that in 1927, the worst year between the wars, there were ten vacancies, and five hundred candidates.<sup>2</sup> The Treasury, as the most prestigious Department, was able to take the best of the candidates. This was not, however, always a success, and in 1927 the Permanent Secretary changed this policy for one of recruiting men with some years experience in other Departments.<sup>3</sup>

Before the First World War, the Treasury was composed of six divisions, of which two were responsible mainly for finance, three for supply and establishments work, and one dealt with the work of the Parliamentary Clerk.<sup>4</sup> During the war two further divisions were added, the famous 'A' division which John Maynard Keynes headed, and which dealt with foreign exchange and security questions, and 'B' division, dealing with new Departments, such as the Ministries of Shipping and of

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1. See for example P.J. Grigg, Prejudice and Judgement (London: Jonathan Cape, 1948), pp. 16-22.

2. Fry, Statesmen in Disguise, p. 82.

3. Private information to the author; H. Roseveare, The Treasury (London: Allen Lane The Penguin Press, 1969), p. 247.

4. Heath, The Treasury, pp. 97-100.

A table of the structure of the Treasury establishment in the period before the First World War will be found on p. 23 as Table. 1.

Munitions. These two divisions were absorbed into the main structure in February 1919, by the addition of two Principals to the permanent staff.<sup>1</sup>

At the head of this organisation there was, before 1914, a single Permanent Secretary. It was even then becoming clear, however, that the job was too much for one man, and when Sir Robert Chalmers resigned the post in 1913 it was split into two, the first occupants being Sir John Bradbury and Sir Thomas Heath. After war broke out, Chalmers returned, and there were three joint Permanent Secretaries for the remainder of the war.<sup>2</sup>

This was only a satisfactory situation where the three men were able to work in perfect harmony, and Bradbury saw that such an arrangement would not always be practicable. Further, two committees which reported during 1919, the Haldane Committee on the Machinery of Government, and a Departmental Committee of Inquiry chaired by Bradbury, recommended major changes in the organisation of that part of the Treasury which dealt with staffing, recruitment and allied problems in other Departments.<sup>3</sup> In September 1919, therefore, the original six divisions were expanded into eleven, grouped into three sections, each called Departments, to deal respectively with questions of Supply, Finance and Establishments. Each Department had a Controller at its head, who was responsible directly to the Chancellor. This rigid arrangement gradually dissolved and became more flexible from the late 'twenties onwards. The whole Department was headed by a Permanent Secretary who was given the title of 'Head of the Civil Service', received a slightly higher salary than the other Permanent Secretaries, and exercised a watching brief over the work of the Controllers, whose positions ranked equal in salary and status with that of the Permanent Secretary in other Departments.<sup>4</sup>

A diagram of the organisation will be found in Figure 1.

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1. P.R.O., T.165/46.

2. Heath, The Treasury, p. 104; Roseveare, The Treasury, pp. 231-2.

3. Roseveare, op.cit., pp. 244-5.

4. Heath, op.cit., pp. 104-5. A chart showing the flow of responsibility and the chain of command within the Treasury will be found on p. 21 as Figure 1.

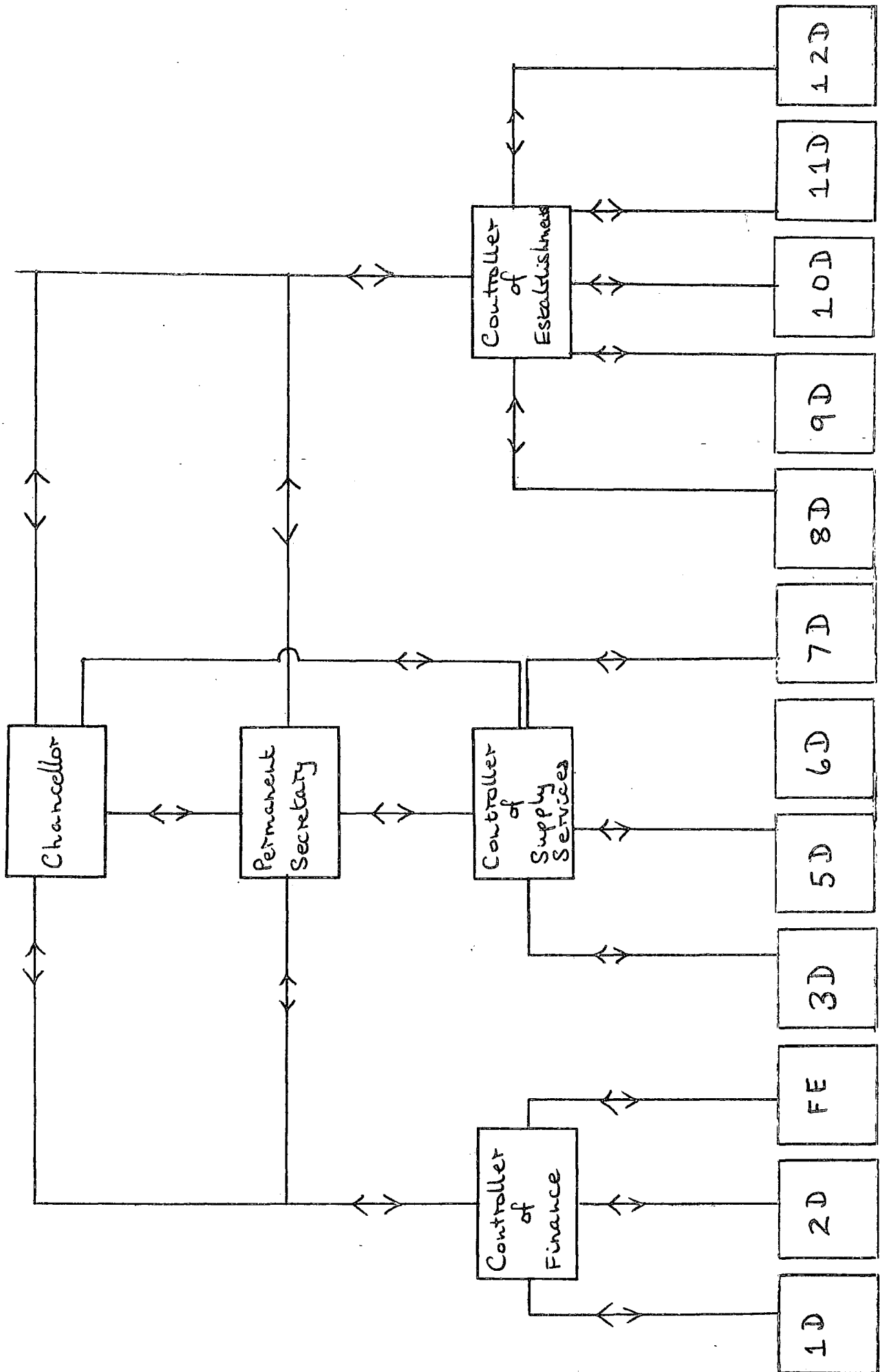


Figure 1

The Treasury Chain of Command

The total size of the Administrative Class in the Treasury at this time was rather more than double the pre-war figure, that is about 80, distributed unequally among the three Departments.<sup>1</sup> The Supply and Establishments Divisions tended to administer at one remove, as it were; their work was primarily concerned with dealing with and through other Government Departments. Thus, although they might have a negative effect on policy through their encouragement or discouragement of the initiatives of other Departments, they had virtually no executive or initiating role independent of those Departments. Only the Finance Department was an executive Department in its own right, and as such was both most closely concerned with policy-making, and also had most contact with the Chancellor, who tended to leave internal Civil Service problems to the Permanent Secretary. In December 1920 the Finance Department had sixteen Administrative Class officials in Whitehall. Of these seven, one Principal Assistant Secretary, four Principals, and two Assistant Principals, were in 1D, which dealt with Home Finance; five, one Assistant Secretary, two Principals and two Assistant Principals, were in 2D; and two, an Assistant Secretary and an Assistant Principal, were in the Financial Enquiries Division. 1D and 2D had pre-war counterparts, though they were smaller; Financial Enquiries was a new division, instituted in 1915, and somewhat detached from the other two, being primarily a research division.<sup>2</sup> In addition, 2D had several members serving overseas in the more important Embassies, such as Washington, Paris and Berlin, and in various other spheres. The Finance Department was, as we have seen, headed by a Controller, who had a Private Secretary of Assistant Principal rank.<sup>3</sup>

Above this Treasury structure were its political masters, the Financial Secretary and the Chancellor of the Exchequer. The Financial Secretary had one

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1. A table of the structure of the Treasury establishment in the post-war period will be found on p. 23 as Table 2.
  2. Unpublished Treasury documents.
  3. Ibid.; Roseveare, The Treasury, p. 271.

The Treasury in 1908

Division	Function and Departments Served	Staff			
		AS	PC	1C	2C
First*	Finance, Banking, Currency etc.	1	-	2	3
Second#	India Office, Service Depts.	-	1	1	1
Third+	Education, Board of Trade, Agriculture, Scottish & Irish Depts.	1	-	2	1
Fourth	Post Office, Local Government Board, Office of Works, Isle of Man etc., Royal Duchies	-	1	1	1
Fifth	Superannuation, Customs, Inland Revenue, Pensions	-	1	1	1
Sixth#	Home, Foreign and Colonial Offices, Law Courts etc.	-	1	1	1

Table 1

Notes

\* AS also supervised 4D. # Supervised by Permanent Secretary.  
 + AS also supervised 5D.  
 AS=Assistant Secretary, PC=Principal Clerk, 1C=First Class Clerk, 2C=Second Class Clerk.

The Treasury in 1920

Division	Function and Departments Served	Staff			
		PAS	AS	P	AP
First*	Home Finance	1	-	4	2
Second*	Overseas Finance	-	1	2	2
FE*	Financial Enquiries	-	1	-	1
Third#	Agriculture & Fisheries, Board of Trade, Arts & Science	-	1	2	1
Fifth#	Services Departments	-	1	2	1
Sixth#	Foreign Office, Royal Duchies, Law Courts, Post Office	-	1	3	2
Seventh#	Education, Health, Labour, Pensions	1	-	2	1
Eighth+	Superannuation	-	1	2	2
Ninth+	General Service & Establishments	1	-	2	2
Tenth+	Services Departments Personnel	-	1	2	1
Eleventh+	Other Establishments	-	1	2	1
Twelfth+	Other Establishments	-	1	2	1

Table 2

Notes

\* Finance Divisions directed by Controller of Finance.  
 # Supply Divisions directed by Controller of Supply Services.  
 + Establishments Divisions directed by Controller of Establishments.  
 PAS=Principal Assistant Secretary, AS=Assistant Secretary, P=Principal, AP=Assistant Principal.  
 Not included in the table are Treasury staff serving as Private Secretaries, in Offices abroad, on secondment to other Departments, etc.

Private Secretary, the Chancellor two, one senior to the other, drawn initially from the lowest grade, that of Assistant Principal. These posts, particularly those attached to the Chancellor, were traditionally regarded as ones in which very bright young men had a chance to learn quickly and to shine. During our period, the occupants of these posts tended to be a little more senior, and to retain their positions a good deal longer, than had been the case before the war; this tended to add to the prestige and influence of these posts.

### Organisation of work

The largest category of work in the Treasury consisted of problems posed from the outside, mostly arriving in the morning post. From this arose the custom, open to much misinterpretation, of senior civil servants not arriving for work until about ten o'clock, to give the clerical staff time to open and sort the morning delivery. It was the task of the Registry to form files, or attach a letter to an existing file, and pass the file to the appropriate junior, usually an Assistant Principal. This officer, being a member of a training grade, had no power to commit the Treasury, but in many cases he would draft an appropriate response for his Principal's approval. If the matter were more complex, the junior would take the matter as far as he could, including accumulating precedents and other related documents. A really difficult problem would be taken up with the Principal's superior, and so on. Where a matter was of sufficient importance as to require Ministerial decision, a senior official would be concerned with briefing the Minister, obtaining a decision, and carrying it out. An interesting account of an occasion on which this proved very difficult will be given later in this chapter.<sup>1</sup> Alternatively, a request for information and advice might originate at a high point in the chain, rather than the advice being offered from below.<sup>2</sup>

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1. See below, p. 68.

2. Heath, The Treasury, pp. 145-7; private information to the author.

In the Finance Department, much of the work originated within the Department, and not in response to a stimulus from outside. Each officer had areas of duty, and within this area it was his responsibility to foresee problems and raise them. However, it has been suggested to me that certain very sensitive areas of policy were excepted from the normal methods of procedure. The Treasury was apparently 'security conscious' long before many other government Departments, and matters of high policy were confined to three or four of the most senior officials in Finance, the Controller, his Deputy, and sometimes the Assistant Secretaries who headed 1D and 2D (the second and third posts were synonymous during our period).<sup>1</sup> This is certainly borne out by the documentary evidence, where in matters of financial policy the great bulk of the written material is from these officials, and indeed primarily from the Controller and his Deputy. What seems to have happened frequently is that the senior officials kept the main matters in their own hands, but brought in more junior colleagues on specific points. For instance, in the Gold Standard files all the written Treasury memoranda submitted to the Chancellor, apart from Hawtrey's work, is by the Controller; but two more junior officials were asked to write a note on a particular aspect, the proposed credit 'cushion', for Niemeyer, and he seems to have used this material in presenting a paper of his own on the subject.<sup>2</sup> It is, however, impossible to be completely dogmatic about this question of juniors' work, because there is evidence that when the files are 'stripped' of excess material before being sent to the Public Record Office for preservation, many handwritten drafts on which the final typed versions of letters or memoranda are based are destroyed, if the final version is on the file.<sup>3</sup> It is often hard, therefore, to be sure whether the person who signed the final version of a letter or memorandum had drafted it himself or not. But the evidence of such factors as style, mode of address, and so on, together with the

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1. Information given to the author in conversation with Sir Henry Wilson Smith.
  2. P.R.O., T.172/1499B, note by Niemeyer on the proposed 'cushion', undated.
  3. Private information to the author.

observations of contemporaries, tends to support the idea that much of the work even of drafting memoranda was done by the most senior men, where the matter was one of high policy.

The work of the Financial Enquiries Division seems to have occupied rather a special position in this system. The Division was created by Sir John Bradbury in 1915, as a Statistical Section, and its first Director was Hartley Withers, brought in specially for the purpose. After the war, in 1919, Withers left the Treasury, and the character of the Section changed somewhat; it apparently became primarily a vehicle for Ralph, later Sir Ralph Hawtrey. The implication is clearly that the Treasury structure could not easily absorb an able economist in a normal way, and so the problem was solved by giving him a unique position. During the period that Bradbury and Blackett were in charge of Finance, Hawtrey's advice seems to have been asked on many occasions, and volunteered on many more; my impression, which has been confirmed by others, is that in Niemeyer's time the proportion of volunteered information grew sharply relative to requested papers. Perhaps this is not surprising, in view of the observed and observable rigidity of Niemeyer, particularly in regard to problems of deflation and interest rates, and Hawtrey's opposition to high rates in a period of depression.<sup>1</sup>

Matters of Treasury concern which were of sufficient importance eventually came to one of the Treasury ministers, the Chancellor of the Exchequer or the Financial Secretary. The role of the Financial Secretary seems to have changed somewhat during the First War. One Treasury official has written,

"In the piping times of peace all important questions came to the Financial Secretary and through him to the Chancellor of the Exchequer; in war-time he was largely short-circuited and left to do the housework."<sup>2</sup>

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1. See, for example, P.R.O., T.176/5, memo. by Hawtrey, 5 Mar., 1923.
  2. Sir Andrew MacFadyean, Recollected in Tranquillity (London: Pall Mall Press, 1964), p. 54.

After the war, this tendency persisted, and during our period the Financial Secretary's role seems to have been an inferior and somewhat invidious one, especially when he and the Chancellor were not on good terms personally. He was responsible for the 'hack work' concerned with the Budget, after the main lines of policy had been laid down by the Chancellor in consultation with the senior officials and with other members of the Government; this mostly consisted of formal approval of Departmental estimates. He was also responsible for settling disagreements over Establishments questions when these could not be solved at the official level.<sup>1</sup>

The Chancellor thus retained in his hands power to take decisions in all important matters of policy; the extent to which he exercised his authority, whether he was a strong or a weak Chancellor, had a profound impact on his officials, and on the work and atmosphere in the upper echelons of the Treasury. He was assisted by two Private Secretaries. During the inter-war period a remarkable continuity of holders of these offices was maintained; one man held the office from 1920 to 1930, and was succeeded by his deputy, who in turn was followed by his deputy, who was senior private secretary from 1933 to 1938.<sup>2</sup> This continuity enhanced the position which these men held, which would in any case have been one of considerable influence. They tended to be the channel through which other Departments, particularly the Departments, such as the Board of Inland Revenue or of Customs and Excise, who had a special relationship with the Treasury, communicated directly with the Chancellor. Quite often this led to the Private Secretary being a buffer between the Chancellor and his less welcome visitors. When Parliament was sitting, the Private Office staff would work with the Chancellor in the Treasury in the morning, and then go with him to the House of Commons in the afternoon, taking with them in despatch boxes any papers which were

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1. Heath, The Treasury, pp. 80-96; private information to the author.

2. Unpublished Treasury documents.

likely to be needed. As a result, there were frequent occasions when the Private Secretary was the only Treasury official in the House, and was frequently asked for advice by the Chancellor. This tended to increase the influence of these officials, and they frequently came to be on such good terms with their master that they were often asked to write manuscript notes on the submissions of senior officials, particularly where the problem had political implications.<sup>1</sup>

### Record-keeping

The way in which the records of this small but complex organisation were kept went through a drastic overhaul in June 1920, soon after the structural changes. Before this reorganisation, Treasury Board papers, which constituted the vast bulk of Treasury material, formed an enormous single class of papers. Within this category, a numbered file was created each year for each letter, group of letters or memoranda on a particular subject; the number of a file had no logical significance for classification purposes. These two practices, of having all subjects in the same filing class, and having a new file for each year, led to considerable confusion and, apparently, loss.<sup>2</sup> In addition to the Treasury Board papers, two other important categories of records existed: the papers of the Chancellor's Office, and the Budget papers. The first class contains much of the significant material for studies of policy, in particular the memoranda by Treasury advisers on many important topics. The second contains all the relevant material on the preparation of the Budget, deputations from industrial interests, drafts of the Budget Speech, notes on Parliamentary amendments and the passage of the Finance Bill, and so on. Both these classes operated on a similar principle to the Treasury Board papers, that is a file was normally created for each subject for each year.<sup>3</sup>

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1. Private information to the author.
  2. Heath, The Treasury, pp. 143-4.
  3. Ibid., pp. 146-7.

The classes of Budget papers and Chancellor's Office papers retained their form and character throughout our period, but major changes were made in the way in which the former Treasury Board papers were organised. Any file which was in use at or created after June 1920 was classified under one of five headings: three of these corresponded to the areas of responsibility of the Controllers, that is Supply, Establishments and Finance; a fourth covered matters in which responsibility was shared among two or three Departments, and a fifth dealt separately with superannuation problems and pension rights within the Civil Service as a whole. The practice of having each file cover no more than a year was discarded, and this combined with a slightly more logical numbering system made it somewhat easier to keep related material together. The initial file numbers were allotted in chronological order, but if the material in a particular file became too bulky, a second file would be created with the same file number and an indication that it was a continuation.<sup>1</sup> Thus in the Finance section, file number 7528 denotes the material collected during the lifetime of the Chamberlain/Bradbury Committee in 1924-5; within this group, three files, numbered 7528/01/1, 7528/01/2 and 7528/01/3 deal with the discussions and draft reports of the Committee, three further files, 7528/02/1, 7528/02/2 and 7528/02/3 deal with the minutes of evidence, and another file, 7528/03, contains Press comments on the Committee's Report. This form of organisation helps to keep papers on a particular subject together, but it can make subjects which have not been well described difficult to trace, since no system of cross-referencing was used.<sup>2</sup>

This, then, was the way in which Treasury records were kept. However, the records which are available to the historian are by no means a complete set. The reasons for this are manifold, and the selection of material for preservation has taken place on at least three levels. Firstly, not all the material on a particular

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1. P.R.O. Catalogues and the documents referred to.

2. P.R.O., T.185/2.

subject was retained in the file at the time. To begin with, it has been suggested that the informal habits of the pre-war Civil Service largely persisted until the Second World War, and that as a result less written material was created. Secondly, and linked to this, committee sessions in camera tended not to be recorded; this is borne out at any rate by the minutes of the Cunliffe Committee, which merely contain a note of the date of meetings at which the reports were discussed.<sup>1</sup> Furthermore, there is some evidence that Sir Warren Fisher, Permanent Secretary from October 1919, was personally inclined to dispose of superfluous material. Where a policy matter concerned both the Treasury and the Prime Minister's Office, Fisher was apparently inclined to leave record-keeping to the latter, and destroyed his own copies of documents.<sup>2</sup>

The completeness of the records is further affected by the fact that in the inter-war years, as in the years before the war, rules about what public papers an official might take with him when he left office were less well-defined and stringent than in modern times. As a result, much material which would today be kept in public files was then retained by the officials themselves. The fate of these papers has varied. Sir Warren Fisher is believed to have destroyed all his official papers on leaving office.<sup>3</sup> Sir Basil Blackett's papers are still in private hands, and are not available for inspection. The papers of Sir John Bradbury and Sir Otto Niemeyer have been deposited in the Public Record Office, as have those of Sir Frederick Leith-Ross, a junior official in our period; in some instances these papers contain material which is apparently not to be found elsewhere.

The officials were not the only sinners in this respect; politicians, too, had considerable hoards of private papers, many of them removed when the men left office. However, of the Chancellors of our period only Snowden is believed to have done this to any extent. Bonar Law's papers contain very little of use about

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1. Private information to the author.

2. Ibid.

3. Ibid.

the last part of his time at the Treasury; Austen Chamberlain's have virtually nothing, and neither have Baldwin's; Churchill's papers are not yet available for inspection. Snowden had a reputation for taking large quantities of documents with him and destroying many that were unfavourable.<sup>1</sup>

Finally, files and records which survive initially go through a weeding process before being transferred to the Public Record Office. Individual files are stripped of duplicate material: where a handwritten draft put forward by a junior is modified and approved by his senior and passed for typing, and the handwritten draft and the carbon copy of the final version both remain on the file, it is the handwritten version which is stripped. Personal items, such as invitations and personal letters, are also stripped. In some circumstances, press cuttings and excerpts from Hansard are also removed. Finally, certain categories of file are destroyed altogether. These include files prepared for replies to Parliamentary questions, which are usually prepared from the subject files; any unique material from a question file is normally removed to the subject file before the question file is destroyed.<sup>2</sup>

#### Relations with other Departments

The relationships which the Treasury had with other Government Departments can be considered in three main categories. Firstly, the Supply divisions were in constant touch with the Departments about their estimates and expenditure, and these contacts were mainly formal ones at the official level, consisting of either an exchange of letters, or occasionally formal interviews. Secondly, there were the relationships with the Departments very close to, and in a sense dependent upon, the Treasury, notably the Boards of Customs and Excise and Inland Revenue. These Departments worked directly with the Chancellor as far as possible, through the

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1. Information to the author from the Treasury.  
2. Ibid.

Private Office. Thirdly, there were contacts about matters of mutual interest with Departments of equal status, such as the Foreign Office; these were primarily the province of the Finance divisions.

As far as the formation of policy was concerned, the contacts in the third category were of greatest importance. The first kind of communication tended to be at a very low level; since the Treasury for this kind of business was not an executive Department, questions of policy tended to be settled in the Department concerned, and where arguments arose with the Treasury, serious disagreement tended to be settled at Ministerial level, in Cabinet if necessary. This tended to be the area in which the Treasury's 'saving candle-ends' approach to economy was most evident, and it is perhaps not surprising that relations between the Treasury and the new Departments created during the war were often less than amicable, in view of the fact that these Departments tended to be 'big spenders'. The Ministry of Reconstruction, in particular, had a number of brushes with the Treasury at several levels. Addison had protracted discussions with the Treasury about reconstruction expenditure in early 1918, and he crossed swords with Sir John Bradbury, who was most unwilling to give any concessions on expenditure without having details of how it was to be spent.<sup>1</sup> There were further clashes when, in the spring of 1919, Addison moved to the Local Government Board to supervise the setting up of the Ministry of Health. Addison became exasperated with what he regarded as the penny-pinching attitude of the junior Treasury officials, and alleged that his Director-General of Housing resigned his post largely on this issue.<sup>2</sup>

The 'new' Departments were singled out for special treatment in the 'Economy' campaign of summer 1919. This episode was one in which Sir Warren Fisher, at the request of the Prime Minister, took a principal role. Lloyd George's secretary wrote to Fisher asking him to make a special enquiry into possible economies.

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1. P.R.O., T.170/125.

2. Lloyd George Papers, F/1/5/9, Addison to Lloyd George, 27 Feb., 1919.

Fisher sent a circular letter on the subject to all Departments, and replied to the Prime Minister telling him of the action he had taken, and suggesting some areas in which economies would be possible. His chief suggestion was that all Departments which were war-time creations should be "disbanded immediately and not continued"<sup>1</sup> and it seems not implausible that the vehemence of Fisher's antipathy was related to the difficulty which the Treasury had in bringing expenditure in these Departments under control.

Relations between the Treasury and the 'client' Departments, the Boards of Customs and Excise and Inland Revenue, are much less well documented above the purely formal level. This is primarily because these Departments were rather sensitive about their technical equality with the Treasury, and their contacts tended to be with the Chancellor through the Private Office, rather than with the main-line administrators.

The third kind of contact, the most important for our study, was that between the Treasury, usually the Finance Department, and other Departments of equal status about matters of common interest. These relationships were of course at varying levels, and took different forms. Relations with the Foreign Office, for instance, tended to be of two kinds; one involved the Foreign Office simply as a kind of Post Office for communications to the Treasury from official sources abroad; the other involved discussion about policy problems in which both were concerned.

Relations with the Foreign Office at this time seem to have been extremely cordial. During the long period of negotiation over inter-Allied debt, and particularly over the funding and payment of the American loan, a great deal of correspondence passed between the two offices. It was the practice of the Treasury to communicate with the British Ambassador in Washington through the Foreign Office, and for that Office to ask for Treasury advice when queries were received from the Ambassador on financial problems. An example of this is an episode in the autumn

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1. P.R.O., T.171/155, Fisher to Lloyd George, 3 Sep., 1919, *underlining in the original.*

of 1922, when the Americans were urging Britain to take steps to fund the war debts she owed to America. The U.S. Embassy in London had written to the Foreign Office to communicate the text of the Funding Act which Congress had just passed; Sir Auckland Geddes, the Ambassador in Washington, had telegraphed requesting a statement of the policy of the Government on funding. Sir Eyre Crowe, Permanent Secretary at the Foreign Office, wrote to Blackett asking him "to draft a telegram (or letter or despatch or whatever it is)"<sup>1</sup> in reply to Geddes. Blackett answered that he thought the most appropriate way to communicate Government policy in this matter would be in the form of a reply to the U.S. Embassy, rather than through Geddes. He included a draft reply. The Foreign Office took his advice, and the letter was duly sent.<sup>2</sup>

This example is typical of the kind of communication which took place between the two Departments. As far as policy matters were concerned, it was almost entirely on a very senior level, as in this example; virtually all the written material sent from the Foreign Office to the Finance Department of the Treasury was addressed either to Blackett or Niemeyer, or very occasionally to Fisher, by name. On the whole, the relationship seems to have been a very harmonious one; it is noteworthy that the Foreign Secretary was Chamberlain's strongest ally in the Cabinet in his championship of Blackett's 'Beau Geste' plan to solve the inter-Allied debt problem.<sup>3</sup>

The Cabinet Office does not fit easily into any of the three categories outlined, but probably it is most appropriate to place it with other Departments of equal status, like the Foreign Office. In fact, formal communication between the officials of the two offices was relatively rare; the Treasury had, as one of the 1919 innovations, an official permanently seconded to the Cabinet Office, and it was his duty to look after Treasury interests there. The first occupant of the post, Leith-Ross, has commented:

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1. P.R.O., T.160/557/6, Crowe to Blackett, 17 June, 1922.
  2. *Ibid.*, Blackett to Crowe, 19 June, 1922.
  3. See below, p. 234.

"One of the duties of the new post was to keep a special watch on all proposals for new expenditure and to make sure that the Chancellor of the Exchequer had had sufficient time to pronounce on their financial implications before they were submitted to the Cabinet for decision."<sup>1</sup>

Treasury Procedure: an example

At this point it would perhaps be appropriate to include a detailed example of Treasury procedure; the example is atypical in the sense that the 'history of the case' is preserved in detail, that it concerns only the senior officials (although that is only atypical of Treasury work as a whole, and is probably typical of matters of policy) and that it involves the relationship between the Cabinet Office and the Treasury; but as far as it is possible to judge the general form of the Treasury treatment is typical.

The episode occurred in July 1921, when alarm was once again being expressed over the high levels of Government expenditure, just before the Geddes Committee was appointed. An organisation called the Independent Parliamentary Group, whose chairman was Horatio Bottomley, wrote to the Prime Minister with some suggestions about the economic situation.<sup>2</sup> Lloyd George's secretary, A.J. Sylvester, was instructed to acknowledge the letter and to pass it to the Treasury for their observations.<sup>3</sup> The letter was given to Niemeyer, the Deputy Controller of Finance, by Grigg, the Chancellor's Private Secretary; Niemeyer noted that he was writing a memorandum, and then passed the letter to Sir Robert Scott, Deputy Controller in the Establishments Department of the Treasury, for his comments. Scott returned the letter and his remarks to Blackett, the Controller of Finance. Niemeyer also submitted his comments to Blackett, and asked for Blackett's own views. Blackett combined his own views and Niemeyer's into a single Finance Department memorandum, and submitted it and the Establishments document to Fisher, the Permanent Secretary, suggesting that Upcott, the Principal Assistant Secretary

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1. Sir Frederick Leith-Ross, Money Talks (London: Hutchinson & Co., 1968), p.53; Leith-Ross was transferred to the Cabinet Secretariat in January 1920, but only remained a few months.
  2. P.R.O., T.172/1391, Major Lowther to Prime Minister, 9 July, 1921.
  3. Ibid., Sylvester to Chancellor of Exchequer, 15 July, 1921.

in the Supply Department, should be asked to combine the views of all three sections into a draft reply to the Independent Parliamentary Group. Rowe-Dutton, Fisher's Private Secretary and an Assistant Principal at the time, noted that Fisher would be glad if Upcott would do this. Upcott's draft was returned to Fisher, and was amended in Rowe-Dutton's hand: the implication is that the changes were Fisher's, but of course this cannot be definitely asserted. The draft was then sent back to the Prime Minister's office, for typing and for signature by Lloyd George.<sup>1</sup>

This example is atypical in the sense that the stages through which the letter and its reply went are better documented than is common: the file is a fascinating hotchpotch of notes written on the back of other men's memoranda, scribbled notes, and so on. But other more fragmentary evidence suggests that it is typical in its display of the way in which problems presented to the Treasury from outside were handled.

#### Treasury relations with the Bank of England

Up to this point, except when giving detailed examples, it has proved possible to discuss Treasury structure and procedure in a formal sense without being particular about the conduct of individuals, which might have detracted from the generality of the analysis. But where the Bank is concerned, the situation is quite different, for during our period, to a very great extent, Montagu Norman, the Governor of the Bank from 1920 to 1946, was the Bank. As a result, relations between the Treasury and the Bank of England during the inter-war period depended on the personal relationships between the Chancellor and the chief officials, and the Governor. Generally, the tone of the correspondence passing between Norman and the Treasury was cordial. The main point of conflict

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1. P.R.O., T.172/1391, the draft reply was typed and despatched on 25th July, 1921.

came over interest rates. During the reconstruction period, while Treasury Bills were still available on tap, Treasury Bill rates were the effective arbiter of market rates, and Bank Rate was rendered ineffective by the ability of the joint-stock banks to let Treasury Bills run off without renewal, rather than having to go to the Bank for accommodation, when they became short of liquid funds. Thus there are several instances during late 1919 and early 1920 of Norman urging the Chancellor to raise interest rates, often unsuccessfully, and at least on one occasion this lack of success was due to Lloyd George's intervention.<sup>1</sup> This difficulty reached its height in the spring of 1920, when the matter became the subject for formal debate,<sup>2</sup> and interest rates were raised to penal heights in April 1920 in an attempt to curb the post-war boom.

After the Treasury Bill tap issue ceased, the pre-war practice of leaving the matter of the Bank Rate entirely to the Bank of England was resumed, and during the remainder of the inter-war period it was a constant assertion of Controllers of Finance that Bank Rate changes were the sole responsibility of the Bank, and that there was no practice of consultation between the two offices. Indeed, there is a document in the files which gives the views of several Permanent Secretaries on the subject, all agreeing that the practice of consultation which grew up during wartime was quite outside normal peacetime practice, and that after the reconstruction period the pre-war practice was resumed. For instance, Bradbury is quoted as saying:

"There has never so far as I know been any suggestion that the Treasury has any official concern with the Bank Rate..."<sup>3</sup>

and Niemeyer, writing in 1929, is quoted as saying:

"There never has been, either in my time or previously, any 'consultation' between the Bank of England and the Treasury in any shape or form with regard to changes in Bank Rate."<sup>4</sup>

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1. Sir Henry Clay, Lord Norman (London: Macmillan & Co., 1957), p. 124.
  2. P.R.O., T.172/1384, Dear Money papers of Feb., 1920.
  3. P.R.O., T.176/13 pt. 1.
  4. Ibid.

As far as one can tell, Churchill was the only Chancellor in our period to question this arrangement; this first arose very early in his period of office, when Norman raised the Bank Rate to prepare for the return to the Gold Standard. It was not, as we have seen, the practice of the Governor to consult the Treasury before making such a change, but he did usually warn the Chancellor a little in advance, on the day of the change. On this occasion, Churchill was away, and Leith-Ross, who was deputising for Niemeyer while the latter was in Geneva, promised to give Churchill the Governor's message as soon as he returned. Churchill was most aggrieved that he had not been consulted, and Leith-Ross wrote to Niemeyer telling him of the incident and asking for his comments. Niemeyer replied:

"Winston will never realise that he is not Governor of the Bank...As regards Parliament, if it arises, Winston is absolutely entitled to say that it has never been the practice for the Bank of England, an independent bank fixing its own discount rate, to consult the Treasury, that it did not do so on this occasion, and that there is no reason why it should have."<sup>1</sup>

During the reconstruction period, Norman also took a leading part in the move to begin funding the National Debt and repaying the floating debt, urged on by the difficulty which the large volumes of the latter had led to in attempts to control the money market. In April 1920 he submitted a scheme to Blakett for a forced loan from income tax payers, for the purposes of repaying debt, which would, one supposes, have brought him the astonished support of the Capital Levy proponents in the Labour Party.<sup>2</sup> The scheme was rejected as being politically impossible.

Norman's attitude to the funding of debt, and also his determination to stabilise the international financial situation as a necessary preparation for returning to the Gold Standard, made him a fervent supporter of the policy of sending a funding mission to the United States, to make arrangements for funding

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1. Sir Frederick Leith-Ross, Money Talks, p. 95.  
2. Sir Henry Clay, Lord Norman, pp. 117-8.

the obligations incurred by Britain during the war. In this connection, there is an interesting example of the high-minded tone which Norman sometimes adopted in some correspondence in June 1922, about interest payments due on the American loans. Part of Norman's letter to Blakett on the subject reads:

"The Court of Directors have received an intimation of your intention, at an early date, to withdraw gold from the Bank in order to pay interest on the demand obligations due by this country to the United States Government...They further understand that...a request [for funding] has been put forward by the Foreign Debt Commission of the United States. They trust that His Majesty's Government will comply with this request."<sup>1</sup>

However, only a small part of the discussions between the Treasury and the Bank took place on paper. Because Norman personified the Bank, and because he tended to do things on a personal basis and as secretly as possible, most of the contact between the two institutions took place on a personal level. It was Norman's custom to call at the Treasury, either alone or with the Deputy Governor, every weekday except Friday, at about 5.30 in the evening, on his way home. He would go first to see the Chancellor's Private Secretary, who would tell him if the Chancellor were free to see him; then he would go and chat to the Controller of Finance and other senior officials; finally he would go to the Chancellor's office if necessary and if the Chancellor were available - this tended to be once or twice a week. It fell to the Chancellor's Private Secretary to warn all concerned that the Governor was on his way. Sir Henry Wilson Smith, who was a Private Secretary for some years in the 'thirties, remembers being able to give a good early warning to his colleagues of the Governor's mood, because he could always deduce it from the manner in which Norman addressed him. Normally the Governor would call him "Wilson Smith"; if he were in a particularly benign mood he would address the Private Secretary as "Wilson"; but Sir Henry knew that if Norman addressed him as "Smith", then "all hell would be let loose!"<sup>2</sup>

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1. P.R.O., T.160/557/6, Norman to Blakett, 22 June 1922; a copy was sent to the Chancellor.
  2. Information given to the author in conversation by Sir Henry Wilson Smith.

This close and frequent contact implies a good deal of co-operation between the two institutions. But the very closeness and personal nature of the contact has resulted in a lack of documentation of the relationship, which makes more detailed examination very difficult.

### Treasury Personnel

The formal structure and organisation of the Treasury is, of course, only a part of the subject matter of this chapter. Equally important is the way in which the organisation was operated by the men who staffed it, and we shall now turn to a brief study of this aspect of the problem. As we have already seen, at the end of the war there were three joint Permanent Secretaries to the Treasury, Sir John Bradbury, Sir Robert Chalmers and Sir Thomas Heath. Chalmers retired at the end of the war, and Heath left for a post outside the service soon afterwards: Sir John Bradbury, who had been in charge of the financial side of the Treasury during the war, was therefore the obvious choice for the post of Permanent Secretary under the 1919 reorganisation scheme. However, it was decided that he should go to the Reparations Commission as the permanent British representative, and Sir Warren Fisher, previously Chairman of the Board of Inland Revenue, took the post instead.

It was, as has been noted, intended that the Permanent Secretary should exercise co-ordinating powers, leaving the chief burden of responsibility for the various Departments in the hands of the Controllers. This intention was reinforced as far as the Finance Department was concerned by Fisher's personal inclinations. He remained Permanent Secretary until 1939, and was noted for his overriding interest in the questions of Service organisation and staffing; the authoritative biographical article on Fisher contains not a single reference to the singularly intractable economic problems experienced by this country during his time at the Treasury.<sup>1</sup> During the period from 1919 to 1925, the only point at which he

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1. Sir Horace Hamilton, "Sir Warren Fisher and the Public Service", Public Administration XXIX (1951), notes 12 and 13 on page 10.

figures with any prominence in a major matter of economic policy is in late 1919, immediately after he joined the Treasury, when he is revealed as a staunch upholder of the ideas of financial orthodoxy common in the Treasury and among economists at the time.<sup>1</sup>

When Fisher became Permanent Secretary, Basil (later Sir Basil) Blackett was appointed Controller of Finance. He occupied this post for three years, and was succeeded by Otto, later Sir Otto, Niemeyer, who remained in the Treasury until 1927. Thus during the period 1918 to 1925 there were three men successively in charge of Finance, Sir John Bradbury until October 1919, Sir Basil Blackett until the late summer of 1922, and Sir Otto Niemeyer until 1927. In addition, Sir Warren Fisher held an overall responsibility for co-ordination. During the same period, there were no fewer than seven Chancellors of the Exchequer. Of these, only one, Sir Austen Chamberlain, held office for more than eighteen months, although Bonar Law had been in office for some time by the end of the war, and Snowden and Churchill held office for longer periods after 1925. Thus during the years from 1918 to 1925 there was a single Permanent Secretary at the Treasury, and three different financial advisers, all of whom were career civil servants who had been in the Treasury most of their working lives. The Chancellors of the period, in contrast, held office for an average of one year each, and were in the main without experience of the Treasury. Bonar Law (December 1916 - January 1919), Horne (April 1921 - October 1922), Neville Chamberlain (August 1923 - January 1924), Snowden (January 1924 - October 1924) and Churchill (November 1924 onwards) had never served in the Treasury before; Baldwin (October 1922 - August 1923) had previously been Financial Secretary to the Treasury from 1916 to 1920, and Sir Austen Chamberlain (January 1919 - April 1921) had previously been Chancellor from 1903 to 1906. Moreover, while Bonar Law, Churchill and Sir Austen Chamberlain were already

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1. P.R.O., T.171/155, Fisher to Lloyd George, 3 Sep., 1919.

senior Ministers when they went to the Treasury, for Neville Chamberlain and Snowden it was their first experience of an office of Cabinet rank, and Horne and Baldwin had not previously been prominent Ministers.<sup>1</sup> Thus the period 1918-1925 was one in which the Chancellors were often inexperienced, and always short-term appointments; while the officials were career civil servants with both wide experience and security of tenure, and provided the continuity absent at Ministerial level. We shall now examine in a little more detail the personalities of the men concerned within the Treasury in the formation of economic policy during our period.

The civil servant in charge of the Finance side of the Treasury until autumn, 1919, then, was Sir John Bradbury. He entered the Treasury straight from Cambridge, and followed the traditional Treasury career of a bright young man by becoming private secretary to Asquith when he was made Chancellor in 1905. By 1908, when he was 36, he had become head of one of the six pre-war divisions of the Treasury. He helped Lloyd George to frame his Budget of 1909, and in 1911 became one of the first Insurance Commissioners, while retaining his post at the Treasury. In 1913, he became joint Permanent Secretary, until 1919, when he went to the Reparations Commission. He remained in that post until 1926, when he retired. His chief claim to public fame came from his designs for small currency notes at the outbreak of the war; these notes, known as 'Bradburys', made Sir John's name a household word.<sup>2</sup>

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1. A.J.P. Taylor, English History 1914-1945 (Oxford: Clarendon Press, 1965), pp. 640-5. The term 'orthodox' is used frequently in this work to describe the opinions held by the majority of men in high positions in the City and in public life during the period following the First World War. The ideas and views of Sir John Bradbury were so typical of those of other men in these spheres that his opinions have been taken as embodying the orthodoxy of the period, and thus for a definition of the term 'orthodox' for the purpose of this work the description of Sir John Bradbury's views on pp.88-90 should be consulted.
  2. Dictionary of National Biography (London: O.U.P., 1959), Supplementary volume for 1941-50, pp. 98-9.

The picture of Sir John Bradbury which emerges from the Treasury files and from the evidence submitted by him to various Committees is of a man whose opinions are typical of many men at the Treasury and in the City during our period, so that in some sense he embodies the financial orthodoxy of the day. Bradbury believed first and foremost that the Gold Standard was the most important element in Britain's success both in international finance and in business during the pre-war period. He believed also that the way in which the money market and the other institutions of the City of London had been run before the war was the best way in which they could be run and that these institutions and mechanisms, including an effective Bank Rate and a powerful and independent Bank of England, were essential to the prosperity of business in this country and abroad, and thus to the economic life of the nation. Implicit in these judgements was a laissez-faire view of the economic functions of the State, and he therefore felt that it would be an inestimable benefit to the economic prosperity of the nation if the Government were to withdraw as quickly as possible from those spheres of economic activity which it had been obliged by the exigencies of war to enter, and not to take a more active part in the operations of the money market than was made necessary by the need to manage efficiently the great load of government debt.<sup>1</sup> He was an implacable enemy of inflation, and tended to adhere to the classical economic views about the necessity for reductions in wages in times of depression, in order to bring costs and prices down, and thus stimulate demand.<sup>2</sup>

Sir John seems to have combined a rigid personal honesty with considerable doubts about the ability of politicians to pursue a long-term goal, and maintain

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1. P.R.O., T.160/197/7528/01/2, Second Draft Report of the Committee on the Currency and Bank of England Note Issues (the Bradbury Committee) and Sir John Bradbury's proposed amendments, Sep., 1924.
2. P.R.O., T.185/1, minutes of evidence of the Committee on Currency and Foreign Exchange after the War (the Cunliffe Committee), 3rd meeting, Feb. 1918, and 9th meeting, March 1919.

their integrity in this connection in the face of political temptations. Keynes has related a revealing incident, from the period just before the Americans entered the war in 1917, when British credit in New York had reached its nadir:

"Chalmers and Bradbury never fully confessed to Ministers the full extent of our extremity when it was actually upon us, though they had of course warned them, fully but unavailingly, months beforehand of what was coming. This was because they feared that if they emphasised the real position, the policy of the peg might be abandoned, which they thought would be disastrous. They had been brought up in the doctrine that in a run one must pay out one's gold reserve to the last bean...I recall an historic occasion a day or two after the formation of the second coalition government at the end of 1916. The position was very bad. We in the Treasury were all convinced that the only hope was to pay out and trust that the drain would suddenly dry up as it had on previous occasions. But we had no confidence in the understanding of Ministers. Chalmers went...to report to the newly-formed War Cabinet. 'Well, Chalmers, what is the news?' said the goat [Lloyd George]. 'Splendid', Chalmers replied in his high quavering voice, 'two days ago we had to pay out \$20 million; the next day it was \$10 million; and yesterday it was only \$5 million.' He did not add that a continuance of this rate for a week would clean us out completely, and that we considered an average of \$2 million very heavy. I waited nervously in his room, until the old fox came back triumphant."<sup>1</sup>

According to the official minutes of that Cabinet meeting,

"Sir Robert Chalmers...[was] able to congratulate the War Cabinet on the fact that the amount required daily had dropped in the last two days from 17 million dollars - first to 8 million and then to 4 million dollars."<sup>2</sup>

Another incident in which Bradbury's distrust of ministerial integrity is evident occurred over the return to the Gold Standard. In his account of the famous dinner party at which Churchill invited Bradbury and Niemeyer to argue the matter out with Keynes and McKenna, Grigg reports:

"Bradbury made a great point of the fact that the Gold Standard was knave-proof. It could not be rigged for political or even more unworthy reasons. It would prevent our living in a fool's paradise of false prosperity..."<sup>3</sup>

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1. J.M. Keynes, Activities 1914-1919: The Treasury and Versailles (London: Macmillan and Co., 1971), Collected Writings of John Maynard Keynes XVI, ed. E. Johnson, p. 211.
  2. P.R.O., Cab. 23/1, 9 Dec., 1916, quoted in Keynes, op.cit., p. 212.
  3. Grigg, Prejudice and Judgement, p. 183.

On a more personal level, Bradbury, despite his rather narrow and rigid outlook, seems to have been admired and respected by his contemporaries. One colleague describes him as a typical product of Manchester Grammar School, a shrewd Lancastrian, proud of his origins and retaining his Lancashire accent, popular in the City and with many connections there.<sup>1</sup>

Another colleague, Sir Andrew MacFadyean, who was Secretary to the British Delegation to the Reparations Commission while Bradbury was British Representative on the Commission, has left a fuller portrait of the man, which adds valuable colour to the two-dimensional picture which emerges from the files:

"Within his own province he had, as Keynes had, a mind like a razor blade, but relatively his province was a narrow one. I think he loved rhetoric. I doubt if he cared much about literature in general, and I am sure he knew nothing about art. He was one of the world's worst bridge players, and an even worse driver! He was an introvert, and therefore self-centred. He was quite passionately fair, and nobody and nothing would have induced him to sacrifice a point of principle. He was, as he abundantly proved in the Reparations Commission, a born debater. Two remarks which he made will suffice as examples. When the Germans were adjudged to be in default over timber deliveries, which led to the occupation of the Ruhr, he denounced the decision with the scathing observation that history recorded no similar use of timber since Troy fell to the stratagem of the wooden horse. On another occasion, when the Commission seemed slow to give the Germans what the Treaty accorded them 'a just opportunity of being heard', he reminded his colleagues that this was different from 'an opportunity of just being heard'....He was an inveterate cigarette smoker...On retirement from official duties he was elected a director of The Imperial Tobacco Co., presumably, as Keynes said, as their largest customer.

I do not think he liked foreigners; they were all 'foreign bodies' to him, though I hasten to add that he never allowed that to deflect his judgement...He was capable of flying into a rage, and once stalked out of a meeting of the [Reparations] Commission...He quite rightly regarded his function as largely judicial and was unwilling to accept orders from the Treasury or even the Chancellor of the Exchequer. One result was that a letter of resignation was permanently domiciled in his breast pocket; the grenade never quite went off! The conclusion of the whole matter is that he was a very human person, a delight to work with or for..."<sup>2</sup>

Sir John left the Treasury in October 1919, but throughout his term as British representative on the Reparations Commission he was in fairly close touch with his erstwhile colleagues at the Treasury. When Philip Snowden, who was then Chancellor,

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1. Private information to the author.

2. MacFadyean, Recollected in Tranquillity, pp. 74-5.

set up a Committee in the summer of 1924 to examine the Cunliffe Report in the light of ensuing experience, Bradbury became a member, and when Sir Austen Chamberlain became a member of the new Conservative Government in December 1924, Bradbury took over from him as Chairman. It seems that the extent to which the Report of this Committee echoed the original recommendations of the Cunliffe Committee was in part due to the influence of Bradbury himself.<sup>1</sup> There seems little doubt that he was among the leaders of the body of men in the financial and business world who felt, as did Montagu Norman, that their best hope was in "saving Britain by trying first to save the world."<sup>2</sup>

When Bradbury left the Treasury he was succeeded by a man of rather different stamp, Basil Blackett. His early history was similar to Bradbury's, as to dozens of other able civil servants of his time and later. He too entered the Treasury straight from Cambridge, where he had taken a First in Classics. He had originally intended to enter the Indian Civil Service, but on coming top in the Civil Service examinations in 1904, he opted for the Treasury instead. He retained his interest in India, and was Secretary to the Royal Commission on Indian Currency in 1913-1914. He went to the United States during the war, and was finally British Treasury representative in Washington from 1917 to 1919.<sup>3</sup> His experiences in America, combined with a love of Germany which began while on holiday from Marlborough in his teens, and ended with his death there in a car accident in 1936, may have contributed to the formation of his ideas about reparation and the inter-Allied debt, which came to the fore in 1920.<sup>4</sup>

During his time at the Treasury Blackett was on the whole an orthodox adviser to his Chancellors, but he tended to err on the side of caution in such matters as deflation in a way which neither his predecessor nor his successor did.

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1. D. Moggridge, The Return to Gold (Cambridge: C.U.P., 1969), pp. 33-4.
  2. A. Boyle, Montagu Norman (London: Cassell and Co., 1967), p. 143.
  3. Dictionary of National Biography, 1931-40, pp. 83-84.
  4. See below, pp. 216-222.

In his evidence to the Select Committee on War Wealth in 1920, he made it apparent that while he believed that the National Debt should be reduced as quickly as possible, due consideration should be paid to the dangers of deflating too fast.<sup>1</sup> In most ways, however, his views were along the same lines as those of his colleagues; the difference was one of emphasis rather than of content. Blackett certainly did not have any prote-Keynsian ideas on balancing budgets at this time.

Typical of his opinions in this matter is a memorandum written in 1922 in reply to a suggestion by the Minister of Health, Sir Alfred Mond, that the Chancellor should present a deficit Budget in order to be able to reduce taxation, and thus stimulate investment. The idea of reducing taxation to increase consumption per se had not as yet apparently occurred to anyone, so Blackett's reply must be seen simply as a rebuttal of Mond's suggestion, not of budgeting for a deficit in general, although the tone of Blackett's reply indicates that he deplored the idea in principle as well.<sup>2</sup> Blackett deplored Mond's idea on the grounds that experience had shown, and all men of sense agreed, that this was the way to financial ruin. Britain, in company with the United States and Japan, had steadily reduced its government debt in the period immediately before the war; no other country had done so. It was no coincidence in his view that these three countries were the only ones to emerge from the war with their financial structures unscathed. In addition, at every international gathering since the war, Britain had advocated strongly the necessity of every country's balancing its budget as soon as possible; it would be a tremendous shock to world confidence for Britain to fail to balance her own budget. The same applied at the private business level; the effect on confidence in the City would be disastrous. Furthermore, it was not a shortage of capital for investment purposes that was in fact the trouble at that time; Blackett stressed that the problem was one of a lack of security for good

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1. House of Commons Papers, 1920 (London: H.M.S.O., 1920), No. 102, p.98, Q.1546.  
2. P.R.O., T.171/202, memo. by Blackett, 24 Mar., 1922.

investments, because of the disorganisation of industry in Europe and the lack of demand by people on the Continent for our goods.<sup>1</sup>

Thus on matters of internal finance Blackett tended to advise in orthodox vein. In international matters, his opinions were less conventional, in one particular area, that of our attitude to the American debt and to the debts owed us by the other Allies, his ideas were unconventional to a surprising degree. They were also politically unpopular, and failed to gain acceptance.<sup>2</sup> But Blackett's ideas in this sphere show him to be a man of imagination, and a man willing to adapt his ideas to changes in circumstance; his solution to the debt problem had an air of 'cutting the Gordian knot' about it, not perhaps the sort of idea which one would expect as a product of a 'Treasury mind'.

Blackett made as favourable an impression on most of his contemporaries as on the reader of his written work. Sir Ralph Hawtrey found him more receptive of Hawtrey's ideas about the domestic economy than some of his colleagues. Blackett was one of the three men whom Sir Ralph most admired among his colleagues at the Treasury, the others being Bradbury and Frederick (later Sir Frederick) Phillips.<sup>3</sup> One colleague of Blackett's judged him to be both brilliant and flexible,<sup>4</sup> and another described him as

"...exceedingly handsome, welcome everywhere, a flowing (broadminded) handwriting, quick in decision, he seemed to me to make an excellent head..."<sup>5</sup>

Late in 1919, an experiment was made in promoting two members of the Executive Class to the Administrative Class, one at Assistant Principal level and the other to Principal. In the opinion of a contemporary, Blackett was responsible for this innovation, believing that there was no-one else in the Treasury at the time "with both the desire and the power".<sup>6</sup>

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1. P.R.O., T.171/202, memo. by Blackett, 24 Mar., 1922.

2. See below, Ch. V, passim.

3. Information given to the author in conversation by Sir Ralph Hawtrey.

4. Private information to the author.

5. Ibid.

6. Ibid.

Thus Blackett seems to have been a man of great brilliance and originality, both successful within the establishment and yet with sufficient independence to pursue and hold his own views, even when they were unorthodox. In 1922, Blackett left the Treasury to go to India, where he served for six years on the Viceroy's Council as Finance Member. While there, he implemented a series of major reforms, which included setting the country's railways on a sound financial footing, concentrating debt charges into a statutory sinking fund, and bringing the provincial financial members together for annual conferences. He became Leader of the Assembly, and restored the rupee to a fixed value. He returned to England in 1928, where he was found a position in charge of a major international company, and was sponsored by Montagu Norman as a Director of the Bank of England. He had of course by this time left the Treasury, and when the great financial crisis of 1931 came, he was free to express and develop his own ideas, independent of the restrictions of official duties. A lifelong friend of Keynes, he now became a champion of the Keynesian cause, of deficit budgeting during depressions, and of planned money, a subject on which he published a book, Planned Money.<sup>1</sup>

When Blackett left for India in 1922, he was succeeded by his Deputy Controller, Otto (later Sir Otto) Niemeyer. Niemeyer had also been a career civil servant all his life, and had entered the Treasury in 1906. He was always keenly interested in international affairs; he was a member of the Financial Committee of the League of Nations from 1922 to 1937, and after he left the Treasury in 1927 to go into commerce, he undertook a number of missions to the Dominions and to China on financial matters.<sup>2</sup> The tone of his memoranda is uncompromisingly orthodox, and he regarded inflation and large volumes of government debt as inherent evils in much the same way as Sir John Bradbury did, without Blackett's awareness of the dangers of precipitate action in the economic

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1. Sir Basil Blackett, Planned Money (London: Constable and Co., 1932).

2. Who's Who, 1970 (London: Adam and Charles Black, 1970), pp. 2294-5.

sphere. He tended to feel the forces urging governments in the direction of too great expenditure and too little control over that expenditure to be so great that a Treasury man must do all he can to bring influence to bear on the other side.

One of the most contentious economic problems of the inter-war years was that of the relief of unemployment. In the autumn of 1921, Niemeyer wrote a memorandum on present and future financial policy which contains a whole-hearted advocacy of the traditional attitude to the problem. The budget must be balanced, in order that no inflation shall occur; this is desirable for its own sake, but also because if inflation occurs, prices in Britain will rise relative to those in other countries, and British exports will be placed in a bad competitive position vis-a-vis other exporting countries.

"...if British trade is to compete in the markets of the world the prices of British goods must come down. This in effect means that the wages of British labour must come down.... Experience has shown that the earnings of British industry are not sufficient to pay the present scale of wages all round. Consequently if present wages are to be maintained a certain fraction of the population must go without wages. The practical manifestation of which [sic] is unemployment."<sup>1</sup>

He went on to point out that there was a tendency in America at that time towards inflation, and that if this continued it would help lessen the amount by which deflation would have to occur in this country for the two currencies to be brought back to their pre-war relationship.

Niemeyer then turned to the problem of financing the relief of unemployment, while the transition to lower wages and fuller employment which he hoped to see occurred. He did not regard it as a practical possibility that the Government could raise more revenue by taxation or by long-term loans; therefore any help that could be given would have to be found by recourse to Ways and Means advances, with the accompanying dangers of inflation. Some help would have to be given to

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1. P.R.O., T.172/1208, memo. by Niemeyer, para. iv; undated, but internal evidence suggests that it was written in October, 1921.

the unemployed; but any help would be likely to encourage inflation because of the means by which the Government would have to raise the money, and so the assistance should be as small as possible.

"It is obvious that certain minimum assistance must be given to the unemployed to prevent starvation; but for the ultimate solution of the unemployment problem it is essential that this assistance should be kept to a minimum...Ambitious schemes of expenditure of credits can only intensify the evils of unemployment by maintaining wages and prices and making its ultimate remedy more difficult.

Indeed the best assistance which the State can give to unemployment (apart from the minimum to prevent starvation) is (1) to reduce its expenditure and (2) to repay its debts."<sup>1</sup>

Furthermore, it was, according to Niemeyer, much better from the economic point of view for relief of unemployment to be given by the Poor Law Guardians than by the State.

"It is sometimes urged that relief of unemployment this winter will cost £100 million and that the State might just as well make that £100 million available itself. But there is all the difference in the world between relief given by the Guardians and an equivalent expenditure by the State. The Guardians borrow temporarily, ultimately, from the rates and the effect of their expenditure is to force ratepayers to save. The State is in a far less effective position to enforce such savings...if the State were to provide the money it would inevitably come from the creation of artificial credit and not from savings."<sup>2</sup>

The correct remedies for the unemployment situation were therefore, according to Niemeyer, the traditional ones: balanced budgets, repayment of debt, reduced government expenditure, increased private savings. His advice to the Chancellor continued to be along these lines throughout his time at the Treasury, and he remained deeply concerned with the problems of debt repayment.<sup>3</sup>

Niemeyer impressed his contemporaries as being essentially a rigid and inflexible man, though just and humane too. One colleague, whose appointment to a Private Secretary post, with an appropriate salary allowance, had to be blocked because the work on which he was engaged was too important for him to

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1. P.R.O., T.172/1208, memo. by Niemeyer, para. vi; undated, but internal evidence suggests that it was written in October, 1921.

2. Ibid.

3. See, for example, P.R.O., T.171/196, memo. by Niemeyer on Permanent Debt Charge, 11 Feb., 1922, and another on the undesirability of abolishing the Sinking Fund in P.R.O., T.171/205, 22 Apr., 1922.

leave it, found that Niemeyer had arranged for him to receive, for the time being, an allowance equivalent to that which he would have received had the move taken place.<sup>1</sup> Grigg, who was fervently in favour of the Gold Standard, wondered whether the 1931 crisis would have pushed us off it if "the stout-hearted and resourceful Niemeyer had still been at the Treasury".<sup>2</sup> Hawtrey, however, who was more worried about the deflationary problems which the efforts to return to gold exacerbated, found Niemeyer rigid, and unimpressed by Hawtrey's forebodings.<sup>3</sup> One colleague summed him up as being both decisive and obstinate, and likened him in both respects to Neville Chamberlain,<sup>4</sup> while another described him as "a terrific worker of outstanding ability who was rarely challenged when he had spoken firmly."<sup>5</sup>

For half Niemeyer's time as Controller of Finance, the Chancellor of the Exchequer was Winston Churchill. Examples of the stormy nature of their relationship abound, particularly over the return to the Gold Standard.<sup>6</sup> One interesting episode occurred during the preparation of the Budget of 1925, when Niemeyer was becoming concerned at the level of the estimates of government expenditure, and was trying to persuade Churchill of the need to exhort his colleagues to economy. He wrote a note to Churchill on the subject which is abrupt and peremptory in tone: it suggests that there were two points of principle which would have to be adhered to with determination. These were that expenditure must be curtailed, and that no tax concessions must be given, since there was practically no margin of safety in the Estimates. Finally, Niemeyer suggested:

"You make like, when offering your Budget to the Cabinet, to demand the support and collaboration of your colleagues in realising these propositions."<sup>7</sup>

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1. Private information to the author.
  2. Grigg, Prejudice and Judgement, p. 259.
  3. Information given to the author in conversation with Sir Ralph Hawtrey.
  4. Private information to the author.
  5. Ibid.
  6. P.R.O., T.176/21, Niemeyer to Churchill, 6 Apr., 1925.
  7. Ibid.

Thus the impression formed both from the written material and from the evidence of contemporaries' recollections is of a rigid and rather austere man, efficient and able, who adhered to his own beliefs and opinions to the point of inflexibility. It is also worth noting that during the years of his tenure of the Controllershship, little written material submitted by his Deputy to the Chancellor is to be seen on the files, although when Niemeyer himself was Blackett's Deputy this is not the case, and there is a good deal of material written by Niemeyer in the papers of the Chancellor's Office. His three-year partnership with Blackett seems to have been a fairly harmonious one, since their approaches and temperaments tended to complement one another, and their general principles were the same. However, one colleague has commented that although the two were far more often in accord than not, Blackett was not one to hesitate if he wished to advise a Minister in a different sense from Niemeyer.<sup>1</sup>

The organisation of the Treasury underwent, as we have seen, a complete revision in the year following the end of the war, and in October 1919 Sir Warren Fisher came from the Inland Revenue to take over the position of Permanent Secretary to the Treasury. Blackett and Niemeyer served under him, but their appointments ranked equal in pay and status to that of Permanent Secretaries in all other Departments, and they were responsible directly to the Chancellor. The one time at which Fisher seems to have taken a direct and controlling interest in the financial side of the Treasury's work was at the very beginning of his term of office, during the great economy campaign of 1919, which we shall be examining in detail later.<sup>2</sup> From his actions at this time it is apparent that in so far as he concerned himself with financial affairs he was as rigidly orthodox as Niemeyer, and held a nineteenth-century civil servant's view of government expenditure. Addison was not alone among Ministers in his complaints to the Prime Minister

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1. Private information to the author.

2. See below, pp. 182-203.

about the obstructive attitude of Treasury officials in this respect, as Lloyd George's papers show.<sup>1</sup>

Despite his general lack of interest in the details of the work of the Finance Department, Fisher does seem to have been consulted verbally by some of his subordinates on particular issues. An instance of this is the discussion of the Blackett plan for the solution of the inter-Allied debt problem in 1920; Blackett addressed his draft version of the plan to Fisher, adding the words, "This is an attempt to put down the conversation we had this morning."<sup>2</sup> Fisher duly read the draft and passed it to the Chancellor for his comments. But this was unusual; the bulk of the written material submitted by the Controller to the Chancellor was addressed to him direct.

It may not be an accident that the instance given was one in the field of foreign affairs, in which Fisher had a profound and lifelong interest. He was a strong believer in the merits of the Gold Standard, and Lord Francis Williams has recorded how, in 1931 when a monetary crisis seemed imminent, he was rash enough to suggest to Fisher that Britain might be forced to leave the Gold Standard. Fisher replied:

"To suggest that we should leave the gold standard is an affront not only to the national honour but also to the personal honour of every man and woman in the country."<sup>3</sup>

Fisher was on excellent terms with Baldwin, having got to know him well during his long period as Financial Secretary; in view of Fisher's own rather autocratic nature, it may be significant that Baldwin was at that time most unwilling to take decisions on his own, without the support and advice of others.<sup>4</sup> After Baldwin became Prime Minister, he still saw and corresponded with him frequently, and on at least two occasions disregarded all official and

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1. Lloyd George Papers, F/1/5/9, Addison to Lloyd George, 27 Feb., 1919; see above, p. 32.
  2. P.R.O., Cab.24/97, C.P.584, Blackett to Fisher, 12 Feb., 1920.
  3. Lord Francis Williams, A Pattern of Rulers (London: Longmans, Green and Co., 1965), pp. 111-2.
  4. See below, p. 68.

parliamentary conventions to bring certain peccadilloes of Churchill, his Chancellor, to Baldwin's attention. During the preparation of the 1925 Budget, Fisher wrote to Baldwin enclosing a copy of a memorandum by Niemeyer on the subject of the Old Sinking Fund:

"The occasion for its [the memo's] preparation is the oft-repeated threat (not so far however made in my presence) by Winston that in spite of everyone he is going to seize and divert from debt redemption any surplus there may be on the present year 1924-5...when the time comes I am going to tell Winston in my own language what I think about it."<sup>1</sup>

On the whole, however, it seems from the evidence of colleagues that Fisher was more likely to intervene in a finance question to protect the Chancellor from the importunacy of his officials, rather than the reverse; he tended to maintain the rather aloof, Olympian attitude which has been described, and only to descend on an issue, as he did over the Economy Campaign, when particular pressures made it necessary. Fisher always received a copy of material from Finance which went direct to the Chancellor, and he would intervene if he thought Treasury advice was tending to push the Chancellor into a corner, especially in terms of the political aspects of issues, or if the Chancellor was uneasy about Treasury advice.<sup>2</sup>

Before he went to the Inland Revenue, Fisher had been a prominent member of the Insurance Commission; indeed, this was where he 'made his name', as did many of his contemporaries in that forcing-house of official talents. But after he went to the Treasury he ceased to be such an innovator, and concentrated on consolidating the work of the newly-formed Establishments Department. It was Fisher who, after one or two disappointing entrants into the Treasury through the normal examination channel in the late 20's, decided on a change of policy in this respect (he is reputed to have said "no more firsts") and initiated the practice of taking new Treasury recruits from among the best juniors in other Departments.<sup>3</sup>

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1. Baldwin Papers, Vol. 3, D/2/3, Fisher to Baldwin, 13 Mar., 1925; see also P.R.O., T.176/21, Fisher to Baldwin, 25 May, 1925.
  2. Private information to the author.
  3. Ibid.

Fisher was thus, like Niemeyer, a man of rigid and orthodox mind, but with these qualities compounded by a somewhat autocratic attitude; one colleague has commented that he was a man who was concerned that others should observe the forms and protocol towards him, but who felt able to disregard these formalities himself in the treatment of others.<sup>1</sup> However, with rare exceptions, he was during our period concerned primarily with Establishments work, and not with Finance.

Among the changes made in the 1919 reorganisation was the appointment of Ralph, later Sir Ralph Hawtrey as Director of Financial Inquiries. Sir Ralph had joined the Treasury in 1904, having spent a year on the staff of the Admiralty after leaving Cambridge.<sup>2</sup> Hawtrey's position seems to have been essentially a research post, and there are a number of memoranda in the Treasury files, some of which will be referred to later.<sup>3</sup> While at the Treasury Hawtrey wrote a considerable amount on economic and financial topics, and much of his work consisted in propounding a belief in the monetary theory of the trade cycle as a fundamental principle of economics. This being so, he was a staunch defender of the 'Treasury view' of public works as unnecessary, irrelevant and possibly even harmful in reducing unemployment.

"...expenditure on public works, if accompanied by a creation of credit, will give employment. But...a creation of credit unaccompanied by any expenditure on public works would be equally effective in giving employment.

The public works are merely a piece of ritual, convenient to people who want to be able to say that they are doing something, but otherwise irrelevant. To stimulate an expansion of credit is usually only too easy. To resort for the purpose to the construction of expensive public works is to burn the house down for the sake of the roast pig."<sup>4</sup>

Hawtrey regarded the unemployment problem as essentially subsidiary to the phenomenon of the trade cycle, and he was a firm believer in the Gold Standard.

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1. Private information to the author.
  2. Who's Who, 1970, pp. 2294-5.
  3. See below, pp. 304, 311, 317.
  4. R.G. Hawtrey, Trade and Credit (London: Longmans, Green and Co., 1928), p.112.

"The problem of unemployment, as we knew it before the war, is the problem of the trade cycle....The true solution of the problem is to be found in the stabilisation of prices...in my opinion the trade cycle can be eliminated, or at any rate so reduced in extent as to avoid epidemics of unemployment, without any departure from the gold standard, provided the banking authorities of the different gold standard countries co-operate for that object.

Even without this refinement, a gold standard is an approximation to stability."<sup>1</sup>

In later years, Hawtrey came to have doubts about the wisdom of deflation, and criticised the monetary policy of the period.<sup>2</sup> Immediately after the war, however, Hawtrey was with his colleagues strongly in favour of measures to curb inflation, and with them advocated a rise in the Bank Rate in the spring of 1920.<sup>3</sup> Indeed, he adduced a further argument to that of the other officials, suggesting that because the attractions of fixed-interest bearing securities tended to be lessened by inflation and enhanced in periods of deflation, dear money would thus make the problem of funding the short-term debt easier.

"...for the success of future funding loans deflationary measures are essential. And every week that such measures are deferred makes the evils to be cured greater."<sup>4</sup>

In addition, Hawtrey suggested that the disadvantage of dear money to the Treasury, that it raised the price the Government would have to pay for loans, was very much a short-term problem, since interest rates would not have to be maintained at a penal level for very long. By the spring of 1923, Hawtrey felt that the deflationary process had gone on long enough, and that further deflation should be avoided,<sup>5</sup> but by then the Bank Rate had come down to 3%,<sup>6</sup> the floating debt had been reduced by one-third from its 1920 peak,<sup>7</sup> and the rigorous deflation of the early 'twenties was over. However, from this time on Hawtrey maintained his

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1. R.G. Hawtrey, Trade and Credit (London: Longmans, Green and Co., 1928), pp.78,80.

2. K. Hancock, "Unemployment and the Economists in the 1920s", Economica XXXVII (1960), p.309.

3. P.R.O., T.172/1384, "Cheap or Dear Money", memo. by Hawtrey, 4 Feb., 1920.

4. Ibid.

5. P.R.O., T.176/5, memo. by Hawtrey, 5 Mar., 1923.

6. See below, Statistical Appendix, Table 2.

7. Ibid., Table 3.

stand against deflation, and continued to argue this in harness with a belief in the Gold Standard. His views are well summarised by a passage from a memorandum written in March 1923:

"(1) We must avoid any further deflation, and with a view to the early absorption of our unemployed a moderate degree of inflation, such as has been experienced in the last twelve months in America, would be desirable;

(2) We must restore sterling to its gold par as soon as possible."<sup>1</sup>

Hawtrey realised that these twin objectives could hardly be realised without co-operation from other countries, and particularly from America; this acceptance of the need for joint action was one of the prime factors in the preparation of the Currency Resolutions for the Economic Conference at Genoa in 1922, in which Hawtrey took a leading part. The acceptance of these proposals, which called for a return throughout Europe to balanced budgets and stable currencies, including a return to the Gold Standard in every country as soon as was feasible, at the pre-war parity if humanly possible, was at that time regarded as a major step forward in the reconstruction of Europe, and as some compensation for the failure of the Conference in most other respects.<sup>2</sup>

During the discussions over the return to the Gold Standard in the spring of 1925, Hawtrey maintained this attitude, but to no avail. In his reply to Churchill's "exercise", he made it clear that he felt that a rise in Bank Rate would not be necessary to a restoration of the Gold Standard, and would be damaging to the internal economy:

"No active measures at all need be taken. It is to be hoped that the exchange will come to par of itself. If it does not, a credit contraction is still undesirable. We should be prepared, if necessary, to export gold in case of a threatened reaction after par has been reached...If the gold exports are insufficient, it would be better to let sterling fall to a discount [than to raise Bank Rate]."<sup>3</sup>

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1. P.R.O., T.176/5, memo. by Hawtrey, 5 Mar., 1923.

2. See P.R.O., T.172/246, Cab. 31/1.

3. P.R.O., T.172/1499B, memo. by Hawtrey, 2 Feb., 1925.

However, Hawtrey's advice on this point, although apparently in agreement with Churchill's own opinions, was ignored by Norman, as was his prerogative at that time.<sup>1</sup> Hawtrey has told how

"...on the 6th March Bank Rate was put up to 5. On that day I encountered Montagu Norman in Niemeyer's room at the Treasury. Norman said he had become something of a popular character in the City, for the price of wheat had fallen. What he said I do not remember, but it breathed reproaches, and I fear I had sacrificed the goodwill formerly gained by my advocacy of dear money."<sup>2</sup>

Hawtrey's general role in the Treasury is a little difficult to establish, partly because it was a personal one, in the sense that no other man before or since ever held that precise post; but partly also because his role seems to have changed over the years. The impression one gains is that from the time Bradbury made the appointment in 1919 until Blackett's departure in 1922, Hawtrey tended to be consulted as a matter of course; during Niemeyer's term as Controller his influence waned, and by the 1930s his memoranda tended to be volunteered, or else requested as an afterthought. But it is difficult to find concrete evidence for this.<sup>3</sup> It is certainly true that whereas there is a good deal of Hawtrey material in the general files in the early 'twenties, much of the material he wrote in Niemeyer's time went into Niemeyer's own private papers, and since in many cases it is what appears to be the top copy that is filed there,<sup>4</sup> it seems legitimate to surmise that these documents got no further than Niemeyer. It is impossible, in the absence of Blackett's papers, to do anything other than speculate about this. But apparently Churchill, at any rate, felt that the Treasury did not make sufficient use of Hawtrey's powers. Grigg remembers Churchill

"...demanding from time to time that the learned man should be released from the dungeon in which we were said to have immured him, have his chains struck off and the straw brushed from his hair and clothes and be admitted to the light and warmth of an argument in the Treasury board room with the greatest living master of argument."<sup>5</sup>

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1. Information to the author from Sir Ralph Hawtrey; Leith-Ross, Money Talks, p.95.
  2. Information to the author from Sir Ralph Hawtrey.
  3. Private information to the author confirms this impression for the later period.
  4. See, for example, P.R.O., T.176/13 pt.I, "The Credit Situation", memo. by Hawtrey with notes by Phillips, 5 Dec., 1925.
  5. Grigg, Prejudice and Judgement, p. 82.

However, some of the Treasury officials did make use of Hawtrey's talents in discussion: notably Frederick (later Sir Frederick) Phillips, who had a penchant for developing his own views by contradiction, and used Hawtrey as a 'chopping block'.<sup>1</sup> There is a fascinating example of this in a memorandum written by Hawtrey in December 1925, attacking a recent rise in Bank Rate. The paper is annotated in the margin in Phillips' tiny, spidery writing, and includes some fairly pithy comments, such as "this is nonsense" and "bunkum".<sup>2</sup> However, since a rise in Bank Rate at a time of falling prices and high unemployment was perhaps not the best of policies, this episode embodies an apparent hardening of Treasury attitudes over the inflation controversy immediately before and following the return to gold, and it is perhaps no accident that the waning of Hawtrey's influence seems to have been a parallel development.

In the policy-making part of the Treasury functions, the junior officials, as we have seen, played little part. Some names crop up in the files from time to time; that of Grigg, for instance, who was throughout most of our period the Chancellor's Private Secretary, and who has written an autobiography, as did another man, then a junior posted overseas, who was to become successful and well-known later in life, Leith-Ross. Ernest, later Sir Ernest Rowe-Dutton was for part of this period in the Home Finance Section, then moved to 2D, the Foreign Section of Finance, from which he went as the Treasury Representative on the funding mission to Washington in 1923, with Baldwin, Norman and Grigg.<sup>3</sup> Rowe-Dutton with Leith-Ross, S.D. (later Sir David) Waley and Henry (later Sir Henry) Wilson Smith together provided considerable continuity in the field of foreign affairs during the whole inter-war period, during which time they served continually either in 2D, as Private Secretary to the Chancellor, or in the Treasury missions overseas, in capitals such as Berlin, Washington and Paris. Phillips is another

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1. Private information to the author.

2. See, for example, P.R.O., T.176/13 pt.I. "The Credit Situation", memo. by Hawtrey with notes by Phillips, 5 Dec., 1925.

3. Grigg, Prejudice and Judgement, p. 98; I am informed that Rowe-Dutton kept a diary of this journey, which has unfortunately been destroyed.

man whose memoranda appear occasionally on the files on technical matters, and who later rose to high public office. But beyond the bare chronicles of Who's Who it is very difficult to gain any real knowledge of these men, and virtually all the officials who served in Finance during our period are no longer alive. Those that have written autobiographies tend to be more concerned with events than with people, and it is thus difficult to form much of an impression of the younger men as individuals. However, in view of the fact that as far as one can judge from all the evidence available, the younger men did not play a significant role in the formation of policy, this is perhaps not a serious difficulty, particularly because of another aspect of the Treasury environment to which reference will be made later.<sup>1</sup>

It would be incomplete to conclude this section with a brief reference to Montagu Norman. During our period this strange and incomprehensible man was at the height of his powers. He played a major part in two of the most important issues in which the Treasury officials were also concerned, namely the return to the Gold Standard and the American debt settlement. Like them, he restricted his activities to what he deemed to be the province of the Bank, and did not concern himself with the impact of his actions on problems outside his terms of reference. Norman felt that his principal task was to try to restore normal financial conditions in this country and in Europe, which included putting Britain back on the Gold Standard as soon as possible.

"True to his inherent weakness for never trespassing into territory for which others were responsible, Norman did not worry unduly about the cost in human misery that might result at home if this outward-looking City policy were consistently pursued. The plight of the unemployed was primarily a matter for the Government."<sup>2</sup>

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1. See below, p. 76.
  2. A. Boyle, Montagu Norman, p. 139. For a sympathetic discussion of Norman's views at this time, see D. Williams, "Montagu Norman and Banking in the Nineteen-Twenties", Yorkshire Bulletin of Economic and Social Research XI (1959).

Norman's relations with the Treasury were excellent, and indeed he must have come as something of a relief after the bombastic and unpredictable Cunliffe, with whom, it will be seen, Treasury relations were less than cordial.<sup>1</sup> Norman was also, as far as one can judge, on good terms with the Chancellors during our period; Horne admired and trusted him,<sup>2</sup> Churchill, at any rate in the early part of his term of office, was frequently host to Norman,<sup>3</sup> and Baldwin, too, often invited Norman to his home,<sup>4</sup> in both cases to an extent beyond what was required by convention. Relations between Churchill and Norman cooled gradually during Churchill's term of office, partly because of Churchill's increasing disquiet over the Gold Standard, and partly because, as Niemeyer said,

"Winston will never realise that he is not Governor of the Bank..."<sup>5</sup> and he was unable to accept the fact that at that time the Bank was an autonomous institution with independent control over its own discount rate.

These, then, were the principal official experts with whom the Chancellors in the 'twenties had to deal. It is appropriate that we should now examine, in such detail as is practicable, the personalities and working methods of these Chancellors.

### The Chancellors

The Chancellors whom this group of men advised during the period under review were on the whole inexperienced and in office for a very short time. By the end of our period, only three of the seven men who served as Chancellor during that time had held office for more than eleven months; of those three, Bonar Law, Sir Austen Chamberlain and Horne, only Chamberlain had previously served as Chancellor. Bonar Law was the first of the Chancellors of our period; he held

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1. See below, pp. 86-87.

2. Boyle, Montagu Norman, p. 150.

3. Ibid.

4. Chartwell Papers, File 18/2, Churchill to Baldwin, 12 Dec., 1924; quoted in Moggridge, The Return to Gold, p. 40.

5. Leith-Ross, Money Talks, p. 95.

office from December 1916 to January 1919, but during that time he was also a member of the War Cabinet, and thus was much pre-occupied with problems concerned with the military and strategic direction of the war. He left the Treasury well before the 'bonfire of controls' became intense, but there is little to suggest that things would have been otherwise had he stayed; for Bonar Law, according to his biographer,

"...held the view, unfashionable today, that there exists a wide field of human activity in which Government intervention does no good and may only make matters worse."<sup>1</sup>

Bonar Law was succeeded by Sir Austen Chamberlain, who held the Chancellorship from January 1919 until April 1921, and thus covers a larger part of our period than any other Chancellor. Chamberlain's chief characteristic seems to have been his complete honesty: and it is an interesting comment on the House of Commons of 1918-1922 that at least one observer, a young backbencher elected during the latter part of that Parliament, judged him to be marked out by that quality as "dating" obviously from an earlier era.

"...the most representative and the most attractive of these 'dating' figures was Austen Chamberlain....he was already almost alone in his sense of parliamentary style. If that style inclined a little to the pompous, so much the better; the House of Commons was too august for business statements; it deserved to be treated in the grand manner. And this grand manner was not just a matter of form; it was the expression of a very conscious feeling for the essential virtues of British public life....The sort of integrity we demand from our statesmen is an integration of private with public honour. Austen Chamberlain was, above all, the embodiment of that integrity. He once said that his only conception of diplomatic negotiation was to lay his cards on the table. That is almost a description of his career, the explanation of his honourable successes and his still more honourable failures."<sup>2</sup>

This complete integrity is demonstrated in the most revealing way in an episode which is of immediate interest for this study because it appears to be the only instance during our period of a Chancellor actually changing his mind on an

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1. R. Blake, The Unknown Prime Minister (London: Eyre and Spottiswoode, 1955), p. 499.
  2. Lord Percy of Newcastle, Some Memories (London: Eyre and Spottiswoode, 1958), p. 79.

issue of major importance, because he at first disagreed with his adviser, and then came to the conclusion that the official was in fact right; this was over the American debt problem, where Blackett, then Controller of Finance, put forward a highly original plan for dealing with the problem. At first Chamberlain rejected the advice because he felt that it would antagonise the Americans, but the arrogant behaviour of the United States Treasury caused him to change his mind, and he backed Blackett's plan in the Cabinet against Lloyd George, then Prime Minister.<sup>1</sup>

Chamberlain was followed by Sir Robert Horne, who was Chancellor from April 1921 until October 1922, when the Coalition Government fell; Chamberlain moved to the Privy Seal's Office when he left the Treasury, much to the benefit of his own temper and the detriment of Horne's, as Thomas Jones, who was present at the first Cabinet meeting after the reshuffle, recounted in a letter to Bonar Law:

"I like the new Privy Seal for the simple reason that he is now much less overwrought than when as C. Of Ex. [sic] he had daily to oppose the demands of his profligate colleagues. He is now almost gay and debonair with leisure for a joke and a tale - the one I liked best being the one about the P.M. [Lloyd George] in his inaccurate budget days using figures 'like adjectives'. A.C. talks more in Cabinet than you did and is less elastic in mind than you appeared to be! Horne has also changed countenances with Chamberlain and can only smile with difficulty. The coal business, the dread of a budget speech (now removed), [Chamberlain delivered the speech, which had largely been prepared before he left the Treasury] the unfriendly sallies of Churchill, and too few holidays have united for the moment to rob the new Chancellor of half his buoyancy and made the miners take him for a hard-fisted owner."<sup>2</sup>

Horne came from a business background, entered the Commons as a Conservative in the General Election of 1918, and was immediately brought into the Government, first as Minister of Labour, and then as President of the Board of Trade, before going to the Treasury in 1921. He was thus much less experienced, both as a Member of Parliament and as a Minister, than either Bonar Law or Chamberlain had

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1. See below, pp. 223-226, 231-236.

2. Jones, Whitehall Diary, Vol. I, 1916-25, p. 152, Jones to Bonar Law, 24 Apr., 1921.

been when he became Chancellor. During the summer of 1921, the demand for 'Economy' was again heard loudly in the Commons and in the Press, and the business world was even more emphatic than usual about the need to reduce expenditure so as to ease taxation, in the face of the severe depression in the economy. Grigg commented,

"...Horne showed himself very ready to listen sympathetically to the difficulties and demands of the trading community. At times, indeed, I thought that he was too sensitive to their woes and I daresay I said so. But, with the lamentable results, which the coal strike was producing daily before his eyes, the Chancellor insisted on making a number of easements."<sup>1</sup>

It should not be thought, however, that Grigg's opinion of Horne was generally unfavourable. In August 1921, Horne went to Paris for a meeting of the Supreme Council of the League of Nations, and Grigg accompanied him. Away from the problems that threatened to overwhelm him in Britain, Grigg was able to form a better impression of his master:

"Now that the more pressing of his anxieties were removed, I saw him in his true light. He was quick and intelligent, good-humoured and conciliatory, an extremely competent advocate, most loyal to his subordinates and appreciative of what they did for him...I suppose it could be said that he liked the good things of the material life - who doesn't?...He was a novus homo in that he appeared in the House of Commons for the first time as a Minister of the Crown.... [In addition to the prejudice which this aroused] Horne had a slightly harsh voice which was apt to give a false impression of him. But long before he went to the House of Lords he had become a very popular member of the Commons, not only because the House had come to recognize his fundamental considerateness, but owing also to his quite unusual merits as a mimic and a raconteur. I still laugh at his imitation of Curzon rejecting with contumely the claims to advancement of a certain politician on the ground that he had married 'a woman, of colossal fortune, it is true, but of calamitous appearance'."<sup>2</sup>

Others had a less elevated opinion of Horne:

"Horne was a competent businessman but not a successful Chancellor; indeed he was really out of his depth in public finance, and, what is worse, tended to show it. There is a story that Birkenhead was asked whether Horne should be replaced, and Birkenhead replied, 'I don't think it's worthwhile changing asses in mid-stream.'"<sup>3</sup>

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1. Grigg, Prejudice and Judgement, p. 65.

2. Ibid., p. 72.

3. Leith-Ross, Money Talks, p. 81.

One last point of note about Horne concerns his relationship with the Governor of the Bank of England, which was excellent. Norman's biographer refers to

"Sir Robert Horne, a fairly malleable character, whose docile reactions to the magnetic charm of the Governor resembled those of a favourite pupil to a benevolent headmaster..."<sup>1</sup>

and quotes from a letter written by Horne to Norman in April 1922:

"...you give me such service and such companionship in my tasks that I daren't tell you all it means to me...I am very grateful to you - and no less for your friendship than for your counsel."<sup>2</sup>

The picture that emerges, then, is of a competent businessman, well-liked by his fellows, but rather inclined to be overawed by magnetic personalities like Lloyd George and Montagu Norman, and without the capacity or the experience to make a complete success of the Chancellorship. Further light on this period and on Horne's relations with his officials is gained from the events leading up to the publication of the Balfour Note in 1922, which will be examined later.<sup>3</sup>

The next Chancellor was Baldwin, who held office in Bonar Law's Ministry from October 1922 until May 1923, and then combined the office with that of Prime Minister until August 1923. Baldwin had long had close connections with the Treasury; he was Bonar Law's Parliamentary Private Secretary from 1916 to 1917, Financial Secretary to the Treasury from 1917 until 1921, and President of the Board of Trade from 1921 until 1922. For a few months in 1923, and then from November 1924 onwards, he was Prime Minister. Thus, except for the period of the Labour Government, Baldwin was connected with the work of the Treasury to a greater or a lesser degree throughout our period. Yet, apart from the American debt settlement, made by Baldwin while he was Chancellor, he seems in fact to have made little impact on the course of economic policy in this country during our period. Two notable facts about Baldwin emerge from the biographies and

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1. Boyle, Montagu Norman, p. 150.

2. Ibid.

3. See below, pp. 245-254.

contemporary records: whether they are connected or not must be a matter for individual judgement. One is that he was, while at the Treasury, and after, during his years as Prime Minister, on excellent terms with the Treasury officials; his friendship with Fisher has already been mentioned as a particular instance, and he was also on excellent terms with Montagu Norman. Evidence for this abounds. Norman's biographer records the existence of a rambling club of Treasury officials, called 'the Tramps', who, on weekends in the latter part of the 'twenties, would meet Baldwin and Norman at a convenient pub, and then go to Baldwin's house to sing madrigals; these gatherings were purely social ones, and no 'shop' was talked.<sup>1</sup>

Fisher was, as we have seen, a firm friend and supporter of Baldwin from his early Treasury days, and was delighted when he became Prime Minister in 1923. Thomas Jones has recorded his experiences on the day Baldwin took office:

"...we trooped along to No. 11 [the Chancellor's residence] to offer our congratulations. On the way we ran into Warren Fisher and Boyd Carpenter on the same errand...We found the new P.M. very self-conscious in his frock coat, surrounded by his wife and daughters. 'Thank God,' shouted Warren Fisher with the fervour of an Archdeacon."<sup>2</sup>

Fisher retained his close contacts with Baldwin, and continued to keep him informed on financial matters; some of the letters on the Treasury files, and in Baldwin's private papers, suggest a degree of direct communication, bypassing the Chancellor, which one would judge not to be in accord with normal official protocol.<sup>3</sup> Other officials, too, seem to have liked and admired Baldwin; there is, for instance, a letter in Baldwin's private papers from Sir John Bradbury, congratulating him on the Budget of 1923, which Bradbury judged to be a sound one. He recommended that Baldwin should pay no heed to criticism from other quarters, since in his experience a good budget was nearly always unpopular, and a popular budget nearly always a bad one.<sup>4</sup>

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1. Boyle, Montagu Norman, p. 191.

2. Jones, Whitehall Diary, Vol. I, 1916-25, p. 237, entry for 22 May, 1923.

3. See above, p. 21.

4. Baldwin Papers, vol. 159, Bradbury to Baldwin, 19 Apr., 1923.

The other principal characteristic which is of great interest to us is the very great difficulty which Baldwin had in coming to a decision on any given matter without clear direction from others. This seems to have been very pronounced in his early days; Andrew (later Sir Andrew) MacFadyean, who served under Keynes in 'A' division during the war, has recorded an incident which illustrates this point:

"I remember Keynes expatiating once on the obvious difficulty Baldwin had in making up his mind for himself. Tired of making it up for him, Keynes wrote a memo on a question of some importance which he suggested Ministers must decide. There were two courses between which a choice must be made; the pros and cons of each course were fully set out and by no hint did Keynes suggest which in his opinion was the better course. In due time the file reached Baldwin, and when he had read it he sent for Keynes. For half an hour the matter was discussed from every angle until, when Keynes had volunteered no opinion of his own Baldwin said, 'If you were in my place would you do A or B?' Keynes was not often beaten, but on that occasion he capitulated!"<sup>1</sup>

Baldwin was Financial Secretary at this time, but his reputation for being slow to make decisions remained at least until his appointment to the Premiership. Thomas Jones, in the diary entry already quoted, comments:

"At 3.30 to No. 10 [Downing St.] and discovered that Stanley Baldwin had been summoned to the Palace...and was to be the new P.M. All of us astonished at the swiftness of his ascent. Six years in office...A plain man, domesticated like B.L. [Bonar Law], fond of books and music and walks in the country. Nothing like B.L.'s brain - much slower and always eager to consult one or two others before coming to a decision; but stands by his decision once taken."<sup>2</sup>

It is impossible in the compass of a page or two to sum up adequately the character of such a complex and in many ways unknown man, even to his friends. Grigg, who was on the best of terms with him, comments that "many of those who knew him best felt there was in him a reserved chamber into which they could never enter."<sup>3</sup> One can only hope to attempt a glimpse of particular facets of such a personality which have importance for this study.

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1. MacFadyean, Recollected in Tranquillity, p. 63.
  2. Jones, Whitehall Diary, Vol. I, 1916-25, p. 237, entry for 22 May, 1923.
  3. Grigg, Prejudice and Judgement, p. 107.

One important aspect was his lack of sureness of touch in foreign affairs. One who knew him well at this time, Lord Eustace Percy, has related an incident in 1928, in which President Coolidge had issued an ill-mannered statement about the Anglo-French naval agreement. Percy proposed sending an explanation of the facts, rather than a curt retort; Baldwin replied, "Don't argue with a man who isn't a gentleman when he loses his temper."<sup>1</sup> Grigg, who was one of Baldwin's most ardent admirers, has commented:

"Mr. Baldwin's successes were usually in the domestic sphere, while his failures were outstandingly in the field of foreign affairs....With foreigners he was not at home. He did not understand them and was prone to distrust them."<sup>2</sup>

Other facets of Baldwin's personality, which are closely linked, are indicated in a significant passage of Percy's, commenting on Baldwin's attitude to Lloyd George, and his experiences in the Coalition Government:

"...he told me how he had sat in that Cabinet as a 'new boy', saying little, but watching what went on, and wondering whether the government of England 'would ever be clean again'... [this judgement] affected his whole subsequent attitude to political problems. His pre-occupation...with the education of the Labour party as the source of the alternative government of the future, arose from a sense, not merely of the Labour Party's rawness, but rather of the moral risks run by all parties in the transition between an old order and a new. In that connection, his mind played constantly round the half-myth of the 'lost generation' - the idea that the gradual supersession of age by youth, the natural way in which tradition is preserved and transmitted, had been almost fatally interrupted by the casualties of the war.

Indeed, I think that the chief criticism that might be made of Baldwin's record is that he tended to measure all problems by their relation to the integrity of the party which he led...when later, in discussing the Indian constitutional problem, he expressed to me his determination not to allow the Conservative party to be split over India as the old Liberal party had been split over Ireland, I confess that, although I agreed with his Indian policy, I almost gasped at the apparent inadequacy of the motive."<sup>3</sup>

Isolationism, an obsession with moral rectitude and with the wellbeing of the Conservative Party, and a deep consciousness of the ravages of the war upon the generation of his juniors: this passage has been quoted at length because it

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1. Percy, Some Memories, p. 34.
  2. Grigg, Prejudice and Judgement, p. 108.
  3. Percy, op. cit., pp. 89-90.

summarises so many of Baldwin's principal qualities. Another writer has seen elements of the last aspect in Baldwin's 'anonymous' contribution of £120,000 towards the repayment of the National Debt in 1920, suggesting that the gesture

"expresses the rather desperate sacrificial mood in which responsible men approached the financial situation, a mood in which there was much anguished talk about Treasury control."<sup>1</sup>

The implication is clearly that those who had had to allow others to suffer for them in wartime felt a need to atone for their feelings of guilt by voluntarily undergoing austerity in peacetime.

Certainly Baldwin's attitudes while at the Treasury accord with this judgement, and suggest that he was in complete agreement with the official view of public expenditure. For instance, in a paper circulated to the Cabinet in November 1922, urging economy and thrift on his colleagues, he asserted:

"Money taken for Government purposes is money taken away from trade and borrowing will thus tend to depress trade and increase unemployment."<sup>2</sup>

Baldwin's period as Chancellor, brief though it was, saw a continuation with considerable success of the policy of reducing the floating debt; in the ten months of Baldwin's tenure of office the volume of Treasury bills was reduced from £735 million to £599, and the total of floating debt from £922 million to £797 million.<sup>3</sup> There seems little doubt that this continuing reduction in National Debt, as well as being a central part of Treasury policy, was also in accordance with Baldwin's own views.

"In the light of Treasury policy at the time, these reductions must be regarded as considerable successes. Whether the aims themselves were best for the economy as a whole is another matter. No Chancellor of the period questioned the assumptions nor did Baldwin assert his independence, even if he had wished to, during his short seven months of office."<sup>4</sup>

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1. Roseveare, The Treasury, p. 259.
  2. P.R.O., Cab.24/140, C.P.4314, note by Baldwin on the necessity for National Economy, 20 Nov., 1922.
  3. E.V. Morgan, British Financial Policy 1914-1925 (London: Macmillan and Co., 1952), p. 147.
  4. Middlemass, K., and Barnes, J., Baldwin (London: Weidenfeld and Nicolson, 1969), p. 156.

The man who followed Baldwin as Chancellor, Neville Chamberlain, was only in office for five months, and little of note happened during his period as Chancellor. Grigg served under him during this period, and during his second, much longer term of office as Chancellor was in close contact with him. He comments:

"...he was clear-sighted and competent with perhaps a leaning to orthodoxy and a dislike of high-flying. He was a pleasant chief though shy and reserved, so that those who worked for him could rarely discern the humanity and kindness that were undoubtedly there. Sometimes they shone through the cloud...Nevertheless, reserve was the normal attitude and I am not sure that it did not lead to a certain fallibility in his judgement of persons and as a corollary to a lack of sureness in appraising political situations."<sup>1</sup>

Another colleague has commented that on the administrative level, the relationship between Chamberlain and his officials was "almost perfect, if somewhat soulless."<sup>2</sup>

Neville Chamberlain left the Treasury in January 1924 when, after a General Election hastily called by Baldwin on the protection issue, the Labour Party formed a government for the first time. The new Chancellor was Philip Snowden. The advent of a Labour Government might have been expected to cause some fluttering in the Treasury doves, but Snowden soon allayed all qualms.

"In the fiscal and financial realm, Government policy was entirely dominated by Mr. Snowden. This meant that it was more radical than specialist and pretty orthodox radical at that...New social expenditure was on a safe and unflamboyant scale, and both the rather tiresome outbiddings of the Liberals and the grumbles of the Clyde about non-fulfilment of pledges were taken philosophically. The most in the way of rashness Mr. Snowden ever permitted himself was to accept a private member's motion in principle, while making it plain that fulfilment must await the appearance of more money."<sup>3</sup>

Snowden's acceptability on a political level was matched by his qualities as an administrator and a Minister. Grigg describes him as a man of courage, surprising charm and humour, and complete integrity, and goes on:

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1. Grigg, Prejudice and Judgement, p. 119.
  2. Private information to the author.
  3. Grigg, op. cit., p. 133.

"Of all the Ministers I have ever known, he was easily the most popular with the Civil Servants who worked for him. This is not very surprising. In the first place he was the ideal of what a Minister should be in that he gave a clear lead on all questions of policy, interfered rarely, if at all, in matters of administration, gave decisions quickly and unequivocally, and then defended his decisions against all comers with confidence and vigour - and usually with success. Civil Servants, in fact, knew exactly where they were with him and could rely absolutely on his courage and good faith to defend his own actions and theirs. When there is added personal charm, humour and real kindness and, to his subordinates, gentleness as well as strength, can it be wondered that he is the most beloved of all the many Ministers I have served or known?"<sup>1</sup>

This description of Snowden as being beloved of his Civil Servants is confirmed by another colleague, who remembers his being doubly welcome on his return to the Treasury in 1929, first for his own qualities, and secondly as a contrast to his predecessor: the Snowden period gave the Treasury a chance to recover from "the turbulent and unpredictable Winston Churchill regime which had defied all normal assessments."<sup>2</sup> Snowden's first period of office lasted only until October 1924, to be succeeded by Churchill, who remained in office until 1929. Quite early in his term of office Thomas Jones recorded that "Grigg has not found Winston so malleable as Horne or Snowden"<sup>3</sup> and there is abundant evidence to suggest that the Churchill period was something of a traumatic experience for all concerned. An example is the discussions which took place in the months immediately before the return to the Gold Standard in 1925, which will be discussed in detail later. It seems, too, that the problem was not all on one side: to begin with, at least, Churchill was no happier with his new environment than his new colleagues were with him.

"When I held other offices under the Crown, I could always find out where I was. Here I'm lost and reduced to groping."<sup>4</sup>

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1. Grigg, Prejudice and Judgement, p. 133.
  2. Private information to the author.
  3. Grigg, op. cit., p. 315.
  4. Boyle, Montagu Norman, p. 189; recounted to Boyle by Lady Asquith.

Niemeyer's sometimes peremptory attitude, and Fisher's habit of going behind Churchill's back to 'report' to Baldwin must have exacerbated the problems;<sup>1</sup> even if Churchill was not actually apprised of Fisher's activities, it is hard to imagine that he can have been totally unaware of his Permanent Secretary's attitude.

However, some officials were more adaptable than others, and Grigg soon came to appreciate the qualities of his new chief. Churchill's working methods were quite unlike anything Grigg had ever encountered before, and he was allowed a latitude of expression that was also something new to the Private Secretary.

"[Winston] disliked giving snap decisions on cases stated orally. Nevertheless, he did indulge in a great deal of personal discussion during which he could talk himself into a knowledge and understanding of any topic or problem which came before him. The last duty of his private office at night was to fill a box with the papers and correspondence which required his direction, so that it could be put at his bedside with his breakfast when he woke in the morning. In this he would browse for, say, an hour until a shorthand writer came to get the results of his ruminations. He would then dictate minutes on the papers in the box or on anything else which occurred to him - large or small, grave or gay. The range of his official interests alone was extraordinary....The morning minutes were, of course, the primary agency for airing the ideas, many of them original, some of them startlingly original, which sprang up in that teeming brain. They were intended to go to the appropriate branch or department for examination and report. One of the jobs of the more specifically Treasury private secretary was to suggest to his master that not all of these were worthy of serious examination or that to investigate so many at the same time would place an impossible burden on the officials concerned. Occasionally I was allowed, after argument, to suppress his minutes, but more often than not, Winston refused to abandon a project until the department experts had convinced him that it was worthless or inexpedient. And quite a number of them were never abandoned but survived, though perhaps modified considerably, to become part of his adopted policy."<sup>2</sup>

One can understand, therefore, that the officials must have found Churchill a somewhat wearing master. Even Grigg was critical of Churchill's lack of discrimination:

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1: See above, pp. 54-55.

2: Grigg, Prejudice and Judgement, pp. 175-6.

"I have sometimes thought that his critical faculties stopped short of his own children, and that the best service those who worked for him could provide was to ensure that he was given time to discover for himself which were the weaklings among the offspring of his own brain. This process of Spartan exposure was sometimes a rough one for what he called the alguazils as well as for the ideas, and many of my recollections are of heated and even violent arguments with Winston. On his side, the heat nearly always disappeared the moment the argument was suspended, and sometimes he showed an unexpected measure of patience and placidity with his too persistent servants. On one occasion I recall having been provoked into retorts which went far beyond the latitude allowed to equals let alone subordinates, but instead of getting the sack, as I deserved, all that happened was a somewhat pained look over the top of his spectacles and the mildest of exhortations: 'Don't be so controversial.'"<sup>1</sup>

Grigg goes on to quote another instance, this time of a note written to him by the Chancellor after one of these battles:

"P.J.: Always be assured that our friendship is proof against all minor tiffs. But make allowances for the effect of suddenly pulling me up with a round turn, and forcing me to some measure of self-defence - however mild. 'Get animal...etc.' Yours ever. W."<sup>2</sup>

Grigg certainly found such experiences stimulating, but they could be frustrating too:

"Altogether, nothing can take away from the gratitude for the frank and equal intimacy which Winston allowed me. When I say equal, I mean only that the master did not take advantage of his position of authority and that he conceded the utmost freedom of speech. On the other hand he also exercised the utmost freedom of speech and as he was a magnificent rhetorician, the servant was very often worsted - sometimes even when he was right."<sup>3</sup>

Despite his affection for Churchill the man, the difficulties which Grigg experienced with Churchill the administrator and policy-maker are evident if one reads between the lines. A man of indiscriminate enthusiasms, who liked to have all the arguments for and against a decision put to him at length and if necessary discussed interminably, and with the ability to debate so effectively that he often won the argument even when he was, from the officials' point of view, in the wrong, inconsistent, turbulent, and fond of rhetoric: such a man can hardly expect to be well regarded by the average civil servant with a job to do.

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1. Grigg, Prejudice and Judgement, p. 176.
  2. Ibid.
  3. Ibid., p. 177.

One last comment by Grigg will suffice both to conclude our brief look at Churchill's behaviour in office, and our survey of the Chancellors in general. Grigg served as Private Secretary to all the Chancellors of our period except Bonar Law and Austen Chamberlain; looking back over this time he comments:

"I notice that, with Winston's advent, the character of my recollections changes. Instead of being centred mainly on events and only secondarily on persons, I find them clustered round a single dominating personality."<sup>1</sup>

This is hardly surprising, but it lends some support to the supposition that during our period the Chancellors succeeded one another in such baffling rapidity that the continuity provided by the officials became unusually important, and that Churchill, who only took office five months before the last major policy event of our period, the return to the Gold Standard, was the only one of our Chancellors really to impress his own personality upon policy-making in the Treasury during the 'twenties.

### Treasury Attitudes

Perhaps the most important and obvious point to be made in summarising the evidence of this material on the structure, organisation and attitudes of the Treasury, is the significance of traditional influences and historical precedents within the Treasury. This is demonstrated in a number of different ways. Firstly, as we have seen, before a decision could be taken on a particular problem, any relevant material on that and similar cases had to be collected together for the benefit of the person taking the decision. The search for similar cases was not restricted to the recent past: it will be remembered that one of the papers commissioned during the discussions over the return to the Gold Standard was on the subject of the return to the Gold Standard after the Napoleonic Wars. There was thus a strong inbuilt tendency for patterns of decision-making to remain

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1. Grigg, Prejudice and Judgement, p. 174.

unchanged. Secondly, the way in which junior entrants to the Treasury were trained tended to instil into them the traditions of the Department by gradual stages in a fairly painless way: at least in the Finance Divisions, there were normally two Principals to one Assistant Principal, and the junior would be jointly responsible to his two seniors. Thirdly, and linked with this, the way in which business was carried out lent itself to the absorption of traditional methods by the younger members. Drafts which they had written for letters or memoranda would be annotated or corrected by the senior man, and the draft remained on the file, so that the junior could see each time he read the file how his ideas and suggestions differed from those of his superiors. One contemporary remembers that when he was an Assistant Principal, he had an office which was located in between the offices of his two Principals, with connecting doors to each, and when he wrote a draft which needed amending the senior would come into his room and discuss the problem with him informally, and leave the draft for alterations to be made. One can see how such a system is liable to enhance the importance of tradition and precedent, and it is the view of several of those who served in the Treasury at the time that this was in fact the case. This emphasis on tradition had, of course, many disadvantages, even in terms of the officials' ability to cope with problems presented to them; the lack of adaptability which it tended to produce or encourage seems to have been a contributory factor in the difficulties which the Treasury encountered during Winston Churchill's term of office.

Another factor which is not immediately obvious but which emerges quite forcibly both from the files and from the evidence of contemporaries is the importance of the pivotal position of the Chancellor's Private Office. The young men who staffed this part of the Treasury acted as a buffer between their Chancellor and all comers, including, on occasion, senior officials in their own Department. When Parliament was sitting, they would accompany their chief to the

House in the afternoons, and often would be the only Treasury officials available to give advice to the Chancellor when matters concerning his province came up unexpectedly. As we have noted, this pivotal position was of particular importance in relation to the client departments of the Treasury, the Boards of the Inland Revenue and of Customs and Excise. The continuity of holders of the Private Secretary posts during our period must have enhanced still further the importance of this already prominent Office.

One facet of Treasury life which seems to have undergone some change during the war is the position of the Financial Secretary. The influence of this post waned during the war, and this Minister tended to be left with the 'hack' work, particularly when his relationship with the Chancellor was not too cordial. This situation persisted after the war, and it is rare to find documents in the files on policy matters which have been through the Financial Secretary's hands, as far as one can judge.

Relations with other Departments and with the Bank seem on the whole to have been cordial at the senior level during our period; the fact that the Treasury is a senior Department, and the Chancellor usually a man of considerable ministerial experience and weight in his party, tends to contribute to this harmony. The main exceptions during our period occurred with the 'new' Departments set up during the war, where the arguments about levels of expenditure reached much higher in the Treasury echelons than was normal with such matters, largely because what was at stake was by no means of the 'candle-ends' type of savings which the Treasury was normally engaged in trying to extract from other Departments.

As we have seen, the work of the Treasury involved three main categories: these were dealt with by, respectively, the Departments of Supply, Establishments and Finance. Of these, the work of the Supply and Establishments Departments was rarely concerned with the making of policy; occasionally their activities would have the effect of negating a policy decision made in some other Government

Department, but as far as policy-making in a positive sense in the economic sphere is concerned, it is primarily the Finance Department with which we have to deal. From the point of view of personalities, a consideration of the Finance Divisions falls into three phases in our period: the first, from the end of the war until the reorganisation of Treasury structure in 1919, is one in which several men are active, but no one man has impressed his stamp on the period. Following this are the two phases during which the Finance Department is dominated by the personality of its Controller, the more so since, as we have noted, the Treasury was even at this stage very 'security conscious', and it was therefore primarily with these men that the Chancellors would discuss official policy. Despite the individual personality differences, however, the two men, together with Bradbury, who was much involved in the post-war period, and Fisher, who was Permanent Secretary from the time Bradbury left until after 1925, had a great deal in common in terms of background and education. Two of them were educated at public schools, the other two at schools of the 'direct-grant' type; all four had received the benefits of a classical education at either Oxford or Cambridge. This commonality of education and experience, which was shared by most of their juniors, was another very strong factor in promoting the homogeneity of the Department and the consistency of its advice.

Thus the impression which one gains from an examination of the Treasury during the period from 1918 to 1925 is of a small, friendly place, in which most of the staff had much common experience, and in which tradition played a very important part. It might be thought that this emphasis on tradition would be rather stultifying to a junior; on the whole, this seems not to have been the case. The commonality of experience must have helped; so, too, did the insidious nature of the absorption process, so that a junior did not really notice how like his superiors he was becoming. Another point is that the contact between seniors and juniors was so close, and the seniors' knowledge of the juniors' work and

ability so great, that on the whole merit and hard work were rewarded by appropriate promotion, and they tended to feel that their abilities were being recognised.

One point which has been impressed upon me by several contemporaries is the importance of the personality of the Chancellor, and the extent to which the Minister could affect the character of the Treasury and its policy.

"Because the post of Chancellor of the Exchequer is so senior - usually ranking as second or third in the Cabinet - the Treasury normally gets the kind of Minister it needs and wants. A Minister of intelligence and decisiveness, of considerable political and Parliamentary and other experience, of stature and authority in his party, in the House of Commons and in the Cabinet. What it dislikes most is a weak and indecisive Chancellor with insufficient influence and authority - which fortunately rarely happens. Despite recurrent suggestions that a Chancellor of the Exchequer becomes a prisoner of the Department (and especially of the 'Treasury Knights' at the top) a Chancellor who falls within the above description as most do is clearly the boss."<sup>1</sup>

At first glance, this stress on the importance of the personality of the Chancellor may seem to contradict the supposition that during our period it was the officials who had an unusual influence over policy formation. However, closer examination suggests a rather different conclusion. The first of our Chancellors, Bonar Law, fulfils the necessary requirements for a strong Chancellor, as does Sir Austen Chamberlain; but Bonar Law was much preoccupied with the problems of the waging of war during his term of office, and for much of Chamberlain's time as Chancellor he was also deputising for Lloyd George during the latter's absence at the Peace Conference. Of the Chancellors who followed him, only Churchill had had substantial previous Ministerial experience; this was of course a somewhat unusual period politically, covering the 'government of the second eleven' and the first Labour Ministry, but this does not alter the facts. Thus, whether the Treasury liked it or not, during virtually all our period it had a Chancellor who

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1. Private information to the author.

was either much pre-occupied with problems outside the Treasury, or else had very little previous experience of office. As a result, there was a strong tendency for the factors normally contributing to the superiority of the Chancellor over his subordinate officials to be missing. However, as we have seen, there is little evidence that any of the Chancellors were in any sense 'railroaded' into making decisions with which they were in fundamental disagreement: all the evidence suggests that the Chancellors, apart from Churchill, who seems to have been an exception to every rule, were as orthodox as the officials who advised them, on matters of economic and financial policy.

### Note on Sources for this Chapter

The sources of information necessary to construct this chapter have presented some special difficulties. Much of the information is by its very nature not recorded in the formal documents of state. Because of this, I have had to rely heavily on oral information from some of the few men still alive who remember the period well, and to them I have already expressed my gratitude. Several of those who helped me in this way expressly asked that I should preserve their anonymity, and I have therefore endeavoured to attribute remarks to particular individuals only where specific permission has been given to me to do so. For the rest, I have had to make extensive use, to a degree which one would not normally have considered necessary, of quotations from the works of other participants in these events, many of whom were either closely involved in Treasury activity, or else knew well some of the people who were. Without the use of such information it would have been virtually impossible to attempt to assess some of the more intangible and personal factors involved in this study.

CHAPTER THREE

THE REPORTS OF THE COMMITTEE ON  
CURRENCY AND FOREIGN EXCHANGES AFTER  
THE WAR OF 1914-18

## Introduction

The Committee on Currency and Foreign Exchanges after the War was set up in January 1918 under the joint auspices of the Treasury and the Ministry of Reconstruction. Its Chairman was Lord Cunliffe, retiring Governor of the Bank of England, and the Committee is familiarly referred to by his name. Its other members were largely bankers, the exceptions being Sir John Bradbury, Joint Permanent Secretary to the Treasury, and Professor Pigou, who held the Chair of Economics at Cambridge University. The Committee brought out a first interim Report, which contains the bulk of its recommendations, in August 1918,<sup>1</sup> and the final Report in December 1918.<sup>2</sup> The final report echoes the earlier one in virtually every respect. The two main differences are that by the time the second Report appeared the Committee considered that the time had come to implement certain proposals which it had previously put forward without suggesting a date for their inception, and that the final Report extends the application of the principles enunciated in the interim Report to the Scottish and Irish Banks. The importance of these two Reports in any consideration of the British Government's financial and economic policy after the First World War is considerable, and an examination of them is an essential preliminary to any detailed discussion of Government policy in other parts of the economic sphere, since the principles on which much of this policy is based are expressed in their strictest form by the Reports of the Cunliffe Committee.

The Reports were accepted by the Government, with minor reservations, in December 1919.<sup>3</sup> Their central recommendation was that Britain should return to the Gold Standard as soon as possible. That this return should

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1. Cd. 9142 (London:H.M.S.O., 1918).

2. Cmd. 464 (London:H.M.S.O., 1919).

3. House of Commons Debates, 1919, .CXXIII, cols. 43-46.

be at the pre-war parity was only stated by implication, since the question of parities was not discussed. The Committee regarded a reduction in the floating debt and a rapid return to 'normal' conditions - that is, those conditions which were normal before the war broke out - in the fields of credit creation, State expenditure and industry (particularly those sections most concerned with the export trade) as essential prerequisites of this policy. Government policy, with only slight deviations from the straight and narrow, proceeded along these lines from the publication of the Report until the return to the Gold Standard, which was the central recommendation of the Reports, was achieved in April 1925. The Report, then, is of special importance in any consideration of Government action, especially in monetary policy in the period up to 1925.

#### The Background to the Reports

The Cunliffe Committee was set up as a result of discussion between the Treasury and the Ministry of Reconstruction as to the best form of enunciating policy about currency, credit and the foreign exchanges after the war was over. Originally a single Committee was intended, but Addison suggested that the provision of credit for industry should be considered independently, and as a result this problem was given to a separate Committee called the Financial Facilities Committee.<sup>1</sup> Originally the idea that such a Committee or Committees was necessary seems to have originated with Lord Balfour's Committee on Commercial and Industrial Policy after the War.<sup>2</sup> The first interim Report was presented jointly to the two departments, but by the time the final Report appeared

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1. The Final Report of the Financial Facilities Committee was issued as Cd. 9035 (London: H.M.S.O., 1918).
  2. Cd. 9227 (London: H.M.S.O., 1918).

the Ministry of Reconstruction had been wound up and the Committee had come entirely under the aegis of the Treasury. There is some suggestion in the Treasury material on the setting up of the Committee that the total orthodoxy of the Reports was not entirely accidental, and Dr. Addison's move to separate the provision of industrial credit from the Currency problem may have been an astute manoeuvre designed to prevent worries about inflation from overshadowing the needs of industry for reconstruction capital.<sup>1</sup> Writing to Sir Austen Chamberlain to ask him to take the Chairmanship of the new Committee, Sir John Bradbury notes Addison's inclination towards comprehensive and expensive reconstruction schemes, and comments:

"...the primary condition of sound reconstruction is that we should cut our coat according to our cloth and that to embark on all sorts of ambitious programmes of expenditure before securing the groundwork of stable finance would be to build upon the sand."<sup>2</sup>

Chamberlain, however, did not in the event take the chair; that position was offered to Walter, first Baron Cunliffe, who was Governor of the Bank of England from 1913 to 1918, and he accepted.

#### The Chairman of the Committee

In his financial views, Lord Cunliffe had a reputation as a strictly orthodox Governor. In his dealings with other men, including the Chancellor of the Exchequer, he was extremely high-handed. He very nearly came to an open breach with Bonar Law in 1917, over the activities of Sir Robert Chalmers and Keynes in the Exchange control field. Cunliffe felt that Keynes and Chalmers were usurping the functions of the London Exchange Committee, of which he was chairman; he was particularly vitriolic about

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1. P.R.O., T.1/1238/4228.  
2. Ibid.

Keynes' behaviour, since he had been given a verbal promise by McKenna, Bonar Law's predecessor, that Keynes "should not meddle again in City matters".<sup>1</sup> Cunliffe therefore wrote direct to Lloyd George, who was his personal friend, complaining of the attitude of these Treasury officials.<sup>2</sup> Bonar Law was extremely angry at this move, reinforced as it was by a letter from Cunliffe to Bonar Law himself effectively demanding Chalmers' resignation.<sup>3</sup> The Chancellor replied, in uncompromising tones, that in effect Cunliffe was demanding Bonar Law's own resignation, since both officials were working under his authority, and he was responsible for their official conduct.<sup>4</sup> Cunliffe then committed an inexcusable and irretrievable blunder.

Earlier in the war, large stocks of gold had been transferred to Ottawa for safe keeping. Cunliffe wired the Canadian Government that in future no gold was to be given to the British Treasury representative in Canada on demand, and that the whole hoard was to be transferred to the Bank of England's account with J.P. Morgan in New York. When Bonar Law protested, Cunliffe replied in terms which made it clear that the sole reason for this high-handed behaviour was that it was an act of 'reprisal' for the Treasury's actions over exchange.<sup>5</sup> Further, Cunliffe opened and read to the Treasury Committee of the Bank, the telegram in reply from Morgan's - which was addressed to Bonar Law in person.<sup>6</sup> Bonar Law was furious. He discussed the situation with the Prime Minister, and then set down his views in writing. He was not prepared, he said to

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1. A. Boyle, Montagu Norman (Cassel & Co., 1967), p.117.
  2. R. Blake, The Unknown Prime Minister (London: Eyre & Spottiswoode, 1955), p.352. Cunliffe to Lloyd George, 3 July, 1917.
  3. Boyle, op.cit., pp.117-118.
  4. Blake, ib. cit., p. 352.
  5. Ibid., p.353.
  6. Boyle, ib. cit., pp. 118-9.

continue as Chancellor without having in his possession a letter signed by Cunliffe offering to resign at Bonar Law's behest.<sup>1</sup> Cunliffe temporised at first, but even Lloyd George could not persuade the Chancellor to accept an apology alone, and eventually he got the letter he had demanded.<sup>2</sup>

Montagu Norman was at this stage working fairly closely with Cunliffe, and Boyle's account of Cunliffe's last few months at the Bank gave a picture of a man of extreme arrogance whose behaviour at times had strong megalomaniac tendencies.<sup>3</sup> Early in the autumn he was apparently attempting to ensure that he was allowed to remain as Governor until the end of the war, and to this end he himself collected a Memorial from the Clearing Bankers urging that Cunliffe should continue.<sup>4</sup> At his final meeting of the Bank's Court, he read a long and embarrassing speech which Norman described as

"eulogizing the Bankers, bum-sucking the press, promising as Chairman of the Currency Committee changes by statute in the Bank Charter and Act of 1844...even Cockayne much disgusted with such an unfriendly finale. A dangerous and insane colleague."<sup>5</sup>

Norman was not alone in this view of Cunliffe; other colleagues at the Bank also had grave doubts about his behaviour at this period.<sup>6</sup> Certainly he had become totally incapable of discussing a problem or of allowing his wishes to be questioned:

"Clear that all must bow down to the Governor or risk being crushed..."<sup>7</sup>

wrote Norman in March 1918. This unwillingness to listen to others is occasionally apparent in the Minutes of Evidence of the Cunliffe Committee, and leading questions were frequently put to witnesses.<sup>8</sup> This

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1. R. Blake, The Unknown Prime Minister (London: Eyre & Spottiswoode, 1955), pp. 353-354.
  2. A. Boyle, Montagu Norman (Cassel & Co., 1967), pp. 119-120.
  3. Boyle, op.cit., pp. 120-123.
  4. Boyle, op.cit., pp. 121-122.
  5. Ibid., p. 123, entry in Norman's diary for 21 Mar., 1918.
  6. Ibid., p. 120.
  7. Ibid., p. 122, entry in Norman's diary for 3 Mar., 1918.
  8. See, for example, P.R.O., T.185/1, Minutes of 15th meeting, 27 May, 1918.

conviction of his own infallibility was to some extent borne out by his experience; his formative years at the Bank had been during the period when the Gold Standard was working at its classical best, and when circumstances were particularly favourable to its smooth operation.<sup>1</sup>

#### The Members of the Committee

Of the remaining members of the Committee, only three were not bankers by profession. None was currently working in Commerce or Industry; it had early been decided that it would have been impossible adequately to represent commercial and industrial interests in the membership of the Committee without making it large and unwieldy.<sup>2</sup> It was therefore decided to fulfil this purpose by calling witnesses from these quarters. The non-bankers were Sir John (later Lord) Bradbury, Joint Permanent Secretary to the Treasury, Lord Inchcape, and Professor Pigou, who held the Chair of Economics at Cambridge. Bradbury had been appointed in 1913 to be Joint Permanent Secretary with special responsibility for Finance, and he remained in that office until 1919, when he was appointed British representative on the permanent Reparations Commission set up after the Peace Conference. He was succeeded by Sir Basil Blackett, who also took his place on the Cunliffe Committee for the last few meetings. Apart from the deliberations of the Committee, the main source of evidence for Bradbury's opinions are to be found in the Treasury files and in the evidence he gave to various Commissions and Committees.<sup>3</sup> Of these latter, perhaps the most important and well-known is the Macmillan Committee on

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1. An episode often referred to in this connection is the gold loss of 1907, when a rise in Bank Rate to 7% brought about a spectacular reversal of the flow which "impressed itself deeply on the minds of the Directors of the Bank..." S. Pollard, The Development of the British Economy 1914-1950 (London: Edward Arnold, 1962), p. 17.
  2. P.R.O., T.1/1238/4228, Bradbury to Minister of Reconstruction, 23 Jan., 1918.
  3. See above, pp. 42-46.

Finance and Industry, which reported in 1931, and on which he served as a member.<sup>1</sup> He found himself unable to sign the Report even with reservations, and wrote a dissenting report expounding his own views. It was a classic exposition of the orthodox approach:

"It is to the best interests of this country to continue to adhere to the international gold standard at the existing parity, but efforts should be made to secure by international agreement a better working of that standard..."<sup>2</sup>

In the domestic field his views were equally orthodox:

"The best contribution which the State can make to assist industry and to promote employment is strict economy in public expenditure and lightening the burden of debt by prudent financial administration. Attempts to give positive assistance by diverting international trade from its natural channels, the State financing of enterprises other than the ordinary public services, or the artificial cheapening by State guarantees of the supply of capital to particular undertakings are more likely to retard than to accelerate the restoration of a healthy and progressive economy."<sup>3</sup>

As to the particular economic difficulties which might be expected to confront Britain after the end of the war, Bradbury was convinced that one of the most important was the problem created by the size of the Government's floating debt. In a memorandum written in answer to one from Addison urging the importance of providing adequate finance for reconstruction purposes, in which it was implied that this was not compatible with a big effort at floating debt redemption, he suggested that in fact these two aims were not in opposition. He stated that the raising of money by taxation to be used to pay off debt involves simply a transfer of purchasing power from one member of the community to another, and in so far as the money taken from the tax-payer is money which would have been spent on consumer articles, and that given to the investor is re-invested in securities, the capital stock of the nation is actually increased.

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1. Report published as Cmd. 3897 (London: H.M.S.O., 1931).
  2. Cmd. 3897, p.281, para.36(1).
  3. Ibid., p.281, para.36(5).

"The creation of a substantial sinking fund for the war debt out of revenue is therefore thoroughly sound from the economic point of view and will itself assist the re-establishment of industry by restricting consumption and increasing the demand for and making funds available for the production of new capital goods." <sup>1</sup>

Unfortunately this exposition takes no account of the fact that to a large extent repayment of the floating debt, and in particular of Ways and Means advances from the Bank of England, involved an actual destruction of purchasing power. This salient fact was recognized by members of the Treasury, notably by Blackett, in other contexts, particularly when credit inflation was under discussion.<sup>2</sup> But Bradbury, at any rate, seems not to have realised that if increases in the floating debt are inflationary and imply increases in purchasing power, decreases in floating debt must involve a fall in purchasing power and deflation.

Blackett, who replaced Bradbury, was, as we have already noted, a rather different sort of Treasury man; his evidence before the Select Committee on War Wealth in 1920 shows that he was conscious of the dangers inherent in a rapid deflation by means of reducing purchasing power through a reduction in the floating debt.

"Anyone responsible in any degree for a policy of deflation must guard with the most careful eye against doing more harm than good." <sup>3</sup>

After Blackett left the Treasury, he became more and more convinced of the dangers inherent to the economic system in frequent and drastic changes in the value of money, and eventually became a convert to planned money. But he was present at only a few meetings of the Cunliffe Committee, and that after the First Interim Report had already been published. In

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1. P.R.O., T.170/125, memo. by Bradbury, 21 Feb., 1918.
  2. Minutes of evidence of Mr. B.P. Blackett, taken before the Select Committee on Increase in Wealth (War), House of Commons Papers, 1920. (London: H.M.S.O., 1920), No. 102.
  3. Ibid., Minutes of evidence of Mr. B.P. Blackett, Q.1546.

that first Report considerable stress is laid on the importance of repaying the floating debt as soon as possible,<sup>1</sup> and no mention is made of the possible dangers of such a policy. In the Final Report, which Blackett signed, the only mention of this is a paragraph in rather less strong terms on the need for abolishing Bank Ways and Means as a method of escape from all but the most temporary difficulty.<sup>2</sup> Whether there is any significance in this it is difficult to assess, since the discussion of the form the Reports were to take were not recorded in the Minutes.

The second committee member who was not a professional banker was the only economist in the group, Professor Pigou. The presence of an economist of his eminence makes some of the Committee's omissions, notably the failure to qualify in any way their exposition of the 'automatic' operation of the Gold Standard in pre-war days, the failure to consider the 'par' question, and the absence of any comprehension of the macro-economic implications of some of their recommendations, at first seem rather remarkable. But Pigou in the years before the war had been primarily concerned with parts of the discipline not connected with international economics, notably in the writing of his book on the Economics of Welfare. During the war he had, indeed, written a book on War Finance,<sup>3</sup> but in that and in much other writing he was primarily concerned with the inequities and iniquities of Government financing of the war. His view was that the extent to which inflation had taken place, and the more dubious ways in which the Government had expanded credit for its own purpose, for instance by backing Ways and Means advances with their own securities, were entirely reprehensible. He also believed that to pay for the war by

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1. Cd. 9142, para. 17.

2. Cmd. 464, para. 5.

3. A. Pigou, The Economy and Finance of War (London: J.M. Dent & Sons, 1917).

borrowing to the extent the Government had done was highly inequitable, since it created an asset which would remain after the war, and for the service of which all, even the poorest, would be taxed. Since war-costs are a once-for-all expenditure, he argued, it would not be seriously disincentive to tax the rich very heavily in war-time, particularly in view of the efficacy of appeals to patriotism at that time. Pigou did not, however, develop ways in which the harshness of the debt burden could be averted once it had been incurred.<sup>1</sup> It seems likely that, in his preoccupation with the dubious nature of Government finance, Pigou became convinced of the necessity of ending this 'rake's progress' by restoring normal credit conditions and by repaying a large portion of the National Debt, without considering fully the harmful effects which would result from the deflation which such a course, especially if precipitate, would produce.

The other non-banker was a man very well-known in the City, Lord Inchcape. He was originally a merchant, was a partner or a Director in numerous firms concerned in trading with the Far East, including the Peninsular and Orient Company, of which he was chairman, and had been on numerous official Committees and Commissions before and during the war. He was a member of the Committee of Imperial Defence in 1917, and he was a frequent speaker in the House of Lords.<sup>2</sup> His chief pre-occupation in the Chamber was with Government spending and extravagance, which on the whole he seems to have regarded as necessary concomitants of one another. Later he was to be a member of the famous Committee under Sir Eric Geddes, which wielded the so-called Geddes Axe with such vigour in 1921-2.<sup>3</sup> His

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1. Pigou, The Economy and Finance of War, pp. 66-83.
  2. Dictionary of National Biography (O.U.P., 1949), Supplementary volume for 1931-1940, pp. 573-575.
  3. National Expenditure Committee, Reports published as Cmd.1581, 1582, 1589 (London: H.M.S.O., 1922).

opinion on financial matters was thus at any rate highly orthodox, and perhaps reactionary, even in terms of opinion in the 1920s.

The remaining members of the Committee were all bankers of different kinds, drawn from among the various interests in the City. Two were members of private banking firms, among them Rupert Beckett, of the Yorkshire Banking house which was one of the few remaining private banks with the right of note-issue, and which finally merged with Westminster group in 1920.<sup>1</sup> There was one member representing Scottish banking interests, and two those of the Dominions, from the Banks of Montreal and Australasia respectively. The merchant banking houses supplied Gaspard Farrer, of Baring Brothers and the banks with overseas interests Sir Charles Addis, of the Hong Kong and Shanghai Banking Corporation. Finally, there was Goschen, Chairman of the National Provincial Bank and of the London Clearing Banks Committee.

#### Political and Economic Background to the Committee's Discussions

The period in which the Committee was set up and deliberated was a crucial one for the whole history of the inter-war period. During 1918 and 1919, and particularly in the six months after the Armistice, public opinion gradually turned from positive ideas of Reconstruction towards feeling that the sooner the Government ceased to interfere in the economic life of the country more than was absolutely essential even in peace-time, the better it would be for industry and for the economy in general. Another increasingly popular pastime was criticism of Government extravagance; demands for economy are common in the editorials of the leading papers of the day.<sup>2</sup> Criticism on this count was also strong in the

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1. Economist, XCI, 18 Dec., 1920.

2. Notably in the Economist; there is a leader on the subject in almost every issue in 1918.

Houses of Parliament.<sup>1</sup> Both these ideas found favour with the Cunliffe Committee, and on the whole their attitude on these questions seems to have been very much in tune with those current at the time.

On the economic front the period during which the Committee was reporting was one of considerable upheaval. The absorption of returning soldiers was completed with remarkably little difficulty, and the post-war boom gathered way. Prices continued to rise fast.<sup>2</sup> From the point of view of the deliberations of the Cunliffe Committee one very important event was the de facto abandonment of the Gold Standard in March 1919 when the export of gold was prohibited except under licence. But there is little indication in the Final Report that the Committee members were very conscious of the changes which had taken place between the times of the interim and final Reports; and indeed this is one of the criticisms which was made of the final Report at the time.<sup>3</sup> For further elucidation it is necessary now to turn to a consideration of the evidence given to the Committee, its deliberations, and the conclusions which it reached.

The Minutes of Evidence of the Cunliffe Committee: Preliminary Discussion

The Committee began by devoting several meetings to a general discussion of the problems facing them. They then called a number of witnesses, and at the same time set up a small sub-committee to draft preliminary proposals. These proposals and the evidence given so far were discussed at two meetings at which no minutes were taken, and the first Report was published almost immediately; only five months elapsed between the first meeting and the publication of the first Report. During the autumn of 1918 and spring of 1919 Cunliffe was fully occupied with Reparations

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1. See below, pp. 182-183.
  2. The Ministry of Labour Cost of Living Index rose from 185 in January 1918 to 225 in December 1919 (July 1914=100), Morgan, Studies in British Financial Policy 1914-25, p.284.
  3. Economist, LXXXIX, 20 Dec., 1919.

problems, and the committee did not meet again for almost a year. Then again the same pattern was followed, with witnesses being called, and a discussion of the Final Report at which no minutes were taken. The witnesses were drawn about equally from banking and from commerce and industry, with in addition a number of specialists from other fields. No representative of labour interests was among them; indeed most of the Committee's deliberations indicate a feeling that the matters under discussion were largely the province of the City and to a much lesser extent of other commercial interests.

The first ten meetings, held during February and March 1918, were devoted to general discussion. At the first meeting Pigou, supported by Bradbury, suggested that the question of the exchanges should be considered first, particularly the problem of whether it would be better to attempt to maintain certain rates of exchange or to leave the pound to float. However, Cunliffe, while in favour of maintaining the value of the pound by official action, thought that it would be difficult to make suggestions about this in advance of the event, and proposed that the Committee should consider banking problems first, and in particular the Bank Charter Act of 1844. He was supported by the other bankers, and the proposal accepted.<sup>1</sup>

One of the principal problems which occupied the Committee, often at great length, was the best way of dealing with panic calls on the Bank, which had previously led on several occasions to the suspension of the Act.<sup>2</sup> It was strongly felt in the City that a system which was not sufficiently flexible to allow for crises was in need of overhaul. Unfortunately for the bankers, none of them could agree as to the best

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1. P.R.O., T.185/1, minutes of the evidence of Cunliffe Committee, 1st day.
  2. Sir Albert Feavearyear, The Pound Sterling (2nd edn.; Oxford:Clarendon Press, 1963), pp.284-286, 293-295, 301-303.

way of providing for crises, and eventually the Committee decided to recommend that the Act be retained. Lord Cunliffe had a suggestion of his own; he wanted the Joint Stock Banks to be compelled to hold a certain proportion of their liabilities in short-term Government stock, which could then be discounted at the Bank at a penal rate in an emergency.<sup>1</sup> There were two main objections to this scheme; one was that it only catered for crises where the public demand was for notes, not for credit only, and the other that it was irrelevant in circumstances where the banks already held large balances at the Bank. They could then draw on these to such an extent as to force the Bank to ask for suspension of the Act before any penal rate notes had been drawn at all.<sup>2</sup> In any event, Cunliffe was not successful in promoting this scheme, and most of the others which were suggested came to grief for similar reasons, or because they made it too easy for crisis measures to be taken where no crisis in fact existed.

Bradbury was less concerned with general problems, and more with the post-war situation. He had more success with his projects, largely because they were not new ideas at all, but consisted in urging the current orthodoxies with vigour and persistence. His principal concern was to restore the efficacy of Bank Rate, and the connection between an external drain and the supply of money in the domestic market.

While other members of the Committee took some part in these discussions, Cunliffe, followed by Bradbury and Pigou, were the principal contributors. Pigou, however, made his suggestions mainly in the form of memoranda for discussion, and his ideas, though largely a toned-down version of the orthodox, do not seem to have made much impact - perhaps

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1. P.R.O., T.185/1, Minutes of evidence of Cunliffe Committee, 2nd day.  
2. Ibid., appendix to minutes for 2nd day.

because people cannot be forced to read memoranda, although they are obliged to listen to fellow Committee members' speeches. Pigou's main contribution in the early stages was a memo on the fiduciary issue after the war, and on credit control. He was anxious that credit should not be allowed to continue to expand after the war, since the more it did the more difficult it would be to deflate eventually.<sup>1</sup> A paper on this subject was also submitted by Bradbury, who had similar anxieties, although he was principally concerned with the importance of the expansion of the note issue. He suggested that since the public had become used to notes it should be accepted that a return to the circulation of gold coin was unnecessary, and indeed undesirable since increased gold reserves would be needed.<sup>2</sup> It would therefore be easy to centralise all the banks' gold holdings at the Bank of England. He further suggested that the uncovered note issue should be reduced whenever possible,<sup>3</sup> and that this policy should be continued until a reserve of not less than £150 million gold had been built up and maintained for at least a year.<sup>4</sup>

The next few meetings were concerned with discussing the form of the Bank's accounts, the possibility of merging the Banking and Issue departments, and the forms and frequency of the accounts issued by the Joint Stock Banks. At this point the Committee members decided that they could not adequately discuss the Bank of England without being able to discuss its organization; it was for instance mooted that the Bank should have one permanent official as an assistant to the Governor, to provide continuity. The terms of reference of the Committee were therefore

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1. P.R.O., T.185/1, memo. by Pigou on the fiduciary issue, 26 Feb., 1918.
  2. It was generally accepted in many of the Committee's discussions that the Bank's gold reserves were insufficiently large before the war.
  3. The difficulty of building up a reserve of anything approaching this figure pre-war was discussed with Cokayne, P.R.O., T.185/2, minutes of evidence of Cunliffe Committee, 21st day, 8 July, 1918.
  4. P.R.O., T.185/1, memo. by Bradbury on the fiduciary issue, 9 Mar., 1918.

modified by the Chancellor, at Cunliffe's request, to include the constitution of the Bank.<sup>1</sup>

A small sub-committee had been appointed by the Committee at its fifth meeting in March, and towards the end of that month it produced some provisional conclusions for the consideration of the Committee, although they were not in fact discussed until the end of May. This sub-committee consisted of Cunliffe, Bradbury, Goschen, and Jeans of the Bank of Australasia. The principal recommendations of importance were that credit inflation must be reduced, that government borrowing must cease at once and a sinking fund be established, that the interest rate level should be manipulated with regard to that in the other principal foreign trading countries, and that the uncovered note issue should be reduced. Gold import should be uncontrolled, but gold exports should only be permitted if the gold had been obtained from the Bank of England for that purpose; this proposal is tied in with the recommendation that internal gold circulation should not be resumed. A return to the Gold Standard is simply assumed; it is not explicitly suggested, but it is clear from the other proposals that the sub-committee took that one for granted.<sup>2</sup>

At the tenth meeting the matter of witnesses was discussed; numerous suggestions were made, and about half of these were acted upon. It was suggested that a representative of labour interests should be included, but this did not in fact happen. It was also suggested that each witness should be asked to answer a questionnaire, but this proposal was rejected. Some witnesses put in memoranda on which they were questioned; but those who did not, and often those who did, were asked a set of questions to

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1. P.R.O., T.185/1, minutes of evidence of the Cunliffe Committee, 9th day, 19 Mar., 1918.
  2. Ibid., minutes of evidence of the Cunliffe Committee, Appendix to 9th meeting.

begin with, the form of which became quite standard, and effectively asked for the witness's agreement to the proposals of the sub-committee. One witness who could not attend was in fact sent a questionnaire on these lines.<sup>1</sup> So that the principal questioning, which was done by Cunliffe, had become quite formalised on matters of principle fairly early on, and witnesses were effectively being asked to rubber-stamp the sub-committee's statements of principle. It should be added that most witnesses had no hesitation in answering unequivocally in the affirmative when asked to support these principles, but it may be wondered if some of the answers might have been a little different if the questions had not been so 'loaded'. It is of course common knowledge nowadays that the answers given to questions can be markedly affected, both by the answers which the respondent knows are expected of him if such there be, and by the form in which the question is put, it being apparently a basic human preference to reply in the affirmative rather than the negative.

The Minutes of Evidence of the Cunliffe Committee: Hearing of Witnesses

The first witness to be examined was Sir William Holden, chairman of Barclays' Bank, and a prominent figure in the City. His views on currency and exchange were orthodox in the extreme, but not so his ideas on banking. He deplored the suggestion that the circulation of gold coin should not be resumed after the war, and the idea that the Joint Stock Banks should be asked to deposit all their gold holdings at the Bank of England. He felt that both these sources of gold acted as a 'hidden reserve' in times of gold shortage, although his opponents on the Committee suggested and held to the view that in fact centralisation of the gold

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1. Professor J. Shield Nicholson, see below, pp. 104-5.

reserves would be more economical in times of crisis. Holden seems to have been unduly obsessed with the problems which had arisen pre-war in maintaining an adequate reserve. The City had become used to a customary reserve which was lower than that which the Bank would like to have kept, and thus expected interest rates to fall when that level was reached; they were able to put pressure on the Bank to reduce rates in accordance with their expectations, and so the reserve never reached the level the Bank would have liked.

Holden acceded to the ideas of the sub-committee on inflation, but suggested that the only way to put the exchanges right was to increase exports after the war was over. He urged that it was worth accepting a temporary worsening in the exchange position while large imports of raw materials with which to make the exports came in, in order to lay a sound foundation for the future.<sup>1</sup> He was followed by Sir Felix Schuster, another prominent City figure, and the author of several books, including one on the Bank of England largely in favour of the Bank Charter Act.<sup>2</sup> Sir Felix agreed with Cunliffe that the only way to reduce inflation was for the Government to cease borrowing, but he urged that the calling in of currency notes should not be done too precipitately or too soon, since this would have a bad effect on commerce. He also agreed with Cunliffe's suggestions about improving the exchange position by increasing short-term interest rates. This, together with the encouragement of exports to Europe in particular, should be sufficient to improve the exchange position; he was not in favour of prohibiting the export of gold after the war. He was not so fervently in favour of the removal of Government restrictions as some witnesses; he suggested that control over Capital Issues should

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1. P.R.O., T.185/1, evidence of Sir William Holden before the Cunliffe Committee, 11th day, 8 Apr., 1918.
  2. Sir Felix Schuster, The Bank of England and the State (Manchester: The University Press, 1923).

be retained for two years after the war ended.<sup>1</sup>

Most witnesses paid lip-service to the needs of industry for finance for reconstruction purposes, but this was usually expressed in very general terms. One witness who made more explicit suggestions, and some of whose ideas call to mind irresistibly the strictures of the Macmillan Committee on the shortage of investment capital in some areas of business,<sup>2</sup> was A.M. Samuel, an M.P. and a member of the Norwich Chamber of Commerce. He submitted a memorandum from his Chamber, advocating a series of reforms in the constitution of the Bank of England, including amalgamation of the Banking and Issue departments and the appointment of a permanent sub-Governor for a term of seven years. He also suggested that financing of major investment projects was a big problem for the small and medium size business, which was not large enough to float an issue of its shares on the Stock Market. The banks were unwilling to lend for long or fixed periods, and such businesses were constantly in danger of sudden bankruptcy if they attempted to finance expansion by means of overdrafts.<sup>3</sup>

Cunliffe did not see the need for any sort of central lending institution such as the one Samuel proposed, which was to be based on credit given to customers for approved projects by the banks, subject to a Government guarantee. Samuel suggested that for the banks to lend under the aegis of such an institution would solve the problems of both sides, since the banks would be able to regain a measure of liquidity in an emergency, while the borrowers would not be subject to recall of loans at very short notice. But he was at cross-purposes with Cunliffe and Pigou, who used the word 'capital' to mean capital goods and services, while Samuel meant investment money, i.e. the purchasing power with which

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1. P.R.O., T.185/1, evidence of Sir Felix Schuster before the Cunliffe Committee, 12th day, 9 Apr., 1918.
  2. Committee on Finance and Industry, 1931: Report published as Cmd.3897.
  3. P.R.O., T.185/1, memo. by A.M. Samuel to the Cunliffe Committee, 26 Apr., 1918.

to obtain these goods. Cunliffe thought that such a scheme would lead to a honeycoming<sup>b</sup> of credit which would be fatal in a crisis; Pigou suggested that it was in any case unnecessary, as what was fundamental was the production of capital goods, not the provision of the means of payment.

Pigou: Still I think you do agree with me that this [plan] is rather machinery, and the other thing [supply of capital goods] is fundamental?

Samuel: I think it is fundamental machinery.<sup>1</sup>

The confusion was never resolved, and this gap in the provision of business credit facilities remained.

Several of the City witnesses favoured a movement by the Bank towards the sort of organisation established by the Federal Reserve Board in the United States; one of the most cogent was Nugent, the Chairman of the Discount Houses. He suggested that there should be more Treasury links with the Bank, and perhaps Treasury representation on the Bank's decision-making bodies. He felt that, in the latter case, such a body could have charge not only of note issue regulation, but also of the foreign exchanges in general and of the Government debt. Nugent was aware of the dangers inherent in too rapid a price fall, and felt that it might be possible for negotiation at central bank level to provide the Bank with some of the gold it would need for the increased reserved which would be required, rather than for the Bank to attempt to attract all the gold it needed in the open market by means of a sharp rise in the discount rates immediately the war was over. For much the same reason he was in favour of restricting gold exports for a time after the war, although he would on principle have preferred an open market in gold. He was also in favour, as were many City witnesses, of a more flexible fiduciary issue.

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1. P.R.O., T.185/1, evidence of A.M. Samuel before the Cunliffe Committee, 13th day, 6 May, 1918.

Like virtually all the witnesses, Nugent stressed the importance of increasing exports.

"The affairs of a nation are much like those of an individual, and...we are...spending more than we can earn."<sup>1</sup>

But he agreed with Bradbury that before exports could be increased, prices must fall relative to other countries, and that to restrict credit and so induce a fall in money prices would be a less drastic remedy than to allow the exchanges to float, causing a fall in real prices. This dictum was not questioned by the other members of the Committee; and it is on this that the assumption of the economic advantages of returning to the Gold Standard at the pre-war parity depend.

One other interesting feature of Nugent's evidence is his emphasis on the likely changes in the mode of operation of Bank Rate after the War. Unlike the pre-war days, he says, Britain is no longer a major creditor, at any rate in the short-term. So a rise in the Bank rate will not take effect by causing a slowing down in the rate of outflow of funds, but will have to operate to increase the inflow of foreign funds to Britain. This observation is one which has since been frequently made by critics of the Committee's reports; apparently Mr. Nugent's observations made little impact on its hearers at the time.

Another City witness who favoured the Bank moving towards the Federal Reserve system was Dr. Leaf, Chairman of the Westminster Bank group. He also favoured the repeal of the Bank Charter Act and its replacement by a system which would allow more flexibility in emergencies. In every other respect he adhered to the usual orthodox opinions, and agreed to all Cunliffe's leading questions on inflation and Government debt. Cunliffe was by now beginning these standard questions with the words

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1. P.R.O., T.185/1, evidence of C. Nugent before the Cunliffe Committee, 14th day, 7 May, 1918.

'you do agree...'.<sup>1</sup> Leaf was anxious about the amount of credit tied up in Government stock, and said that they would have to let some Treasury Bills run off in order to be able to accommodate industry.

Among the commercial representatives was the vice-President of the London Chamber of Commerce, a stockbroker, Mr. F. Faithfull Begg. His Chamber was primarily concerned with the banking implications of the Committee's terms of reference, and they made two main suggestions; one that the fiduciary issue should not be fixed in money terms but should bear a fixed relationship to the quantity of gold in the Bank - the Bank should hold at least one third of the value of the notes in gold - and that note convertibility should be into bars of, say, £1,000 value, so that payment in gold would be possible for external purposes, but gold coin would not be put into circulation. The former suggestion included a rider to the effect that this proportion could be reduced in an emergency on payment of a tax, in similar way to the Federal Reserve scheme.<sup>2</sup>

One of the witnesses the Committee wished to call, Professor J. Shield Nicholson, was unable to attend in person, and he was sent a questionnaire. The form of the questions is a formalisation of those which had been put to the other witnesses, and some of them are an interesting indication of the extent to which the Committee - or at any rate the Chairman - had been decided about the nature and causes of the problems they were considering from the beginning.

Question: Would you agree that there is now considerable credit inflation? If so, can you suggest any means by which it might be reduced after the War?

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1. P.R.O., T.185/1, evidence of Dr. W. Leaf before the Cunliffe Committee, 15th day, 27 May, 1918.
  2. P.R.O., T.185/2, evidence of F. Faithfull Begg before the Cunliffe Committee, 20th day, 11 June, 1918.

To this Shield Nicholson replied that he did agree, and that since the chief cause was the excessive Government borrowing, the remedy was for this to be reduced, and for the currency note issue to be contracted.

Question: Would you agree that for this purpose it is desirable that Government borrowing should cease at the earliest possible moment and that expenditure should be reduced well within revenue so that there will be a substantial sinking fund for the reduction of debt?<sup>1</sup>

In view of his reply to the previous question, it was hardly surprising that Shield Nicholson should agree wholeheartedly, but he thought that this might not be possible at once, since falling prices and profits which would be implied by the desired deflation would also mean reduced revenue from which to provide a sinking fund.

Question: What action should in your opinion be taken to restore and maintain the Foreign Exchanges after the War?<sup>2</sup>

Shield Nicholson was in favour of restoring convertibility as soon as possible, of deflating so as to encourage exports and make imports relatively more expensive, and of reducing Government debt to assist in both these aims. But he did not agree with another of Cunliffe's suggestions, that higher money rates should be maintained in Britain than in those countries with whom we had an adverse trade balance. In his view, such an attraction to foreign funds would be a factor in hindering the necessary price fall and would in the long run do more harm than good. He was in favour of an eventual return to an internal gold circulation, and the maintenance of the Bank Charter Act. As to the dangers of crisis, he felt that increased reserves of gold should be kept to avoid having to suspend the Act.<sup>3</sup>

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1. P.R.O., T.185/2, memo. of evidence by Professor J. Shield Nicholson, 15 June, 1918.
  2. This apparently straightforward question in fact contains the assumption that the sterling exchange should be restored to par after the war.
  3. P.R.O., T.185/2, memo. of evidence of Professor J. Shield Nicholson to the Cunliffe Committee, 15 June, 1918.

One of the last witnesses to be heard was Sir Brian Cokayne, Cunliffe's successor as Governor of the Bank of England. Montagu Norman was by this time Deputy Governor, and his biographer suggests that Cokayne's brief was prepared by Norman.<sup>1</sup> There is no doubt that the evidence Cokayne gave is consistent with this; it is trenchantly orthodox. He agreed with Cunliffe over the increase in the volume of credit, and with the suggestion that the Government should cease borrowing and begin repayment of debt at once. But he distinguished between the pure credit creation involved with Government borrowing by Ways and Means advances from the Bank of England, and Government debt held by genuine investors.

Cokayne also urged the importance of Britain exporting more and importing less; deflation by means of dear money would help, and Cokayne advocated a statutory provision for the reduction in the fiduciary issue. Discussion on this point led to Cokayne suggesting as a basis for this what has since come to be known as the 'Cunliffe limit'.<sup>2</sup> Cokayne favoured the existing idea of a fiduciary issue as opposed to the issue of currency notes in proportion to the Bank's gold stock.<sup>3</sup> It should be added that the evidence of the Bank assumed without argument that the restoration of the Gold Standard in all its pre-war glory was a sine qua non of British post-war recovery.

The memorandum submitted by the F.B.I. largely agreed with this. The importance of restoring the exchanges by achieving a large export surplus was stressed. So, too, was the need for industry to be freed from controls, and for demobilisation to proceed with all possible speed.

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1. Boyle, Montagu Norman, p.128.
  2. See below, p. 120.
  3. P.R.O., T.185/2, evidence of Sir Brian Cokayne before the Cunliffe Committee, 21st day, 8 July, 1918.

However, some control over the disposition of raw materials should be retained in order to give priority to exporters. It was also urged that some repayment of Government debt was essential.

"Serious efforts must be made to deflate the currency by the extinction of debt. It should be borne in mind that most of this debt was incurred at a time when the currency was inflated, and the repayment must be based, if possible, on such a system that the inflated value should be maintained during the extinction of the debt."<sup>1</sup>

This last was a consideration not evident to any other witnesses, nor, apparently, to any member of the Committee; that if the process of contraction were to be achieved, not by a fall in real prices through the devaluation of sterling, but by a fall in money prices through internal deflation, the burden of the contraction would fall not on the community as a whole but only on those whose incomes were not fixed in terms of money. A substantial fall in prices would actually benefit the large numbers of debt holders who had acquired their government paper late in the war when the currency was already heavily debased. But this consideration received no attention in the Committee's reports.

The second series of meetings, during the late summer and autumn of 1919, were concerned primarily with examining witnesses from the Scottish and Irish banking interests, and with dealing with City critics of the decision not to alter the Bank Charter Act.<sup>2</sup> Little discussion took place on the changed conditions accompanying the end of the war and the post-war boom, although the Committee became more worried than ever about the process of inflation, and recommended that drastic measures should be taken to control it. The considerable exchange problems created by the vast sums demanded in reparation from Germany,

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1. P.R.O., T.185/2, memo. by the Federation of British Industry to the Cunliffe Committee, 19 July, 1918.
  2. Bradbury told the Committee that City opinion on this was so divided that the Government were having difficulty in accepting the Report, minutes of evidence of the Cunliffe Committee, 27th day, 23 July, 1918.

and the huge inter-Allied debts, were not allowed to modify the Committee's opinions on the desirability of returning to the Gold Standard at the pre-war par. Indeed, the British debt to America constituted one apparently excellent reason for doing so, since the debt was fixed in terms of gold.

The Minutes of Evidence of the Cunliffe Committee: Production of its Reports

It is unfortunate that there is no record of the Committee's discussions of the First Interim or Final Report. It is, however, apparent from the evidence that is available that the Committee was largely unanimous on the desirability of a return to the Gold Standard, of the reduction in the National Debt, particularly the floating debt, and, at any rate by inference, of the relinquishing of government control over economic life. As far as the return to gold is concerned, it has been suggested that its advocacy by the Committee was the only possible course for them:

"...anyone rash enough then to have advocated a different course might well have been locked up and certified as insane... the opinion advanced by Norman in the Bank's name that a return to the gold standard was essential to the Cunliffe Committee was naturally invested with the quality of dogma, accepted as such by informed opinion...Here was an article of faith as unassailable as the universal belief of mankind before the time of Copernicus and Gallileo that it was the sun which moved, not the earth."<sup>1</sup>

Nor was there any change in this attitude when the consequences of dear money became obvious, and the unemployment queues lengthened. For the financiers, headed by Montagu Norman, believed that Britain could only regain her economic strength when the City of London had regained its pre-war place as the centre of international finance.

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1. Boyle, Montagu Norman, p.128.

"A strong pound had first to be ensured. No doubt this spelled temporary self-sacrifice for many British Businessmen and industrialists....Norman did not worry unduly about the cost in human misery that might result at home if this outward-looking City policy were consistently pursued. The plight of the unemployed was primarily a matter for the Government."<sup>1</sup>

Thus the deliberations of the Committee and the evidence it received were largely in accordance, on the major issues, with one another and with all accepted opinion at the time. On the Gold Standard, the one available economist who might have testified on more unusual lines to the Committee was not called, despite the fact that he was doing war service in the Treasury at the time. Bradbury had early on made it clear that no witnesses from the Treasury would be required, since he himself was a member of the Committee.<sup>2</sup> So that body did not have the advantage of the advice of J.M. Keynes. Keynes was at that time in favour of the Gold Standard, but was by no means as convinced as Bradbury that to restore the equilibrium with world prices by allowing the sterling exchange to become devalued was a bad thing. He wrote a memorandum to this effect early in 1918, for Bradbury's benefit though not apparently at his suggestion, setting out an ingenious scheme whereby a measure of free convertibility could be brought about at current price levels.<sup>3</sup> The details of the scheme are not important, since it never saw the light of day; but in essence the plan was for the British authorities to accept that British prices were about 10% above the American level, and to impose a duty of that proportion on the export of gold. The scheme was devised in such a way that the full 10% would only in effect be charged if the demand for gold for export were sufficiently great to warrant it, and quantities of gold equivalent to amounts imported would

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1. Boyle, Montagu Norman, p.139.
  2. P.R.O., T.185/1, minutes of evidence of the Cunliffe Committee, 10th day, 22 Mar., 1918.
  3. P.R.O., T.170/129, memo. by Keynes., 4 Jan., 1918.

have been allowed out free of duty. The percentage duty could be varied by Order in Council by the Chancellor of the Exchequer. Such a scheme might have been a most useful one, either in its own right, or as a means of gradually reducing the sterling discount on New York by reducing the percentage duty in small stages. But the scheme did not reach the Cunliffe Committee, and their sole assistance from the Treasury came, as we have seen, from Sir John Bradbury. To a detailed consideration of the Reports which this Committee produced, we must now turn.

#### First Interim Report of the Cunliffe Committee

The first interim Report of the Cunliffe Committee begins by setting out what it intends to do, and why it has not completed its labours with one Report. The first Report is to be concerned primarily with the problems of the currency after the war; while the general principles which the Committee will lay down will be applicable both to currency and to foreign exchange, the Committee feels that the emergency proposals for dealing with foreign exchange problems immediately after the war could more readily be dealt with later, as could the application of the principles of the Report to Scotland and Ireland.<sup>1</sup>

The Report then goes on to outline the currency system in Britain before the war. The next two paragraphs, which outline the mechanics of the domestic system, are largely uncontentious.<sup>2</sup> The description then moves to the way in which the system operated externally, and there follows what is generally regarded as a classical exposition of the workings of the Gold Standard for Britain immediately prior to the First World War.

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1. Cd. 9182, para. 1.

2. Ibid., paras. 2, 3.

"One of the most influential models of pre-1914 gold standard operation has been that presented in the British official Command Paper, The Interim Report of the Committee on Currency and Foreign Exchanges..."<sup>1</sup>

The Report describes the process by which the operation of the Gold Standard acted apparently automatically upon gold movements.

"When the exchanges were favourable, gold flowed freely into this country and an increase in legal tender money accompanied the development of trade."<sup>2</sup>

However, when the balance of trade was adverse and exchanges were unfavourable, it became profitable to export gold. Gold being obtainable on demand from the Bank, the Bank would withdraw gold from its Issue Department in exchange for its notes, taken out of its banking reserve,

"...with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell."<sup>3</sup>

The description continues, outlining the process by which such an outflow of gold could be corrected if it became serious:

"If the process was repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream."<sup>4</sup>

The Report goes on to say that it is self-evident that if such gold movements were due to adverse exchange conditions not merely of a seasonal and temporary nature, but were rooted in a more permanently adverse balance of trade, this process would

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1. A.G. Ford, The Gold Standard 1880-1914: Britain & Argentina (Oxford: Clarendon Press, 1962), p.1.
  2. Cd. 9182, para. 4.
  3. Ibid.
  4. Ibid.

"have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the position of London as the financial centre of the world." <sup>1</sup>

The Bank Rate had its effect not merely on foreign lending but on the domestic interest rate structure as well.

"...the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened." <sup>2</sup>

As a result of this lessening activity, employment and therefore consumption would fall; and as the money rates tightened it would become less profitable to hold stocks and these would be unloaded on a falling market.

"The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty." <sup>3</sup>

Combined with a similar chain of events caused in the event of an exogenous rise in the volume of domestic credit - since this would lead to a rise in prices followed by an increase in the demand for legal tender money and thus reduce the ratio of reserve to liabilities and force up the rate of discount -- this system gave the country, in the opinion of the Committee,

"an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general." <sup>4</sup>

The result of these operations was that:

"...this country was provided with a complete and effective gold standard." <sup>5</sup>

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1. Cd. 9182, para. 5.

2. Ibid.

3. Ibid., para. 6.

4. Ibid., para. 7.

5. Ibid.

This completes the Committee's description of the workings of the pre-1914 Gold Standard as it affected Britain. This model was constructed for a purely British purpose; but it nevertheless ignores a number of aspects of its operation which seem vitally important for Britain, and together with a number of internal anomalies a good deal of criticism of the model is possible. Since the remainder of the Report is built upon this foundation, it will be necessary to examine its defects a little more closely.

Firstly, the system was manifestly not fully automatic, even in the Report's description, since a decision to raise or lower Bank Rate has quite frequently to be taken; this involves a judgement as to whether an outflow of gold is a merely temporary affair or whether it is evidence of an underlying maladjustment. Secondly, even in the opinion of contemporaries, the Report glossed over certain other matters which rendered the system less automatic than the Committee considered it. The chief example of this is the fact that the Committee dismisses in half a sentence the process of making Bank Rate effective; whereas at least one contemporary commentator thinks that this glosses over a number of problems which the Bank experienced in making Bank Rate effective in the past, particularly in its action on the cost and availability of credit in the domestic market.<sup>1</sup> Again, its comments on the adjustment of an adverse trade balance makes it clear that the Committee thinks purely in terms of price effects on the trade balance; changes in demand patterns, in elasticities of demand, in world trading habits, to mention only a few other variables, together with the prevailing level of world trade as a whole, are not susceptible to simple changes in the discount rate.

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1. Economist, .LXXXVII, 2 Nov., 1918.

In addition to these defects within the analysis itself, there are a number of important matters on which the Report is completely silent. First of all, the operation of the Gold Standard is considered purely from a British point of view, despite the international nature of the standard and the importance of this fact to Britain. Although Britain was the hub of the system, she was not operating in a vacuum.

"The world's main short- and long-term capital markets were centred in London, together with the world gold market and produce markets, so that this concentration reinforced the key role of Britain in world trading relations and in the working of the gold standard before 1914. Nevertheless, the existence of other developed monetary centres, particularly Paris and Berlin, must not be ignored, for they possessed liquid resources which flowed to ease stress in times of stringency, the Bank of France even being known as the Bank of England's second gold reserve."<sup>1</sup>

This matter of central bank co-operation is not one to which the Reports devote any space, yet by the summer of 1918 it must have been obvious that in view of the destruction of life and property assets brought about by the war, and the huge volume of international indebtedness which existed independent of real assets, this co-operation would be much more vital than before 1914.

Not only did the co-operation of other central banks help the smooth working of the system on very small reserves pre-1914. A number of other factors, some of which had been seriously changed by the war, also assisted the working of the standard in Britain. It was common practice before the war for colonial and dominion countries which had trade surpluses with Britain simply to allow their bank balances in London to rise. With the shortage of liquid resources to be expected after the war, together with the difficulties primary producers - as most of these countries then were - experienced in the 1920s, this was no longer so common.

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1. Ford, The International Gold Standard 1880-1914 : Britain and Argentine, p.19. The remainder of this critique owes much to this lucid exposition. See also W.M. Scammell, "The Working of the Gold Standard", Yorkshire Bulletin of Economic and Social Research XVII(1965).

A similar process was often operated by foreign banks, and could equally certainly not be expected to continue after the war. Another way of easing strains, whereby creditors were paid simply by the process of shifting assets from the credit of a domestic to a foreign owner, could not so often be possible after the war, partly through diminished liquidity, and partly because New York had become equally important as a financial centre.

Another of the important planks of the Gold Standard, the process known as 'playing by the rules of the game', although much less important than it is often regarded,<sup>1</sup> nevertheless went much more by default after the war. This is the process by which central banks allow gold movements to have their full effect on the internal credit situation. There is much evidence to support the view that France and the United States were very lax about this between the wars.

In addition, it seems likely that the Committee over-estimated the extent to which short-term funds were in fact responsive to interest rates even before 1914;

"Movements of private short-term funds were more complex in nature and motivation than is customarily assumed in standard treatments of the pre-1914 system. Unquestionably, short-term interest differentials and exchange-rate fluctuations played a dominant role in directing the flow of private short-term funds, even if the degree of mobility of the funds so motivated has sometimes been exaggerated. But by no means all private short-term capital movements can be explained in these simple terms." 2

According to this authority, other factors to be considered included preferences as to lenders or to markets for loan placement not based

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1. It had been estimated that on a yearly average basis about 60% of movements in central bank assets were in the opposite direction to that which would have made the domestic economy feel the effects of international asset movements; A.I. Bloomfield, Monetary Policy under the International Gold Standard 1880-1914 (New York: Federal Reserve Bank of New York, 1959), pp.48-50.
  2. A.I. Bloomfield, Short-Term Capital Movements under the Pre-1914 Gold Standard (Princeton: Princeton University, 1963), p.90.

on interest or exchange rate considerations; the availability, as distinct from the cost, of credit; the requirements of external debt service; and considerations of banking liquidity. All these factors together exerted an influence which may at times have been more powerful than interest- and exchange-rate factors.<sup>1</sup>

As well as 'normal' movements of funds, there were other possible upsets;

"Capital movements and other 'abnormal' movements of liquid funds were, moreover, of greater importance than is usually believed. And even when of a 'normal' character, private short-term capital movements were by no means always equilibrating in their balance of payments effects."<sup>2</sup>

Another traditionally held view of the Gold Standard which has lately been challenged, and which is of great importance in the light of post-war experience, is that which ascribes most new foreign borrowing in the pre-1914 period to the reinvestment of funds earned abroad on previously invested capital. Recent research suggests that it is much more viable to regard the overseas loan interest and repayments reaching this country as part of the stream of income to be saved or spent at will, than as in some sense 'reserved' for further investment. Two facts seem to bear this out; firstly, foreign investment was often followed, rather than preceded, by an improvement in the balance of payments; and secondly recent analysis suggests that fluctuations in the volume of overseas lending bears a much closer relationship in the ratio between exports and imports than to the level of income payments on overseas investments.<sup>3</sup> In the post-war period it is common for more capital investment abroad

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1. Bloomfield, Short-Term Capital Movements under the Pre-1914 Gold Standard.
  2. Ibid., p. 91.
  3. A.G. Ford, "The Transfer of British Foreign Lending, 1870-1913", Economic History Review, second series, XI, (1958).

to be undertaken than is justified by current balance of payment surpluses; and these investments, unlike those pre-1914, seem not to generate an improvement in the balance of payments in the same way. It may well be that this is associated partly with the increasingly inter-governmental nature of loans post-war. In any case, whether we associate the volume of overseas lending with export-import ratios, income on previous investments, or both, the great decline in both these factors over the war period meant a considerable weakening in the Gold Standard mechanism. For before the war the volume of funds going overseas was considerable, and Bank Rate was expected to have its effect at least initially on these funds when the Bank was losing gold. After the war it was necessary not only to stop funds leaving but also to attract foreign funds to London, a much more difficult task.<sup>1</sup>

Thus the Committee's analysis of the pre-war gold standard contains a number of errors and omissions sufficiently significant to affect the validity of their conclusions. This is the more so in the light of their survey of the way in which the war has affected the working of the system. For of these changes, the Report gives primary importance to those affecting domestic policy and consequent upon Government policy; the changes which affected the international Gold Standard receive one paragraph suggesting that most of the actual movements of the exchanges which had taken place would have done so even if a true gold standard had been maintained, because of the peculiar circumstances of war-time;<sup>2</sup> and three sentences at the end of the last paragraph in this section, the last two of which state that

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1. One witness before the Cunliffe Committee was aware of this problem, see P.R.O., T.185/1, evidence of C. Nugent before the Cunliffe Committee, 14th day, 7 May, 1918.
  2. Cd.9182, para. 8.

"It is not possible to judge to what extent legal tender currency may in fact be depreciated in terms of bullion. But it is practically certain that there has been some depreciation, and to this extent, therefore, the gold standard has ceased to be effective." <sup>1</sup>

Among the domestic changes, the Committee was most concerned with the inflationary developments. The Report describes the process by which the banks are able to buy unlimited legal tender currency from the Bank of England without the Bank's proportion thereby being reduced, under the powers given by the Currency and Bank Notes Act 1914. This Act enabled the Treasury, through the Bank of England, to issue to the commercial banks legal tender to a total of 20% of the Bank's liabilities on current and deposit accounts. The original intention was that these drawings should be advances chargeable for interest at the current Bank Rate. But the banks' deposits became so swollen by the deposits of Government contractors and so on that they were able to buy the notes outright with cash transferred from their accounts at the Bank to the credit of the Bank's currency note account.

This influx of cash was in itself inflationary, since the banks were enabled to lend to four or five times the amount of cash originally deposited and still maintain their customary cash ratio of around 20%. In addition, the cash which the banks had deposited with the Bank of England in payment for currency notes was borrowed by the Government and in substitute the Bank was given government securities. Since the initial increase in Government disbursements had often come from Ways and Means advances by the Bank, the whole edifice was frequently built upon pure credit creation. In addition, it frequently happened that instead of making advances for productive purposes, a bank would use part of its increased lending capacity to buy government securities or

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1. Cd. 9182, para. 14.

lend to a customer who wished to do so; so that quite often the Government was paying interest for the privilege of borrowing sums which it had itself created.

Such a process would normally have very rapidly depleted the Bank of England's gold stock, but since notes became legal tender at the outbreak of the war, and the export of gold was prohibited in practice, the demand for gold was very low.<sup>1</sup>

The Report then goes on to outline its recommendations as to future currency and exchange policy. Its fundamental proposal is that the Gold Standard be restored.

"...the conditions necessary to the maintenance of an effective gold standard in this country no longer exist, and it is imperative that they be restored without delay... Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be a very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardise the convertibility of our note-issue and the international trade position of the country."<sup>2</sup>

Apparently all the Committee's witnesses agreed on this:

"We are glad to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters."<sup>3</sup>

The remainder of the Report is largely concerned with the means by which the return to gold should be brought about; the two principal items are that the Government must cease borrowing as soon as possible, and must begin thereafter to repay a substantial amount of the securities in the hands of the banking system, particularly of Treasury Bills; and that this debt reduction must not be matched by new borrowing for capital purposes, for reconstruction.<sup>4</sup> Other recommendations relate to

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1. Cd. 9182, para. 14.
  2. Ibid., para. 15.
  3. Ibid., para. 15.
  4. Ibid., paras. 16 & 17.

the bringing of the note issue system back to normal, and here is introduced the famous 'Cunliffe limit', whereby the actual maximum of the fiduciary issue in any one year becomes the legal limit in the next.<sup>1</sup> Most of these recommendations are inherent in the basic principle on which the Committee operated, that their aim should be to make the post-war monetary and currency system as like the pre-war as possible.

#### Final Report of the Cunliffe Committee

It was originally intended that the Final Report of the Committee should go into detail on the emergency measures to be used to deal with the exchange situation after the war. The final report actually contains only two paragraphs on this, largely repeating material already in the first Report on the importance of a sound system of currency in restoring the exchanges to health, and the evils in this respect of the expanded system of credit then pertaining. This Report was signed at the height of the post-war boom and it is understandable that the Committee should have felt these anxieties. The only other recommendations of note are that Government Ways and Means borrowing be checked at once; that the 'Cunliffe limit' now be introduced; and that the pre-war situation in Scotland and Ireland be restored.<sup>2</sup>

Thus the guiding principle of the Cunliffe Committee Reports is the restoration of pre-war conditions as far as possible, and particularly the restoration of the pre-war Gold Standard. Unfortunately the Report is rendered less valuable than it could have been by two factors.

Firstly, the working of the pre-war Gold Standard was insufficiently

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1. The whole of this section of the report makes certain assumptions about the principles of sound Government finance, of which the most important is that budgets should always at least be balanced, which are never discussed, but remain implicit.
  2. Cmd.484 (London : H.M.S.O., 1919).

understood. Secondly, the Committee apparently had almost no understanding of the extent to which conditions had been permanently altered during the war.

"An outstanding feature of the Cunliffe Report is its unshakeable confidence in the traditional British methods of controlling credit and supporting the exchanges. It is a trumpet-call for a return to normal techniques. Yet it was the teaching of the war years that techniques must change as conditions change." <sup>1</sup>

The first factor is exemplified by the fact that in the whole of both Reports there is no mention whatever of the pre-war par rate of exchange; and no discussion of whether it would be the correct rate at which to return to the Gold Standard. It apparently did not occur to the Committee that this was a matter for question. Yet this implies not only that 4.866 dollars to the pound, £3. 17s. 10½d. a standard ounce of gold, were rates which could stand for all time; it also showed a belief in the absolute nature of the Gold Standard which is difficult nowadays to comprehend.

"...the essential relativity of the problem was lost sight of and the world had to pay dearly for its faith in the existence of an absolute standard of value." <sup>2</sup>

In essence this is the fundamental error of the Reports. The misunderstandings of the working of the pre-war Gold Standard are serious errors, as is the failure to take into account the nature and extent of war-time changes in conditions - the vast fabric of inter-governmental debt, the coming problems of reparations, the great dislocation in trade and trading patterns, the increasing decentralisation of world financial power, the destruction of assets and the encashment of foreign investments, and the needs of reconstruction,

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1. W.A. Brown Jnr., The International Gold Standard Reinterpreted 1914-34 (2 vols., New York : N.B.E.R., 1940), vol. I, p.168.
  2. Ibid., p.174.

to name only a few; the lack of cognizance of the need to make the Gold Standard serve the British and the world economy rather than the reverse, the losing sight of the 'essential relativity of the problem' - that is the cardinal error. Since British policy was based on that error for many years thereafter, Britain did indeed pay dearly for her 'faith in the existence of an absolute standard of value'.

CHAPTER FOUR

DECONTROL AND RECONSTRUCTION OF THE

ECONOMY AFTER THE

GREAT WAR, 1918-1920

## Government Control of Industry during the 1914-18 War

At the outset of the war, government control and influence over the British economy was minimal. It was the largest single purchaser of supplies in the market, but the proportion of the national income spent by the Government was small; in 1913-14 net government expenditure was £190 million out of a National Income of approximately £2,200 million. By the end of the war the situation had changed dramatically: in 1918-19 government expenditure accounted for about half the national income.<sup>1</sup> It is apparent that such a great change could not have taken place without either the initiation of a comprehensive system of controls, or a complete distortion of the economic system accompanied by unrest and disorder, or a combination of the two. It was not obvious at the beginning of the war that changes on this scale would be necessary, since many people in well-informed circles believed that the war would be a short one, lasting perhaps six months. In addition nobody had any real idea of what sort of war it would be, since Britain had not fought a major war since the Napoleonic War a century before. Very few people foresaw the impact which industrialisation was to have on the methods and scale of waging war. Thus the need for a comprehensive plan of reorganisation of the economic life of the country to put it on a war footing was not foreseen in 1914, and would almost certainly have been politically impossible even had the Government had this foresight.

Largely as a result of this absence of foresight, and also because the Government, in sympathy with public opinion, was in any case unwilling to overturn the nineteenth century principles regarding 'holding the ring'

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### Studies in

1. E.V. Morgan, British Financial Policy 1914-25 (London : Macmillan & Co., 1952), pp. 104-5.

in economic life which had hitherto governed its relations with the economy, those controls which were eventually implemented came into existence in a haphazard fashion, in response to particular situations, notably shortages of various kinds. Some restrictions were of course imposed at the outbreak of the war, such as those prohibiting trading with the enemy. Exports of essential foods and materials were prohibited from the beginning, and control over the export of many important commodities was soon put into effect. The Government took over control of the railways at once, but mainly for military rather than economic reasons. The same logic lay behind the powers given to the Admiralty to requisition shipping, although these were later used to control shipping on a wider basis when the Ministry of Shipping was set up in 1916. The Army Council was given powers to requisition essential stores and supplies of food. The Royal Commission on Sugar Supplies was set up to take the purchase and distribution out of private hands; our main pre-war suppliers of sugar had been Germany and Austria, so this was obviously a necessary move.<sup>1</sup>

For the time being the Government continued to rely on the market to supply unaided its main needs. But before long it became obvious that, particularly in the field of munitions supplies, the free market was incapable of quickly readjusting itself to the needs of a major twentieth century war. The revelations of the shocking absence of ammunition and guns on the Front in France, and particularly the shortage of shells, was the main force behind the fall of the Liberal Government in May 1915, and the setting up of the First Coalition, with Lloyd George as Minister of Munitions. Before Lloyd George took over, the

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.35-36.

War Office had continued to rely on the small number of private firms who had supplied the Army in peace-time, and who had been unable to supply the increased quantities needed. Their situation was not helped by the lack of control over enlistment, which meant that large numbers of skilled workers were recruited for the forces whom the munitions firms found it impossible to replace. The solution was found in the setting up of National Factories specifically for munitions production, and a form of organisation of munitions volunteer labour. But organisation of related supplies and war materials was still absent, and a network of regulations grew up enabling the Ministry of Munitions to cope with the situation.<sup>1</sup>

Shortages of this kind also beset the Service departments, and similar ad hoc arrangements were slowly made to enable the War Office to obtain the supplies needed. Labour shortages in the industries supplying these soon became a serious problem, and a system of selective recruitment designed to leave behind the skilled men, without whom industry could not operate, was slowly evolved. Other early problems concerned essential imports; shortage of shipping space led to a rise in freights to five times their pre-war level during the first year of the war, and as a result import restrictions were drastically tightened early in 1916.<sup>2</sup> The menace to British shipping by the German submarine offensive, which became effective in the spring of 1917, was the main reason for the setting up of universal restrictions and the bringing of import control under the aegis of an inter-Allied body, the Allied Maritime Transport Commission. The German submarine threat and the shortage of shipping space together contributed to the need for obtaining supplies

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.37-40.

2. Ibid., p.41.

from the nearest rather than the cheapest source; the latter cause was a big factor in our increased purchases from the United States, and helped to aggravate the already difficult exchange position. This distortion in the pattern of demand for imports also contributed to the post-war balance of payments problems.<sup>1</sup>

Thus the pressure of government demand led to a considerable increase in its control over the economic life of the nation. Industry could not supply the necessary goods sufficiently fast without control and direction. Inevitably large amounts of productive resources were diverted from peace- to war-time production needs. Together with the necessary controls on imports, shortage of goods for civilian consumption inevitably arose, and even had the quantity of purchasing power in the hands of the public stayed static prices must have risen. But the financial policy pursued by the Government in fact led to an increase in available purchasing power. The avowed aim of the Government became to cover out of revenue normal peace-time expenditure together with the cost of servicing the debt it incurred in covering the rest of its expenditure. As a result the Government's deficit on internal current account was nearly one-third of the national income in 1915-16 and about forty per cent in 1917-18.<sup>2</sup> Such huge sums could manifestly not be wrung from the real savings of the people, and considerable inflation resulted. Price rises in all sections of the economy began to give rise to serious alarm and discontent among the workers. The Ministry of Labour Cost of Living Index rose by 60% between the outbreak of the war and the summer of 1916, and food prices had risen to double the pre-war level a year later. Food prices then settled down a little, and by the Armistice were only 10% higher

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.40-41.
  2. Ibid., pp.41, 104-105.

than they had been eighteen months earlier.<sup>1</sup> By this time Government control of prices had become fairly widespread. But the impetus to rising prices remained, partly because the Government's financial policy continued to be inflationary, and partly because the lack of control in the early years of the war had led to greatly enlarged profits and wages, and therefore in purchasing power, in certain sectors of industry.<sup>2</sup>

The spread of government control, which had received one accretion of power when the first Coalition Government was formed, got another when Asquith's Coalition fell and was replaced by Lloyd George's in December 1916. From this time the controls increased fast, and by the end of the war had spread into every walk of economic and financial life. The legal framework within which the controls were implemented was as ad hoc as the controls themselves. Most of the controls were implemented under the aegis of the Defence of the Realm Act, passed in 1914 and amended several times. This provided for the framing of Orders in Council under which regulations for requisition and control could be issued. Initially compensation for requisition under these regulations was on the basis of market price, and this contributed to the tendency of prices to rise; but by the end of 1916 a basis of cost plus the pre-war rate of profit had been generally accepted. Unfortunately this generally meant that the rates were fixed with regard to the least profitable firms in the industry, and many more efficient firms made big profits, although in some industries pooling arrangements were evolved. Price fixing as such never received legal sanction, but was done under the authority given by a number of regulations, notably D.O.R.R.2E., framed in February 1916, to regulate and license the sale, production and use of food, stores and 'war materials', which was interpreted fairly widely.<sup>3</sup>

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1. Quoted by Morgan, Studies in British Financial Policy 1914-1925, p. 284.
  2. Ibid., pp. 41-43.
  3. Framed 15th Feb., 1916 under the Defence of the Realm Act 1914, 4 & 5 Geo. V, Ch.29. For a full discussion of the legal framework of control, see E.M. Lloyd, Experiments in State Control (Oxford: Clarendon Press, 1924), pp. 50-64.

The administrative structure of the controls was complex in the extreme, partly because, like Topsy, they 'just grewed'. The structure of the controls can be divided into seven main types. Firstly there was the control of productive capacity. This took several forms. For the munitions industry one of the main ones was for the Government to build its own factories; the Ministry of Munitions built about 120 during the course of the war, and took over a similar number from private firms. The Government also took over a number of other industries en bloc, notably the coal mines, and, as we have already seen, the railways. Since the extent to which the Government interfered with the running of such enterprises was not great, the effect was similar to that in cases where the Government bought the whole output of a firm, which was another method of achieving control over productive capacity. In addition there were voluntary agreements in some industries as to prices to be paid for raw materials, and quantities of goods to be supplied at agreed prices to the Government. Fourthly, production in some industries was regulated in some industries, for instance vehicles and beer production, by a system of licensing.

The Government also became active in the purchase of raw materials, particularly food. The goods concerned were mainly imported ones, and the reasons tended to be either because the Government was such a large direct or indirect user that it needed control over supply, or, as in the case of food, to ensure efficient distribution. Control became very widespread in some sectors; for instance the Ministry of Food was buying 85% of our imported foodstuffs by the end of the war. In addition to the control of the supplies themselves, a good deal of influence was exercised

through controls over dealings; this control was sometimes just over the import and export dealings in a commodity, sometimes over domestic dealings as well. Control was exercised by means of licensing, and extended over a wide range of food, raw materials and manufactures.<sup>1</sup>

Another important element in Government control was price-fixing. Apparently the normal method was to allow a cost-plus basis, the plus being based on 'normal' pre-war profits. There was provision for arbitration in some cases, but that this was very rarely invoked suggests that prices were probably slightly higher than could have been obtained from independent arbitration. The area in which the consumer was most affected was in food prices; attempts to control the price of manufactured consumer goods were largely unsuccessful because of the variety of goods involved, and the few attempts at standardisation were largely unsuccessful.<sup>2</sup> Price control over food was supplemented by control over its distribution; this was obviously essential, since the normal market regulation of supply and demand had been suspended, and it was to be expected that supply would exceed demand. Individual rationing was only introduced in the last year of the war, and never played the central role which it did during and after the Second World War. Prior to this control was exercised largely by ensuring equality of distribution between different geographical areas, in which licensed dealers operated as Government agents.<sup>3</sup>

Some indirect control over the expansion of firms whose activities were not contributing to the war effort was achieved through the control of capital issues. A virtual prohibition on lending to foreign countries was imposed, and most of the lending which was in fact done was for loans to allies, which had received Government approval. Domestic issues of

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.48-50.
  2. Ibid., pp.50-51.
  3. Ibid., pp.51-52.

capital were prohibited unless the approval of the Capital Issues Committee, set up soon after the Stock Exchange reopened in January 1915, had been obtained, and their value fell to about one fifth of the pre-war level for each year of the war.<sup>1</sup>

Direct control of labour was only attempted over those eligible for military service. Initially the Forces relied on volunteers, but conscription was finally introduced in March 1916. To prevent the calling-up of skilled men whose loss would have been detrimental to the productivity of industry various systems of 'reserving' occupations were tried. But while some control, largely unsuccessful, was attempted over the employment of these men, none was tried with the women, the older men, and those unfit for active service; public opinion would not have permitted any form of industrial conscription. Some measure of 'dilution', whereby semi-skilled workers were allowed to do jobs traditionally reserved for men with craft apprenticeship qualifications, was achieved by virtue of the Treasury Agreement of March 1915, under which the unions agreed to suspend restrictive practices for the duration of the war, but in 'controlled establishments' only. In addition the agreement contained a clause by which the unions agreed to submit disputes to arbitration, but this was only partially effective, and the course of the war was marked by a number of strikes in essential industries. These were usually settled on terms acceptable to the workers, since the Government could not afford to lose their labour for any length of time.<sup>2</sup>

Thus the structure of control with which the Government ended the war had come into existence in a piecemeal and ad hoc fashion, as and when shortages or discontent arose. In some sectors the control exercised was

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1. Midland Bank Review, quoted in Morgan, Studies in British Financial Policy 1914-1925, p.264.
  2. Morgan, op.cit., pp.52-56.

considerable. By the end of the war practically all the inland and sea transport of Great Britain was under the control of the Government through the operations of the Ministry of Shipping, the Railway executive, and the Canal Control Committee. Raw material supplies and the size of labour forces came under Government allocation schemes; profit and price control was very widespread, purchase, transport and distribution of 90% of imports was largely under Government supervision, and through the melieu of the Ministry of Munitions the Government owned and operated 250 factories employing two million people, and supervised a further 20,000 works in the same industry.<sup>1</sup> But many of the controls were loose and only partly effective. Those operating over direction of manpower and the prices of manufactured goods were weak and largely unsuccessful. Furthermore, the form of many of the controls was such as to make it easier to drop them at the end of the war than to retain them. The bulk of the controls were exercised by Ministries - Munitions, Food, Shipping - which were expected to be temporary creations.<sup>2</sup> The higgledy-piggledy nature of the controls inevitably meant that there were considerable injustices involved in exercising some of them. The fact that the controls had been set up purely in response to the exigencies of war provided a powerful argument for their dismantling. Finally, the legal structure of control was such that the continuation of them beyond, in most cases, 1921 would have required special legislation. The Defence of the Realm Act, under which much of the regulation had been made, provided for regulations to last only 'for the duration of the present war', and those controls and new machinery which were set up by statute were for the most part scheduled to come to an end a year after the end of the war. So the onus was largely on those who wanted to

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1. D.H. Aldcroft, Studies in the Abolition of Economic Controls in Britain after Two World Wars (Thesis presented for Ph.D. at Manchester University, 1962), pp.9-11.
  2. For the fight to turn the Ministry of Munitions into a permanent Ministry of Supply, see below, pp.144-155.

retain the controls to demonstrate their usefulness. As we shall see, they failed signally, and the vast apparatus of control which has been described was very largely dismantled within a year of the Armistice.

### The Process of Decontrol

The most striking thing about the process of decontrol after the war was its rapidity. The bulk of the controls had either been removed or ceased to function within a year of the signing of the Armistice; of those which remained, the vast majority disappeared in the next two years; and the bulk of the small remnant fell to the Geddes Axe in 1922. Comment on this process customarily contrasts the high hopes with which the Government entered the reconstruction period with the speed with which it drew in its horns as soon as it became apparent that there was little public support for the retention of controls. In some instances the facts support this view, notably in the case of the demise while still in embryo of the plan to create a Ministry of Supply out of the Ministry of Munitions. But on the whole the processes of decontrol and of reconstruction seem to have been seen by Ministers as two separate parts of their policy, and it only became apparent later, for instance with the partial failure of Addison's housing policy, that the two were intertwined.

As has already been pointed out, the process by which the Government took control over the economy largely consisted in a series of responses to external stimuli; control over production was taken in response to a shortage of supplies, control over prices began as a reaction to increased costs to the Government and labour unrest caused by increases in the cost of living. There was no theoretical or doctrinal justification for these vast extensions of Government activity. In so far as there was explicit justification by the Government of moves to control particular activities, it took the form of explaining that the action taken was the result of a specific situation having arisen.

"Like factory and public health legislation in the last century, each justified every additional advance as an exceptional concession to some specific emergency, which, because it was exceptional, raised no question of principle. Thus a collectivism was established which was entirely doctrineless. The most extensive and intricate scheme of state intervention in economic life which the country had seen was brought into existence, without the merits or demerits of state intervention even being discussed."<sup>1</sup>

Having set up this vast network of controls without having considered the presence or absence of a theoretical justification of it, the Government was very much a prey to the pressure of the various interest groups which surrounded it both in and out of Parliament.

"Being without any general view, the Government was ready to be pushed. The pressure of business interests, the clamour of its supporters, the noise made by the Press, the advice of the Treasury, the economic situation, and— still more— the prevalent illusions about the economic situation, all pushed in one direction."<sup>2</sup>

Had the economic situation after the Armistice been different, it is possible that there would have been a stronger demand for the retention of at least those controls which might have been supposed to assist the Government in the provision of employment and the maintenance of industrial profits. But the recovery of the economy after the end of the War was remarkably swift. In March and April 1919 the numbers drawing the out-of-work donation were around the one million mark; a year later they were half that figure. This is not an accurate estimate of the number unemployed, since the earlier figure includes a large number of married women who were entitled to the benefit, but did not intend to return to work, and the latter is affected by the extent to which men had exhausted their eligibility.<sup>3</sup> But it serves as an indication; and the apparent prosperity backed up the clamour of the vast majority of businessmen who

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1. R.H.Tawney, "The Abolition of Economic Controls, 1918-21", Economic History Review, XIII (1943), p.7.
  2. Ibid., p.13.
  3. A. Pigou, Aspects of British Economic History 1918-1925 (London: MacMillan and Co., 1948), p.28.

believed that the promised land lay just around the corner, if only they could persuade the Government to give them a free hand in achieving it.

"The great staple industries of the past, shipping, iron and steel, engineering, textiles, and coal - though the latter had later some reservations to make - were emphatic as to the blessings to be anticipated, once the nation had ceased, in the words of the Economist, 'to pay people for putting difficulties in the way of private enterprise.' " 1

In company with most other journals, the Economist was indeed strongly in favour of releasing industry from the coils of Government control. In a Leader written after the signing of the Armistice, it commented:

"The first requisite of industry is the restoration of freedom." 2

The clamour of the press was reinforced by the Government's own supporters in Parliament. This was a most important factor, for Lloyd George had in the nature of things to be very careful with his followers in the House, being dependent as he was on the Conservatives, who as representatives of the business interest were naturally not in favour of Governmental control of industry, although subsidy and protection were different matters.

Furthermore, as we have noted, the nature of the structure of the controls was such as to make their disappearance an easier matter than their maintenance. In the vast majority of cases, they had either been brought into being by regulations framed under the Defence of the Realm Act, for the duration of the war, or they had been initiated after legislation for the purpose, which frequently provided for the operation of the Act to lapse a year or six months after the end of the war. It is little wonder that in the event Government policy followed the line which was not only the one recommended by all but a few, and they the least audible, of the available voices, but which was also that which required no effort and little action on its part.

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1. Tawney, The Abolition of Economic Controls 1918-1921, p.14.
  2. Economist (LXXXVII, 16 Nov., 1918).

"Decontrol, in short, which required only inaction, was the line of least resistance. Though it dissolved an imposing fabric of organised activity, it was the continuance of an accepted policy, not the reversal of it.

That fact, though of minor significance, was not wholly unimportant. It meant that the burden of proof was thrown, not on the advocates of de-control, but on its opponents, and that the Government, if it desired to perpetuate beyond the statutory limit any part of the machinery of economic regulation existing at the Armistice, would be obliged for that purpose to seek fresh authority from Parliament." <sup>1</sup>

In the event, decontrol proceeded with speed and smoothness. Controls over exports were obvious candidates for early removal; articles whose export was prohibited fell from 1,000 in number at the Armistice to 248 by March 1919, and those which remained on the prohibited list were mainly food and raw materials. Imports were also freed soon after the end of hostilities, with the licensing system finally coming to an end in September 1919. There were, however, exceptions here; food imports remained partly in the hands of the Government, who was still the largest importer in 1920, and a further seventeen classes of goods remained under licence, most of them receiving a permanent measure of protection in 1921. The import controls which were retained were in fact largely <sup>ive</sup> protectionary in effect, except for some of those on food imports. Control over food imports and prices was retained largely because of public unease over the price rises of mid-1919,<sup>2</sup> and food control was only finally lifted in 1921.

Control over new issues of capital for domestic purposes was formally removed in April 1919, but the Committee had been allowing virtually every application through for some months previously, and this was a good example of controls becoming defunct because of the attitude of those who operated them, in this case notably Lord Cunliffe, ex-Governor of

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1. Tawney, The Abolition of Economic Controls 1918-1921, p.12.
  2. Morgan, Studies in British Financial Policy 1914-1925, pp.62-63.

the Bank of England. The figures of domestic issues in 1918 had recovered to their pre-war level, although only in money terms, and were about five times those of the previous year. The following two years each showed a sharp rise in the figures.<sup>1</sup>

Control over industrial production was relinquished very quickly. By June 1st 1919 virtually all control on the manufacture and distribution of goods in Britain by the Ministry of Munitions, the War Office and the Board of Trade had come to an end except in the case of a few goods. It had originally been intended to retain some control over the disposal of war materials, to make sure that export firms got priority for raw materials, but eventually the Government decided to release all industrial raw materials, and as a result the War Priorities Committee which had been converted to civilian use by changing its name to the Civil Industries Committee, was wound up in January 1919 as it had become superfluous.<sup>2</sup>

The bulk of the munitions factories which had been in private hands were returned to their owners; those which had been built by the Government were mostly sold. Projects for turning them over to peace work, which had been approved in principal by the War Cabinet in the autumn of 1918,<sup>3</sup> foundered on the problem of whether they were to be competitive with private industry in the general market. A Cabinet decision of January 1919 that the factories could only produce goods if the State was to be their sole buyer and if, in the production of them, the State would not compete with private firms, effectively sealed their fate, since the

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1. Morgan, Studies in British Financial Policy 1914-1925, p.264. Control over foreign issues was released partly in August and fully in November, and the restrictions on the banks deposit rate was also lifted in August. The whole matter was discussed by the Finance Committee of the Cabinet, see P.R.O., Cab.27/71, Minutes of the Finance Committee of the Cabinet, 1st meeting, 24 July 1919.
  2. P.R.O., Recon.1/52.
  3. P.R.O., Cab.23/8, Minutes of War Cabinet meeting No. 491, 24 Oct., 1918.

Government did not use any such goods in sufficient quantity for it to be economical to retain factories for their production.<sup>1</sup> Eventually only three of the factories were retained permanently, and these became the first Royal Ordnance Factories at the outbreak of World War II.<sup>2</sup>

One of the few industries where some measure of control was maintained for a time was coal; the reasons were mainly the shortage of coal supplies and the unwillingness of the miners to see the return of pre-war conditions. Export conditions other than those on price were withdrawn in 1919, and minimum prices were substituted for fixed ones, which enabled the industry to take advantage of the shortage on the Continent to make considerable profits in that year. Because part of the process of control had involved a Government-guaranteed profit standard, above which level the Inland Revenue received 80% of the profits, the Government received a profit of £170 million in 1918-19. It had originally been intended to continue the agreement between the owners and the Government on profits and wages until August 1921, largely as a result of the Government's indecision over the recommendations of the Sankey Commission. By the end of 1920, however, sales and prices were becoming less favourable, and in January 1921 expenses exceeded receipts by £4.8 million, and by £4.5 million the following month. The Cabinet, worried at the thought of the alarming amounts of money they might lose, panicked and abandoned control at a month's notice, on March 31st, five months earlier than planned.<sup>3</sup>

Another area of control which remained for some time in full and which had lasting results was the Liquor industry. There was considerable

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1. P.R.O., Cab.23/9, W.C.514, 8 Jan., 1919.
  2. Aldcroft, Studies in the Abolition of Economic Controls in Britain after Two World Wars, p.21.
  3. Tawney, The Abolition of Economic Controls 1918-1921, pp.22-23.

public support for this on the grounds that the operations of the Liquor Control Board had been instrumental in the considerable reduction in drunkenness during the war, and it was also making a profit - 12½% on its capital April 1918 - April 1921. But vested interests in the trade prevailed, and the Board was wound up in 1921, although two of its three centres carried on business under the control of the Home Office. A Licensing Act was also passed, under which hours of opening were considerably reduced from the pre-war level. The liquor centres were finally abolished in 1922, following the recommendations of the Geddes Committee, which was afraid they might make a loss in the future.<sup>1</sup>

The railways were not formally handed back to the owners until 1921, with the result that when the railwaymen threatened to strike in the autumn of 1919 over a proposed wage cut, it was the Government which had to deal with the situation directly. As one writer rather unkindly puts it,

"Lloyd George allowed Auckland Geddes, President of the Board of Trade, to provoke the strike by his intransigence; then stepped in and settled it on the railwaymen's terms. This was a great stroke for the National Union of Railwaymen..It was also a great stroke for Lloyd George."<sup>2</sup>

But this manoeuvre did at least prevent the effective invocation of the Triple Alliance, at a time when a joint strike of railwaymen, transport workers and coalminers would not only have been economically but also politically disastrous for the Coalition, caught in the middle as they would have been.

Controls over food were maintained longer than in any other sphere. It had originally been intended to phase them out during 1919, and the Ministry of Food was scheduled to disappear in September of that year. But the alarming rise in food prices in the summer of 1919 caused the

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1. Tawney, The Abolition of Economic Controls 1918-1921, pp.24-25; Aldcroft, Studies in the Abolition of Economic Controls in Britain after Two World Wars, pp.21-25.
  2. A.J.P. Taylor, English History 1914-25 (Oxford: Clarendon Press, 1965), p.141.

Government to have second thoughts, and in July it was announced that the Ministry would continue for the time being. Control over some imports was reimposed, elements of it continuing until March 1921, and food rationing was reintroduced. Meat rationing was again dispensed with in December 1919 after only three months, but butter remained rationed until May 1920, and sugar until September.<sup>1</sup> Price controls lasted longer than physical controls, and like these, lasted longer for food than for other materials and goods. Control over coal prices remained until June 1920, bread and flour were controlled until October 1920, butter until March 1921.<sup>2</sup> Since this normally involved the authorities in selling below the market price, and often below cost, these operations made a considerable loss for the Government. The Sugar Commission lost £22 million in 1919 and 1920. The Wheat Commission, which imported foreign cereals and sold them to the millers at the Food Commissioner's price for the native product, who then sold the flour below cost to the bakers, made an average loss of £50 million per year between September 1917 and December 1920.<sup>3</sup>

Such controls over labour as existed were used to control unemployment. It had originally been intended to demobilise the most skilled workers first, in an attempt to get peace-time industry going again as soon as possible, but since these were nearly always the last to have been called up, the resentment caused was considerable, and when Churchill took over the War Office in January 1919 he abandoned the idea in favour of 'first in, first out'.<sup>4</sup> In any case, the process of demobilisation was achieved so swiftly that such considerations very quickly became academic.

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.62-63.
  2. Ibid.
  3. Tawney, The Abolition of Economic Controls 1918-1921, pp.19-20.
  4. W.S.Churchill, The Aftermath (London:Macmillan & Co.,1941),pp.53-6.

In the fifteen months following the Armistice over four million men were released from the forces, but more than half of these were out by March 1919, and by the end of June the proportion was around three-quarters.<sup>1</sup> At the same time, the munitions workers were gradually released, with those who normally worked in the industry the last to go; overtime and payment by results were suspended, and discharged workers were given a free passage home.<sup>2</sup> Because of the general optimism about continuing good prospects for trade after the war, absorption into peace-time industry was swift; within eight months of the end of the war, munitions work had ceased, about six million war workers and forces personnel had been released and nearly 90% of them had either been absorbed into industry or withdrawn from the labour market altogether.<sup>3</sup>

One of the few more permanent legacies of the war was the retention of some protective measures. Certain industries had been found to be essential to Britain for defensive reasons, and their growth had been encouraged in wartime to supply a number of essential articles which we had previously imported almost entirely; a notable instance was the dyestuffs industry. Several of these nascent industries received a measure of protection through the Safeguarding of Industries Act in 1921.<sup>4</sup> In addition the MacKenna duties, imposed by the then Chancellor in September 1915, which consisted of a 33% ad valorem tax on a number of manufactured articles, notably motor cars and bicycles, were retained until 1924. The Free Trade lobby fulminated against what it regarded as a first step towards protection,<sup>5</sup> but the trade and defence interests won the day.

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1. Morgan, Studies in British Financial Policy 1914-1925, p.65.
  2. Ibid.
  3. Ibid., pp.65-6.
  4. Ibid., p.64.
  5. The Economist, traditionally a staunch Free Trade paper, was among the leaders in the protests against permanent measures of import and export regulation; See, for example, Economist, vol.LXXXIX, 22 Nov., 1919, leading article.

Thus by the autumn of 1919, only a year after the Armistice, the vast bulk of the apparatus of war-time control had already been dismantled, and only isolated instances remained. These were largely in areas where their removal, rather than retention, would at that time have caused a public outcry; the obvious example is control over the price and distribution of food. That this 'bonfire of controls' was largely in line with the Government's pre-Armistice intentions is reasonably apparent. In the meetings of the War Cabinet of late 1918, the discussions on reconstruction centre on the positive aspects, such as 'homes for heroes', rather than the negative one of retaining influence over some parts of the economic life of the country by direct controls.

"Economic conditions at the Armistice did not appear to justify the retention of controls for any length of time and in fact there was never any question that controls would be retained any longer than was absolutely essential. Many of them operated under temporary legislation anyway, which was due to expire soon after the declaration of peace and it would have required an unusual Government to have drafted legislation to extend their lease of life for any length of time. In any case the policy of the Government was mapped out before the Armistice and it followed fairly closely the recommendations regarding controls contained in the various trade reports. Once started, the fire of decontrol was fanned by the mounting pressure of public opinion against any form of restrictions on economic activity and by the rapid disintegration of the various international schemes of Government control...."<sup>1</sup>

During the first half of 1919 Lloyd George was absent for nearly all the time at the Paris Conference, and since Austen Chamberlain was the only member of the War Cabinet who remained in England the whole time Lloyd George virtually dispensed with its formal meetings, and decisions were taken largely on an ad hoc basis. The process by which the decontrol of industry was accelerated is therefore extremely difficult to follow, and

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1. Aldcroft, Studies in the Abolition of Economic Controls in Britain after Two World Wars, pp.18-19.

much of the important material is contained in the Prime Minister's correspondence files rather than in the formal Cabinet minutes; this tendency was encouraged by the absence with Lloyd George in Paris of the Secretary to the Cabinet, Sir Maurice Hankey. But on the whole the Government's approach seems to have been most influenced by the employment prospects. Chamberlain, speaking at a war Cabinet meeting in October 1918, said of the plans for running down production in the Munitions factories:

"Generally, the principle to be borne in mind was that every legitimate effort should be made to prevent unemployment, and its accompanying demoralisation. It was far better to run the risk of manufacturing commodities which would not be required, and to resolve them into their elements later, than to have multitudes in receipt of unemployment benefit."<sup>1</sup>

A further complication at this stage was that until the Government knew the Armistice terms it could not be sure what its peace-time munitions needs would be, nor would it have any certainty that hostilities would not be recommenced. This uncertainty was largely removed in the course of the winter, and this, combined with the apparent ease with which men were being absorbed into industry, was a factor in the decision to get rid of the Munitions factories more quickly than had been envisaged in the autumn of 1918.

As to the disposal of the large volume of excess stores which the Government had in its possession at the end of the war, this was carried out with all possible speed where the materials were needed to get industry going again; one of the points which Addison stressed was the need for this.

"The rapidity with which these people unemployed during the transition period could be absorbed would mainly depend on the supply of raw materials..."<sup>2</sup>

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1. P.R.O., Cab.23/8, W.C.491(1), 24 Oct., 1918.

2. Ibid. Addison was still Minister of Reconstruction at this time.

But care was also taken not to flood the market and distort prices too much. In the event, 83% of the surpluses disclosed by all Departments to the Disposal Board of the Ministry of Munitions, which handled the transactions, were disposed of by June 1920, for a total of £504 million, and a further £300 million worth remained to be sold.<sup>1</sup>

Such, in brief outline, was the process by which the Government relinquished its physical and financial hold over the country in the year following the Armistice. Lloyd George had fulfilled his election pledge of October 1918, in which he acknowledged that

"Industry will rightly claim to be liberated at the earliest possible moment from Government control."<sup>2</sup>

But the Government had also pledged itself to a programme of Reconstruction, aimed at increasing the efficiency of the administration of the Government, at alleviating many of the social evils of the age, and at maintaining a high level of employment. On the policy of decontrol, there had been few detractors; in the field of reconstruction the situation was rather different.

#### Problems of Reconstruction: The Ministry of Supply

One of the features of war-time Government control of the economy had been the extent to which it had been necessary to set up new Departments to take charge of the various new functions of the Government. True to its traditional dislike of swollen bureaucratic establishments, this was one aspect of Government expansion which the House of Commons was firmly of the opinion should be cut back as soon as peace came. This clamour, which was in part bound up with the anti-waste campaign,<sup>3</sup> was reinforced by the opinions of the general public, and also by many

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1. Tawney, The Abolition of Economic Controls 1918-1921, pp.19-20.

2. Lloyd George Papers, F/8/2/42.

3. See below, pp. 182-203.

of the Government's advisers. Sir Warren Fisher, the Permanent Secretary to the Treasury, writing to Lloyd George about the economy campaign, urged that

"War time Departments should, I suggest, be wound up as soon as possible and not continued - with the exception of those engaged on an inevitably continuing service which could either maintain a separate existence, e.g. the Ministry of Pensions, or be absorbed into some pre-War Department. The Ministry of Munitions is the most spectacular case for dissolution, but there are others." <sup>1</sup>

Some of the war-time creations were rendered redundant by the coming of peace almost automatically; the need for a Ministry of Food was obviously no longer there after the ending of food price and distribution controls, and the Ministry of Shipping was no longer needed when the requisitioning of ships and shipping space ceased. Even the Ministry of Reconstruction, being a co-ordinating Department without executive power, could safely be wound up once it had discharged its functions of ensuring that the other Departments' schemes for post-war reconstruction were properly integrated.

The Ministry of Munitions might at first sight seem to be in similar case; for, as we have seen, it had ceased to exercise executive power over more than a few factories by the summer of 1919, the vast majority of its workers had been disbanded, and its one remaining major concern, the disposal of war stores, could have been taken care of by transferring the Disposal Board to the care of another Department, probably the Board of Trade. But one of its major functions during the war had been the co-ordination of the supply of munitions of War to all the Service departments and the armed forces which they managed. While Churchill was still at the Ministry he conceived a plan for turning the Ministry of Munitions into a peace-time Ministry of Supply, which would co-ordinate

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1. P.R.O., T.171/155, Fisher to the Prime Minister, 3 Sep., 1919, underlining in the original.

purchases not only of material for the waging of war on behalf of the fighting services, but also all bulk stores for the civilian and military departments as well. Such a plan would, Churchill submitted, bring great savings through bulk purchase, the reduction in the amounts of stores would be needed if these were to be centralised, and a rationalisation of the systems of payment and of distribution. It would also prevent competition between Departments, which tended to result in the Government paying higher prices than it need.<sup>1</sup>

This plan gained some support from the recommendations of a Committee headed by Lord Inchcape, which recommended that supply be brought under the control of a single department. This Committee had been set up by the Chancellor to consider how the contract business of the forces might best be co-ordinated; it reported in March 1918, and Lord Inchcape afterwards made it clear to the Admiralty that he had intended his recommendations to apply only in wartime. But this was not stated explicitly in the Report, and when the Minister of Munitions, Lord Inverforth, canvassed the opinion of the other members in November 1919 they disagreed with Inchcape's interpretation.<sup>2</sup> Backing also came from an administrative viewpoint, through the Haldane Committee on the Machinery of Government.<sup>3</sup> The subject was discussed in Cabinet in October and November 1918, in conjunction with the proposals for continuing Government ownership of the Munitions factories.

The proposal to transform the Ministry of Munitions was contained in a Cabinet paper circulated to his colleagues by Churchill in October 1918. In it he argued that such a Department would bring considerable

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1. Lloyd George Papers, F/28/5/17. Churchill's memorandum was written in February 1918.
  2. Lloyd George Papers, F/28/5/17, Inverforth to Lloyd George, 26 Nov., 1919.
  3. Report of the Committee on the Machinery of Government, Cd. 9230 (London: H.M.S.O., 1918).

peace-time advantages in economy both of money and time. He supported his arguments by circulating at the same time a copy of a report by the Munitions Council Committee on Demobilisation and Reconstruction, which also urged that as soon as peace was declared, steps should be taken to turn the Ministry into a Ministry of Supply.<sup>1</sup> General approval was given to their recommendations in October,<sup>2</sup> and the specific proposal about the Ministry of Supply was discussed at another Cabinet meeting in November. At this meeting, Sir Austen Chamberlain was strongly in favour of the proposal, and the rest of the War Cabinet was in agreement, although Sir Eric Geddes expressed some reservations as to the implications for Departmental autonomy. The Minister of Munitions was instructed to draw up a draft Bill for the setting up of a Ministry of Supply, which would have transferred to it the powers of the Ministry of Munitions.<sup>3</sup> This was duly done, and the draft circulated to the Cabinet at the end of March. It was, as had been intended, a skeleton enabling Bill; the powers of the Ministry of Munitions would be transferred to it, together with existing powers currently held by other Ministries by Order in Council as occasion warranted.<sup>4</sup>

At this stage it became apparent that the Service departments were extremely worried about the whole idea. The draft was discussed by the Home Affairs Committee on March 31st 1919, and the breadth of powers which the Ministry could have was objected to, particularly by the Minister of Works, Sir Alfred Mond.<sup>5</sup> This was hardly surprising; the powers of that office were bound to be encroached upon by the new Ministry, and

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1. P.R.O., Cab.24/67, G.T.6041, 18 Oct., 1918.
  2. P.R.O., Cab.23/8, W.C.491, 24 Oct., 1918.
  3. P.R.O., Cab.23/8, W.C.500, 8 Nov., 1918.
  4. P.R.O., Cab.24/77, G.T.7007, 20 Mar., 1919.
  5. P.R.O., Cab.26/1, Minutes of the Home Affairs Committee of the Cabinet, 25th meeting, 31 Mar., 1919.

indeed it was at one point suggested that it should absorb the Office of Works completely.<sup>1</sup> It was decided that the Bill should be redrafted in consultation with the other Departments concerned. It was not, however, easy to reach agreement. The Services in general contended that since they would have considerable surplus stocks of arms after the war the need for purchase of these in bulk would not be sufficient on its own to justify the existence of the Department. The individual forces had their own specific grumbles as well.

The Admiralty objected to the proposal particularly on the grounds that they could not consent to another department taking over their responsibility for the victualling and supplying of stores to ships. The Admiralty circulated a Paper on these lines to the Cabinet in May, accompanied by a letter from the First Lord, Walter Long, who said that the proposals, in the opinion of his colleagues on the Board of Admiralty,

"would make it impossible for the Board to exercise their constitutional responsibility for the efficiency of the Navy."<sup>2</sup>

The memorandum made a great play with the fact that the recommendations of Lord Inchcape, which had been adduced by the Bill's supporters as being on their side, were intended by him to relate to war-time only. In the opinion of the Admiralty, ships' stores and supplies should be completely in the hands of the Admiralty. It was also doubtful about drawing distinctions between the commissioning of experimental articles of war and of those of proven and accepted value.<sup>3</sup> All the forces felt strongly about this thorny problem; but in the case of the Army it had been solved during the war by making the War Office responsible for design, and for research and development in design, while the Ministry of Munitions,

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1. Lloyd George Papers, F/28/5/17, Inverforth to Lloyd George, 26 Nov., 1919.
  2. P.R.O., Cab.24/78, letter by First Lord of the Admiralty covering G.T.7193, dated 3 May, 1919.
  3. Ibid., G.T.7193, 2 May, 1919.

was responsible for production and for research in this area.<sup>1</sup> A memorandum supporting the proposed scheme was circulated by Edwin Montagu, Secretary of State for India, and opposing the efforts of the Air Force to keep the production of aeroplanes out of the proposed Ministry's sphere of control. The argument of the Air service was similar to the Admiralty argument over design - that the two could not be separated, and that the Air Ministry must have sole control over the design and production of aeroplanes. Montagu pointed out that this argument had already been decided, after exhaustive discussions, in favour of giving the Ministry of Munitions control over aircraft production, and he could see no reason why the Ministry of Supply should not perform this function equally well. This was a very important point, since in Montagu's view it would not be a good idea to make exceptions on any scale.

"...every supply which is taken or excluded from the Ministry of Supply detracts from these advantages..."<sup>2</sup>

Churchill, who had been the main driving force behind the scheme at its outset, now began to have reservations. His move to the War Office in January 1919 had also given him control over the Air Ministry; in this situation he was bound both by his proximity to them and by his obligations to them as their Ministerial head to be influenced by the arguments of his two service chiefs. At a Cabinet meeting in May the problem of aircraft supplies was discussed, and Churchill announced that he had changed his mind about the desirability of centralising the production of non-standard technical supplies as a result of a report of a Committee whose chairman was the Surveyor General of Supply at the Air Ministry, Sir James Stevenson. This Committee considered that the Aeronautical Supply Division

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1. Lloyd George Papers, F/28/5/17, Inverforth to Lloyd George, 26 Nov., 1919.
  2. P.R.O., Cab.24/79, G.T.7250, 12 May, 1919.

of the Ministry of Munitions was really a part of the Air Ministry for all practical purposes, and thus the argument that aircraft supply and production had been centralised during the war under the control of the Ministry of Munitions was neither wholly accurate or relevant to peacetime conditions. The Committee therefore recommended that the design and production of non-standard technical supplies should be the responsibility of the Air Ministry.

With Churchill no longer supporting him, Sir Austen Chamberlain was by now fighting virtually a lone battle in the War Cabinet on behalf of the Ministry of Supply, and the Cabinet decided to ratify the recommendation of Stevenson's Committee subject to the approval of the Prime Minister, who was away in Paris. Chamberlain recorded his formal dissent from this conclusion.<sup>1</sup>

The draft Bill setting up the Ministry of Supply was discussed at two meetings of the Home Affairs Committee in the course of the summer,<sup>2</sup> and it was agreed that little progress could be made until a decision on services supplies in general had been reached. It was apparent that this decision would be crucial to the chances of establishing such a Ministry, and it is ironic that, as we have just seen, Churchill, who had been the originator of the scheme, was in his capacity as Secretary for War and for Air obliged to advocate modifications to the plan which were in the end to prove of central importance in undermining the desire of the Cabinet to institute the new Ministry. But in addition to positive deterrents to the new Ministry, there were other problems, particularly the dropping of the clause in Government contracts which made it obligatory on firms doing such work to make their books available to inspection, for an important

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1. P.R.O., Cab.23/10, W.C.564, 8 May, 1919.

2. P.R.O., Cab.26/1, H.A.C.28, 16 May, 1919; H.A.C.35, 18 July, 1919.

asset in the bargaining process which took place when Government contracts took place was thus lost.

With the coming of the autumn all proposals which involved the increase or the maintenance of present levels of expenditure began to fall under the increasing disapproval of the Prime Minister, at the instigation of and backed by the Treasury. The clamour for reductions in Government expenditure was loudest in the Commons, and it is certain that a Bill to continue the existence of the Ministry of Munitions would have received short shrift. We have already noted the comment of the Permanent Secretary to the Treasury on the Ministry of Munitions; many M.Ps. agreed with him. The cause was not helped by the reorganisation of the Cabinet, first in January 1919, which had deprived the scheme of the wholehearted advocacy of Churchill, and later of October 1919, in which the Minister of Munitions lost his seat in the Cabinet. Churchill had been replaced at Munitions by Lord Inverforth, who only stayed in the Government out of loyalty to Lloyd George; he made several attempts to resign before the Ministry finally disappeared in 1921.<sup>1</sup> But he was wholehearted in his advocacy of a Ministry of Supply. In reply to Lloyd George's circular letter on economy,<sup>2</sup> he stressed the extent to which the Ministry had already shed most of its war-time functions and responsibilities, and put forward the view that the greatest service the Ministry could now make to economy would be to become a Ministry of Supply. This Ministry would be responsible for both bulk purchase and for holding stocks for other Departments; this would result in economies in purchase, and in space, freight costs, administration costs, and in the financial

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1. Lloyd George Papers, F/28/5/11 and F/28/5/16, contain letters dated 7 July, 1919 and 28 Oct., 1919 respectively, both asking Lloyd George's permission to resign.
  2. A copy is to be found in P.R.O., T.171/170, dated 10 Aug., 1919. A copy was sent to all Departmental heads.

costs attributable to holding large supplies in stock; stocks could be considerably reduced for those articles which were needed by several departments. The fighting services were most reluctant to agree to such a development, but it was important that pressure should be brought to bear.<sup>1</sup>

The following month, Inverforth wrote a full-scale memorandum to Lloyd George setting out formally the case for a Ministry of Supply. He traced the steps by which the idea had developed, and attempted to deal with the various objections. A Ministry of Supply would, he suggested, lead to greater efficiency and economy. It would remedy many of the defects of the existing system of purchase and storage, notably in stopping the competition between Departments, which enabled contractors to play one off against another. The defects which he outlined were not, in his view, peculiar to war conditions. Neither could he accept the argument of the Admiralty that the provisioning of ships was a special case; the evidence did not support their contention. As Montagu had noted, all increases in Ministry of Munitions functions during the war had been fiercely opposed, but had been found to make supply more effective.

Inverforth then attempted to rebut the opposition outside the Cabinet. That of the Press was partly, he said, a virtual reflex action, a resistance to the creation of new ministries in general. Their objections to the retention of the Ministry of Munitions on the grounds of its extravagance in war-time, and the suggestion that it was simply an excuse for keeping on staff, ignored the fact that the peace-time aims of the Ministry would be different. In war-time, the aim had been production at all costs; efficiency had had to take a back seat. But peace-time reorganisation

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1. Lloyd George Papers, F/28/5/16, Inverforth to Lloyd George, 28 Oct., 1919.

would enable the Ministry to produce savings in Government supply which would make the cost of the Ministry worthwhile. Finally, he stressed that there was no intention of resuming any form of industrial control by the Ministry.

"...there is no intention whatever of reverting, under the normal conditions of peace-time, to the policy of industrial control and interference which was forced upon the Government by the exigencies of war."

The following day, the Finance Committee of the Cabinet met, and discussed the future of the Ministry of Munitions. It was felt that Parliamentary opposition to the retention of the Ministry would be considerable, and it was decided to recommend to the Cabinet that a Select Committee of the House of Commons be set up to consider the best form of organisation for supplies required by the Government.<sup>2</sup> But when this came up for decision at a Conference of Ministers early in December, it was pointed out that since so many members of the Government had at one time or another been Minister of Munitions, the combined experience of the Cabinet was greater than that of any Select Committee could ever be. In addition, the fact that the investigations of such a Committee would uncover serious differences of opinion among Ministers was felt to be a severe drawback and might prove embarrassing.

The Conference then went on to discuss the general question of the merits of setting up a Ministry of Supply. According to the usual practice the record of the discussion is shrouded in anonymity, but it is stated that a number of Ministers had changed their minds on the subject since the end of the war. It was pointed out that the Army and Air Force would be living on their surplus stores for the next five years, and the number of purchases to be made would not justify the existence of a

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1. Lloyd George Papers, F/28/5/17, Inverforth to Lloyd George, 26 Nov., 1919.
  2. P.R.O., Cab.27/71, F.C.17, 27 Nov., 1919.

separate organisation. In addition, the forces would require staffs to focus their demands, and the Ministry would require personnel to vet them, which would lead to considerable duplication of staff. There was the difficulty, too, of producing accurate estimates. This had caused serious problems during the war, because Munitions Ministry estimates of costs kept changing, and the Service departments felt that they could not take responsibility for their estimates if purchasing were to be done by a separate department. Finally, the Air Ministry would not relinquish control over the production of aircraft, since design could not be separated from supply unless aircraft were to be produced in very large numbers, which was not likely to be the case over the next few years. Another argument was added to those of the Services, that concerning the great difficulty involved in attempting to pass through Parliament a Bill 'involving the retention of the vast organisation of the Ministry of Munitions.'

From the nature of the arguments, and from the evidence provided by the similar discussions in May 1919, it seems apparent that one of the Ministers who had 'changed his mind' was Churchill. It also seems very possible that another was Chamberlain, the only member of the War Cabinet who had until then steadfastly supported the scheme. Chamberlain was by this time, though not in October 1918 when the discussion began, Chancellor of the Exchequer. In addition, between May 1919 and December had come the great economy campaign. As we have seen, Chamberlain's Permanent Secretary at the Treasury was strenuously opposed to any attempt to perpetuate the existence of the Ministry of Munitions. It may be that the combined effects of the advice of his Treasury officials, caused Chamberlain to have second thoughts about the advisability and desirability of having a Ministry of Supply.

There was, however, considerable resistance by the supporters of the measure; the Cabinet had by this time resumed its normal peacetime size, and this was the first opportunity which many of its members had had to discuss the measure in Cabinet. The arguments which they adduced were in the main those put forward by Inverforth in his memorandum. In the end it was decided to ask the fighting Services to draw up lists of articles which might be purchased jointly, and that the possibility of combining the Office of Works, the Stationery Office and the nucleus of a new buying organisation should be investigated.<sup>1</sup>

However, these moves came virtually to nothing. In January, Inverforth was still writing to Lloyd George advocating the new ministry, and urging that it be created by amalgamating the Office of Works, the Stationery Office and parts of the Ministry of Munitions.<sup>2</sup> But opinion was hardening as the post-war boom gathered way, and the attention of the Cabinet was further distracted by the problems of Woolwich Arsenal, one of the remaining Munitions factories in Government hands, about which numerous papers were circulated. The bad organisation of the Arsenal was discussed at length at a meeting in March after cursory references to the supply problem.<sup>3</sup> Finally, it was decided to leave the existing supply organisation alone, apart from the creation of a joint Supply Committee by the three Services, and to allow the Ministry of Munitions to disappear as was provided for in existing legislation, and the decision was announced in Parliament in April.

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1. P.R.O., Cab.23/18, Conference of Ministers held 9 Dec., 1919.
  2. Lloyd George Papers, F/28/5/22, Inverforth to Lloyd George, 5 Jan., 1920.
  3. P.R.O., Cab.23/20, Conference of Ministers held 16 Mar., 1920; P.R.O., Cab.24/95, C.P.372, 30 Dec., 1919; Cab.24/98, C.P.616, 5 Feb., 1920, C.P.657, 14 Feb., 1920; Cab.24/99, C.P.764, 27 Feb., 1920; Cab.24/100, C.P.810, 8 Mar., 1920, C.P.824, 9 Mar., 1920.

## Problems of Reconstruction: Trade Policy

Before the war, Britain's policy on overseas trade had been fundamentally a free-trade one; but the war-time need to restrict trading, partly for economic reasons concerned with conserving shipping space and supplies, and partly as a part of the blockade of Germany and her allies, meant that Britain ended the war with a considerable structure of external trade regulation. In addition, there were two classes of industry which felt they had a right to protection; the first was those which had not existed in any large sense before the war and which had been set up in response to war-time demands for goods which would normally have been imported. The second was the class of nascent industries which had in the main received some measure of protection from the McKenna duties; these were mostly on 'luxury' goods. There was little discussion of the merits of protecting the second class as an entity, but the McKenna duties were allowed to remain without either further sanction or opposition. But there remained the essential goods which were needed for defence purposes and it was strongly felt in many quarters that although it might not make economic sense to protect these industries from foreign competition, it was essential from a security point of view.

A good deal of discussion and submission of papers on this subject went on in the course of 1918. The Treasury was not directly concerned, but the picture of post-war decontrol and reconstruction is incomplete without a cursory examination of the problem. The matter was discussed several times<sup>1</sup> by the Economic Defence and Development Committee of the Cabinet in July and August 1918, and the Committee decided to submit the

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1. P.R.O., Cab. 24/77, minutes of the Economic Defence and Development Committee of the Cabinet, 2nd meeting, 2 July, 1918, 4th meeting, 16th July, 1918, 7th meeting 20 Aug., 1918.

problem to a subcommittee with Austen Chamberlain in the chair. Among the documents considered by the Committee were memoranda by Mond, First Commissioner of Works, and by the Board of Trade. In addition the Committee had been asked to consider the observations on the subject of Lord Balfour of Burleigh's Committee on Commercial and Industrial Policy after the war. Mond put very strongly the case that National security was more important than national wealth. In his view there was also another problem to be solved; that of preventing harm to our home industries from the operation of harmful policies by other nations. Dumping might be a serious problem after the war, since it was very likely that enemy countries in particular would attempt to restore their industries by giving big export bounties in one form or another. Mond also supported Empire Free Trade, although he did not favour the imposing of tariffs on the imports of other countries solely for the purpose of giving the Dominions rebates. But he did feel that strenuous efforts should be made for a considerable measure of self sufficiency within the Empire.<sup>1</sup>

The Board of Trade recommendations followed similar lines on dumping and on the safeguarding of industries, but they took a much narrower view of the number of industries which needed protection, in accordance with the recommendations of the Balfour Committee Report. As that Committee had recommended, the form of the prohibition of import except under licence, and that a 'Special Industries Board' should be set up to report to the Board of Trade on industries which needed safeguarding. It was also suggested that a rebate of one-third the normal customs duty should be allowed on imports from the Empire.<sup>2</sup>

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1. P.R.O., Cab. 27/44, Economic Defence and Development Committee of the Cabinet paper 18, 2 July, 1918.
  2. Ibid., E.D.D.C. paper 33, 20 Aug., 1918.

The sub-Committee reported back that it recommended the adoption of the Board of Trade's memorandum, and this was agreed.<sup>1</sup> Trade policy was discussed on a number of occasions during the next few months, without any concrete decisions being taken.<sup>2</sup> Finally, in the summer of 1919 Lloyd George decided to try to formulate a series of basic principles for the Government's economic policy, and a series of Cabinet meetings on the subject were held during the summer recess. In the meantime the Government had set up yet another committee on the subject, which had held a series of discussions on the subject. The President of the Board of Trade, now Sir Auckland Geddes, had attempted to embody the decisions of the Committee into a memorandum, which although the Committee had not sent it he believed to embody the substance of their ideas. This paper was submitted to the Cabinet, and formed the basis of the subsequent discussion.<sup>3</sup>

The subject of the protection of key industries, and of the prevention of dumping, was becoming urgent, as the 'bonfire of controls' would soon begin to play havoc with the wartime system of protection. As far as the products of key industries were concerned, the Board of Trade planned to keep the restrictions on import when the general controls on import were removed, and to introduce a system of licence fees for the issue of licences to import these products. The main source of friction on this subject was the extent of the protection to be granted, and it was decided to leave it to the sub-Committee to draw up a list of products which should be protected in this way. It was urged by the free traders, notably Churchill, that the list should contain only those industries

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1. P.R.O., Cab.27/44, E.D.D.C.7, 20 Aug., 1918.

2. See, for example, P.R.O., Cab.23/10, W.C.553, 3 Apr., 1919;  
Cab.23/15, W.C.610A, 8 Aug., 1919.

3. P.R.O., Cab.24/86, G.T.7974, 12 Aug., 1919.

which were both essential to our means of making war, and which were either non-existent at the beginning of the war, or else producing goods in quantities which bore no relation to the volume in which they were required in war-time.<sup>1</sup>

But the real problems which arose concerned the proposals on dumping. The chief difficulty was that, in view of the problems involved in formulating an effective policy, better registration of imports would be needed than was customary in peace-time. Even the returns based on Customs reports were largely unreliable. Geddes emphasised that there was at that time no method of obtaining the information which would be required to establish that dumping was taking place, or to prevent it. Chamberlain also suggested that proper registration would be worthwhile simply on the grounds of improving the Customs returns. But the general feeling was that the opposition in Parliament to any general scheme of registration would be considerable, and it was decided that no public mention should be made of the matter at present; if such registration were needed, clauses providing for it could be inserted in the anti-dumping Bill when it was drafted. Lloyd George also suggested that it would be wise to look at the possibility of improving the Customs returns in other ways, which could be done by laying orders before the House of Commons, rather than needing new legislation.<sup>2</sup>

A draft Bill was duly drawn up along the lines of Geddes' suggestions, and presented to Parliament in the autumn. The principal features were that it provided for the prohibition of import of goods which were in the view of the Board of Trade being sold in Britain below the 'foreign value', but with a provision for the Customs to overlook such an offence

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1. P.R.O., Cab. 23/15, W.C.614A, 14 Aug., 1919.

2. Ibid.

on payment of a fine which represented the difference the price paid and the British price; and the prohibition of import of goods on the schedule of key industries, and of all goods from countries where the exchange had collapsed, subject to a proviso that the Board of Trade had power to allow such imports under licence.<sup>1</sup>

The Treasury was not happy about the Bill, but the Board of Trade suggested that it was the best that could be done in the circumstances, and that it was unlikely that it would be much invoked, since it would be a sufficient deterrent just to have it on the statute book. The Treasury did not like the way that duties were effectively being introduced in a disguised form, nor the anomaly by which the Board of Trade were to collect fines if the goods were not detected at the point of entry.<sup>2</sup> But their objections were overruled, and the Bill eventually became law. It did not, however, have much effect on the situation it was meant to control, and its operation had to be strengthened by a further measure, the Safeguarding of Industries Act, 1922.

#### Problems of Reconstruction: the Ministry of Reconstruction

The problems which would occur during the transition period which would follow the end of the war had begun to occupy the minds of the Cabinet as early as 1916; Asquith set up a Cabinet Committee on the subject towards the end of the year, and it continued to meet until the Ministry was set up in the summer of 1917. Among the problems which were to occupy first the Committee and then the Ministry, one of the

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1. Summarised in P.R.O., T.160/21/712.
  2. Ibid., memo. by Blackett, 7 Oct., 1919. This memorandum was accompanied by a letter to the Chancellor from Warren Fisher, who grumbled about 'the immense powers which the bill confers on a bureaucracy to interfere with the business world and incorporates the principle of licensing exceptions to the general rules ... which businessmen so legitimately detest.'

most important was employment. It was early recognised that the dislocation caused by the War in the pattern of output and employment, combined with the absence of millions of men in the armed forces, cause grave employment problems when peace came. An early memorandum drawn up for the Committee in March 1917 suggested that the Ministry of Munitions should find out the possibilities of using some of the National factories on peace-time production, that the local authorities, other Government Departments, foreign and colonial governments should all be approached about their likely post-war needs for men and goods, and that the Ministry of Housing should meet the local authorities and draw up detailed plans on the basis of their estimates of needs.<sup>1</sup> Another Committee, this time of economists, set up by the Board of Trade to consider the probable conditions of industry after the war, also called attention to the problem of employment. They, however, thought that the immediate post-war period would, after a short period of adjustment, be one of full employment, because of the pent-up demand for civilian goods released at the end of the war. But they also recommended that employment schemes should be drawn up, to be put into effect as employment declined, after the first burst of post-war enthusiasm had been dissipated. Then, as unemployment in the relevant areas, for example building, declined, the Government's blue-prints could be put into practice.<sup>2</sup>

Other areas were also regarded as important; Housing for its own sake as well as for its employment possibilities, electricity supply, road building, as part of the longer term spectrum; improved channels of communication between Government and industry, and between employer and worker, better working conditions in industry, improvements in rural

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1. Lloyd George Papers, F/78/2/1, dated 15 Mar., 1917.
  2. Lloyd George Papers, F/88/3/1, May 1917.

life, on the social side; and a multitude of problems concerned with the transition period. The Ministry of Reconstruction was from the first an advisory department, without executive powers; its job was to make plans in conjunction with the Departments which would have to carry them out. The first Minister was Dr. Christopher Addison, who had previously been Minister of Munitions; he was an energetic man, full of ideas and enthusiasm, and close to Lloyd George; like him, he was a Liberal in a mainly Conservative Government. But his Ministry had no real power; he could instruct, advise and write angry letters to his heart's content, but he could not force Departments to carry out his instructions, as he apparently found to his cost when he left to become President of the Local Government Board in January 1919.

Addison began by sending a duplicate letter to each Department asking for a summary of their reconstruction plans.<sup>1</sup> At this stage the Treasury seems to have taken little interest; they were among a number of Departments to whom Addison protested two months later that he had received no reply to his letter.<sup>2</sup> But it was inevitable that, once the process of evolving long-term policy got under way, the question of expenditure should arise, and the Treasury began to take an interest in the Ministry's activities. These ranged across a wide field, as can be seen from one of the many pamphlets issued by his Department on the subject of Reconstruction - Addison was an excellent publicist - during 1917 and 1918. This one was entitled 'the Aims of Reconstruction' and was issued early in 1918.

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1. P.R.O., Recon.1/48, Minister of Reconstruction to all other Heads of Departments, 11 Aug., 1917.
  2. P.R.O., Recon.1/48, Minister of Reconstruction to certain Departments, 16 Oct., 1917. These were the Departments, such as the Treasury and Ministry of Munitions, who had not replied to the earlier letter of 11 Aug., 1917.

The document began by setting out the aims of the Ministry in general terms. Originally, it stated, the tasks of reconstruction had been seen in terms of a simple return to the position of 1914. But as a result of the experience of war, it said,

"People have begun to doubt whether, after all, the social and industrial system in pre-War days was so harmonious and so well-organised as to deserve to be revived in its entirety - whether, indeed, it was in all respects worthy of the men and women who lived under it, or compatible with the ideals for which so many of our best have given their lives." <sup>1</sup>

So, gradually, the idea of returning to pre-war days had been gradually supplanted by

"the larger and worthier ideal of a better world after the War."<sup>2</sup>

Thus the aims of reconstruction were in the main two: to provide for the conditions which will arise when the war ends and the nation returns to the activities of peace-time; and also to provide for wider and longer-term needs, in keeping with the national mood.

"It [the work of reconstruction] has to give shape and satisfaction to the strong feeling which has arisen in all sections of the community, among men and women of the most widely differing opinions and outlook, that there is very much to be ashamed of when we look back to the conditions of July 1914, and that out of justice to the living and out of reverence to the dead, we are called to rebuild the national life on a better and more enduring foundation." <sup>3</sup>

The pamphlet then went on to outline the various tasks with which the work of reconstruction would be concerned. First there was shipping. Detailed plans would be difficult to make until it was known what the situation as to supplies and the position of ships at the cessation of hostilities was; it would also obviously make a difference what season of the year peace was declared, and so on. But it had to be remembered that the problems of reconstruction in general, and of shipping in

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1. P.R.O., Recon. 1/82 part 2, Aims of Reconstruction, pp. 3-4.
  2. Ibid., p. 4.
  3. Ibid.

particular, were not exclusively British in nature, but affected all the belligerents, and it might be necessary to keep the inter-Allied control of shipping going in the post-war period. (This was rendered impossible mainly by the Americans, who were anxious to disband all such joint agencies as soon as possible.<sup>1</sup>)

The next problem was that of raw materials. Some form of priority over the release of stocks of raw material would be needed to ensure that the most urgent claims from a national point of view were satisfied first. The transport of stores and of goods in general was another matter which the Government was investigating; the roads had been neglected during the war, and a renewal programme would be needed at an estimated cost of £60 million.<sup>2</sup>

On demobilisation, the Ministry felt that the aims of civil industry were of paramount importance, and plans had been made for the release of those who were most urgently needed in their peace-time occupations first.<sup>3</sup> The utmost efforts would be made to get men back into employment as soon as possible, but for those who had to suffer an interim period of unemployment there would be unemployment benefit. As to industrial conditions, the policy outlined in the Whitley Report, which recommended the setting up of Joint Councils of employers and workers in all highly-organised industries, to discuss mutual problems,

"[has] been adopted by the Government as the cornerstone of its reconstruction policy."<sup>4</sup>

These bodies would also be able to fulfil the necessary function of providing a channel of communication between the industries and the Government.

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1. See, for example, Tawney, The Abolition of Economic Controls 1918-1921, p.19.
  2. P.R.O., Recon.1/82 part 2, Aims of Reconstruction, p.8.
  3. Ibid., p.9. This proved to be a most troublesome provision, and was done away with by Churchill as soon as he went to the War Office in January 1919; See above, p. 140.
  4. Ibid., p.10.

Where the two sides of industry were not sufficiently highly organised for these joint councils to be set up on a permanent basis, the Ministry was promoting the setting up for the post-war period Interim Reconstruction Committees, which might then provide this facility for joint industry-Government co-operation.

The paper repeated the Government's pledge to restore Trade Union conditions which had been voluntarily suspended early in the war, but it was of course open to the workers to decide whether all such conditions were necessary in the light of the way things had proceeded in their absence. The problems of the land were not forgotten, either. The Ministry was concerning itself with the expansion of forestry work, land resettlement, the reclamation of waste land, and other important matters designed to rejuvenate the life of the countryside.<sup>1</sup> And, just in case the importance of social problems had escaped anyone's attention, the pamphlet ended its catalogue of endeavour by promoting the cause of the main social services, housing, health and education.

Health improvements would need new legislation, to bring together the multiplicity of existing services, at that time supervised by a variety of different bodies, often at loggerheads with each other.

"In the work of reducing this tangle, which has grown up bit by bit during the last century, to greater order and usefulness, the Ministry [of Reconstruction] is naturally called to play a leading part, for all Reconstruction policy must be based upon a healthy and vigorous population..."<sup>2</sup>

Improvements in the stock of housing available would be another important problem to be solved in the reconstruction period; and considerable attention would have to be paid to education,

"for upon the extent to which the country develops and makes use of the innate abilities of its citizens, its future prosperity and happiness depend."<sup>3</sup>

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1. P.R.O., Recon.1/82 part 2, Aims of Reconstruction, p.13.
  2. Ibid., p.14.
  3. Ibid.

Having set out the social and economic problems, the pamphlet then came to that of finance. But not as might be imagined, the problem of financing its schemes; the difficulties were those of reconstructing the financial sector itself. In this connection the Ministry had set up two Committees, one, in conjunction with the Treasury, on currency and exchange, and the other on financial facilities.

Finally, the paper drew attention to the importance of a consideration which it had urged at the beginning; that of remembering the international nature of the problem.

"No single problem of Reconstruction can be solved if it is regarded solely as a domestic problem; to deal with the task in front of them when peace is made will demand from the Allies the same good faith and loyalty, the same forethought for each other and themselves, that has maintained their union during the War."<sup>1</sup>

The problem of financing the schemes of reconstruction was of course mainly the concern of the Department which was to spend the money. But Addison concerned himself with it on a general level. In February 1918 he wrote to the Treasury on the subject, asking for approval in general terms of his schemes, and for an assurance

"that measures which are agreed upon as essential in order to give the country a satisfactory start on a peace footing will not be delayed or refused sanction on the grounds of expense."<sup>2</sup>

He was not in a position to furnish the Treasury with detailed estimates of the cost of the plans he had drawn up, although they would soon be ready, but that was not the point; as a point of principle, there was no point in drawing up detailed plans if there was no prospect of being able to carry them out.

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1. P.R.O., Recon.1/82 part 2, Aims of Reconstruction, p.16.
  2. P.R.O., Recon.1/70, memo, by Addison on reconstruction finance, 10 Feb., 1918.

Addison then proceeded to outline the main headings under which expenditure would be incurred. First, there was the housing programme. This would involve purchase of land and materials on a large scale. Then finance would be required for the transfer to public ownership of land for small holdings, soldiers' resettlement, and afforestation. The transport system was in need of reconstruction and repair. Certain essential industries might need State financial assistance for a period. Unemployment insurance would have to be extended to cover the period of dislocation following industrial and forces demobilisation. Finally, the strengthening of the health service would require extra money; and it might be necessary, if the Committee on Financial Facilities so recommended, to provide State credit guarantees if the financial aid of the banks proved insufficient to help industry back on a peace-time footing. However, this list of needs was not exhaustive; and Addison emphasised that he had not included costs of food subsidies, charges arising out of the dislocation of transport following the end of the war, and other matters. What he was concerned with was not the sanctioning of individual items of expenditure, but the principle that reconstruction would not be hampered by a shortage of funds.

In Addison's opinion, it was essential for the Government to lay down guidelines about expenditure after the war. He felt that there were two main lines of argument on this topic. On the one hand there were people who felt that everything should be subordinated to the paying off of debt, and that there was no prospect of a permanent restoration of prosperity until a large part of the war indebtedness had been liquidated. From this viewpoint it followed, Addison said,

"that the total expenditure of the State should be kept as low as possible, that services such as housing, land settlement, and the improvement of the public health and presumably the restoration of the transport services to their full capacity, must wait until efforts at extinguishing debt are reflected in the improvement of national credit and international exchange."<sup>1</sup>

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1. P.R.O., Recon. 1/70, memo. by Addison on reconstruction finance, 10 Feb., 1918, p.3.

He felt that there would be more force in this argument if it could be shown firstly how expenditure of the kind he suggested involved the withdrawal of capital from production, and secondly how it would in any case be possible to pay off debt and restore the national credit if the maximum possible effort were not put into developing our resources so as to achieve the maximum output in the minimum possible time; and he urged

"that capital expenditure on every one of the subjects I have cited is as vital to efficient production as if it were invested in machinery or factory buildings. To say that the workman must be healthy and must have a house is simply to state two of the prime factors in the scheme of production which we all desire. The means for realising it will not be forthcoming except from the State and so far from withdrawing from industry the capital it requires the State in performing its obligations towards its citizens will be discharging a function which is essential to industry."<sup>1</sup>

So, Addison urged, it was vital that in order to restore the economic machine to proper working order the Government should be prepared to spend money, in large sums if necessary, though with careful regard to gaining value for money. If this were not done, the transfer from war to peace would be accompanied by widespread dislocation and unrest, and there would be agitation for the immediate implementation of the sort of schemes which Addison was proposing, but in haste and without proper consideration.

"It will be no defence to say that vital proposals were not enacted for want of money. Nobody will believe it. We shall be told that the money would have been forthcoming if it had been required for the War and we shall be pressed to accept all manner of wild proposals and to devise hastily extemporised expedients which will satisfy nobody. I hope that we shall not have to legislate and to spend money for reconstruction purposes in an atmosphere of panic engendered by violent agitation and well-founded discontent, but I do most seriously suggest that this is an alternative that cannot be disregarded if our plans are laid for a half-hearted tentative scheme of reconstruction based on the view that we cannot afford to prepare for peace."<sup>2</sup>

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1. P.R.O., Recon. 1/70, memo. by Addison on reconstruction finance, 10 Feb., 1918, p.3.
  2. Ibid., p.5.

In view of the events of early 1919, that last sentence is painfully prophetic, although there is no evidence that the Treasury was entirely or even largely to blame.<sup>1</sup>

Addison's memorandum was circulated to the Cabinet, and considered at a meeting on February 26th. By this time the official Treasury view had been propounded in a memorandum by Bradbury.<sup>2</sup> As was to be expected, Bradbury was not at all happy about the idea of giving a carte blanche to reconstruction expenditure. He disagreed with Addison's view that there was a clearcut division of opinion between people who gave first importance to paying off the National Debt, and who believed that this was an essential prerequisite to the recovery of the economy to its pre-war prosperity, and on the other hand those who felt that the only means of repaying the debt lay in giving first priority to stimulating production to the maximum degree possible by dint of capital outlay on a large scale. He felt that the idea that the faster production developed the greater would be Britain's ability to restore her credit and repay her debt was common ground. However, he felt that behind Addison's criticism of the more cautious school, who believed in putting debt repayment first, was the idea that repayment of internal debt in some way involved the expenditure of capital; and this Sir John regarded as fallacious.

Bradbury then proceeded to put forward the orthodox view of debt repayment, that is, that it involves a transfer of purchasing power from one member of the community to another, and in so far as the transfer was from taxpayers who might otherwise be expected to spend the money, to rentiers who would almost certainly reinvest it, the overall stock of capital would be increased.

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1. See below, pp. 177-182.

2. P.R.O., T.170/125, memo. by Bradbury on Addison's views on reconstruction finance, 21 Feb., 1918.

"It is clear therefore that provided the burden of taxation of profits is not carried to the point of strangling enterprise, taxation for the purpose of repayment of domestic debt tends by a process of compulsory thrift to increase rather than diminish the capital resources of the nation. The creation of a substantial sinking fund for the war debt out of revenue is therefore thoroughly sound from the economic point of view and will itself assist the re-establishment of industry by restricting consumption and increasing the demand for and making funds available for the production of new capital goods."<sup>1</sup>

This argument he regarded as unassailable. But it was a separate question whether at the same time as the Government was repaying debt out of revenue the State should also be borrowing on a large scale for capital purposes.

On this point, Bradbury felt it was not possible to give a categorical judgement as to the correctness of such a procedure. But he felt that there were several reasons for proceeding with extreme caution. The first was that the supply of capital after the war was likely to be considerably below the demand. This was basically not because of a shortage of currency or credit, for the potential purchasing power which the banks could lend their customers on the basis of ordinary banking practice would be on a scale entirely without precedent. But the volume of goods to satisfy the demand was simply not there, and if bankers used all the powers at their disposal to create purchasing power prices would be forced up to a level which 'would dislocate all economic relationships'.<sup>2</sup> Therefore, any Government borrowing after the war would involve not the creation of new credit but the diversion of purchasing power from private into Government hands. Bradbury questioned whether this was wise:

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1. P.R.O., T.170/125, memo. by Bradbury on Addison's views on reconstruction finance, 21 Feb., 1918, p.2. The analysis, in a pre-Keynsian world, is accurate within limits. But even in the context of the times, it ignores two problems: first the deflationary nature of some forms of debt repayment, in which purchasing power may actually be destroyed, and secondly the imperfections in the capital market.
  2. P.R.O., T.170/125, memo. by Bradbury on reconstruction finance, 21 Feb., 1918, p.3.

"The question therefore resolves itself into this, shall a portion of the insufficient supplies of raw materials which are available be diverted from the channels into which the ordinary laws of supply and demand would carry them to special purposes which in the opinion of the Government are desirable for social betterment, and shall a certain part of the labour which if economic forces were allowed to operate freely would undoubtedly be employed for purposes of the most pressing economic necessity...be diverted to certain services which however desirable from a social point of view are certainly less pressing from the point of view of economic necessity."<sup>1</sup>

In Bradbury's view, the likelihood of unemployment on a large scale except very temporarily after the war was most unlikely.

"While there is considerable danger of the restoration of industry being impeded by purely mechanical causes resulting from the war disturbance of the markets, uncertainty of the developments of demand and the difficulties of demobilisation, the general world shortage of commodities of all kinds, capital and consumable, is quite sufficient to absorb for some time to come the maximum production which can be made available."<sup>2</sup>

In addition to the economic arguments against considerable Government borrowing for capital purposes after the war, there was of course the administrative one. Since for many years after the war the Government would in any case have a heavy programme of maturity of short-term borrowing to cope with, any additions to the burden would only harm the economy in the long run by making the load of debt even more intractable.

However, Bradbury did not rule out altogether the possibility of raising moderate amounts for some reconstruction purposes after the conclusion of peace. But considerable care would be necessary.

"...the amount which can be so raised without grave risk to the whole financial fabric within any given period can only be determined from time to time as events develop and to decide 'that measures which are agreed upon as essential in order to give the country a satisfactory start on a peace footing shall not be delayed or refused sanction on the grounds of expense' would be to follow the historical precedent set up by King Canute in relation to the activities of the tides."<sup>3</sup>

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1. P.R.O., T.170/125, memo. by Bradbury on reconstruction finance, 21 Feb., 1918, p.4.
  2. Ibid.
  3. Ibid., p.6.

The matter came before the Cabinet on 26th February, and it was decided that the problem should be settled by discussion between Addison and the Chancellor of the Exchequer. No record of these talks has come to light, but in any case the problem did not really become pressing until the spring of 1919. Up to that time the problem was one of planning rather than execution. During the remainder of his time at the Ministry Addison continued to pursue the problems of reconstruction with energy and enthusiasm, dealing with such issues as the date for the ending of the war (an important issue because much of the authorisation of emergency action contained a proviso that the powers only extended to the 'period of the present war'), the formation of Joint Industrial Councils, familiarly known as Whitley Councils, of Interim Reconstruction Committees, relinquishing of Government control, sale of surplus Government property, and numerous others. There is little evidence of further conflict with the Treasury in the earlier part of this period, since most of Addison's work did not directly involve expenditure; as we have noted, his was not an executive department.<sup>1</sup>

One of Addison's major achievements at this time was the promotion of a unified Ministry of Health. This was an issue which had vexed British politics for years, since the various vested interests involved took diametrically opposed views.<sup>2</sup> But the experience of the war won many converts to the importance of unifying the nation's health services, and the Ministry finally came into being in July 1919. The final decision on the inception of the Ministry was one of many which Addison had

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1. P.R.O., Recon. 1/70, part 1.
  2. A detailed analysis of the events leading up to the creation of the Ministry of Health is to be found in F. Honigsbaum, The Struggle for the Ministry of Health, (to be published as) Occasional Papers on Social Administration No. 37 (London: G. Bell & Sons).

considerable difficulty in obtaining from Lloyd George; it was a perpetual complaint of Addison's that Lloyd George spent too little time on reconstruction problems and that he allowed his determination to win the war to exclude the necessary consideration of other problems. During October 1918 he wrote to Lloyd George several times asking for his support in getting urgent problems of reconstruction settled by the Cabinet.<sup>1</sup> For part of this period Lloyd George was absent in France; he was also much taken up with the problems of the forthcoming election. Finally, on the 29th of October Addison wrote to Lloyd George in France with a long list of matters requiring urgent Cabinet decision. Lloyd George responded by setting up a Committee with power to make the necessary decisions.<sup>2</sup>

This did not however solve his problems at once. On the one hand he was still dogged by unwillingness to take decisions - despite the fact that Lloyd George had expressly given the Committee power to take decisions in the name of the War Cabinet, it was unwilling to decide on the question of redeeming war pledged<sup>s</sup>, particularly those on labour use, and eventually Addison had to cable Lloyd George to reassure its members that they were entitled to make a decision.<sup>3</sup> On the other, he met obstruction from the Departments. The Treasury deputation at a discussion on out-of-work benefit proposed 14/- plus marriage and child allowances as a sufficient weekly sum; Addison wanted 20/- plus allowances. He was not pleased at the Treasury reaction.

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1. Lloyd George Papers, F/1/4/27, 25 Oct., 1918; C. Addison, Four and a Half Years (2 vols; London: Hutchinson & Co., 1934), vol.II, pp.583-585.
  2. Addison, op.cit., p.585.
  3. Ibid., p.586.

"...their chief spokesman was in his most insolent mood... I told him that if he were to go to the Tommies in the trenches and tell them he thought 14/- would be enough for them to live on if they could not get a job after demobilisation, he would probably be strung up to the nearest post and would deserve it."<sup>1</sup>

As well as opposition, he also had problems caused by inaction. He and General Smuts, who was co-operating with him on the Committee, had an interview with senior officials from the Local Government Board on the progress of their housing plans - an important election issue, on which Lloyd George was later to pronounce

"A big housing scheme is one of the principal features of the Government's avowed programme."<sup>2</sup>

Addison was appalled by the situation which the officers demonstrated pertained at the Board.

"Our interview...was the most shocking revelation of incompetence that I have ever experienced."<sup>3</sup>

It was not long before he got the chance to remedy the position himself.

The decision to set up the Ministry of Health finally taken, Addison presented the Bill enabling it to Parliament under the ten-minute rule on November 6th, and three days later Lloyd George summoned him to Downing Street to offer him the new Ministry in the Government reorganisation which was to take place in January following the election.<sup>4</sup>

However, the authority for the new Ministry was not complete, and it was not to come into existence until July, so until that time Addison was to be President of the Local Government Board. Under the Ministry of Health Act, this department was then merged with the National Insurance Commission, and took over the powers of the Board of Education with regard to the medical treatment of schoolchildren.

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1. Lloyd George Papers, F/1/4/27, 25 Oct., 1918; Addison, Four and a Half Years, Vol. II, p.585.
  2. Lloyd George Papers, F/8/2/42, speech notes dated 20 Nov., 1918.
  3. Addison, op.cit., p.586.
  4. Ibid., p.588.

The President of the Local Government Board had until early November been W. Hayes Fisher (later Lord Downham). He was obliged by Lloyd George to resign over the total inadequacy of the registers of voting of men serving with the forces,<sup>1</sup> and Sir Auckland Geddes, then Minister of Reconstruction, was asked temporarily to replace Downham as well, in order to prepare the voting registers for the Election with all possible speed. Thus Geddes spent two months at the Board, while still also Minister of National Service, on an inter-regnum basis to do a particular job for Lloyd George. Geddes seems not to have seen the situation quite in that light, and being highly dissatisfied with the organisation which he found when he arrived, made plans to change it. Addison was not pleased, and wrote to Lloyd George protesting in his usual vein.<sup>2</sup> However, the situation seems to have been smoothed over, and Addison went to the Board in January as planned, there to begin a considerable programme of re-organisation, which included the wholesale removal of the senior officials on the Health side - most of them were prematurely retired.<sup>3</sup> He found that the Board's organisation and plans on housing were lamentably inadequate. Nothing had been done to carry out the Reconstruction Committee's instructions about the Housing Plan, although the local authorities were well disposed.<sup>4</sup> Addison decided that he would need all support he could get from other Departments, and wrote to Lloyd George along these lines in the hope that he would emphasise Addison's needs.<sup>5</sup> Despite the fact that housing was a central plank in the Government's policy, Addison was still having problems with

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1. Frank Owen, Tempestuous Journey (London:Hutchinson & Co., 1954), pp.503-4. Lloyd George wrote an angry letter to Fisher, which Bonar Law begged him to tone down. The response was uncompromising: 'The P.M. doesn't care if he is drowned in Malmsey wine, but he must be a dead chicken by tonight'.
  2. Lloyd George Papers, F/1/4/30, 22 Nov., 1918; F/1/4/31, 25 Nov., 1918.
  3. See Honigsbaum, The Struggle for the Ministry of Health (to be published.)
  4. Lloyd George Papers, F/1/5/3, Addison to Lloyd George, 22 Jan., 1919.
  5. Ibid.

the Treasury over finance, this time of the increased staff which would be necessary if the L.G.B. were to carry out the housing programme. Addison had written to the Treasury, telling them of his schemes, and had at first had no reply. When approached again, a Conference at the Treasury was arranged. The behaviour of the Treasury officials towards the senior members of Addison's Department angered the latter considerably, and he wrote to Lloyd George in protest.

"Sir James Carmichael [Director General of Housing] was subjected by a junior officer of the Treasury to a cross-examination on such points as to whether he and his deputy could not share a typist. He has now, I am sorry to say, formally resigned his office, as he tells me it is utterly impossible for him to get on with the work, and I agree with him, if he is to be subjected to miserable triflings and delays of this kind."<sup>1</sup>

While Addison was struggling to introduce order and action at the L.G.B., his place at Reconstruction had been taken by Sir Auckland Geddes, who was now combining this Ministry with National Service; both Ministries were wound up during the course of the early summer, and Geddes became President of the Board of Trade. Views as to the efficacy of the Government's reconstruction programme so far were varied. Addison in his book quotes a letter from a friend at the British Embassy in Washington:

"Everyone I have seen is amazed at the completeness and efficiency of the British Reconstruction programmes and they are all bewailing the fact that they have not been able to produce anything themselves on these lines."<sup>2</sup>

Not everyone agreed, and certainly in the field of Reconstruction in which the State might conceivably compete with private industry there seem to have been conflicting aims of policy. As we have seen, the Government decided in October 1918 to investigate the prospects of converting some of the Government factories to peacetime purposes; it also

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1. Lloyd George Papers, F/1/5/9, Addison to Lloyd George, 27 Feb., 1919.
  2. Addison, Four and a Half Years, Vol. II, p.604, Dec. 1918.

apparently intended that the operation of Break clauses in Munitions contracts and the like should take into account the probability of numbers of men being thrown out of work.<sup>1</sup> However, the industrial situation at the Armistice did not seem to justify too much worry on this account, and the Treasury view was still that propounded by Bradbury earlier in the year, that the greater the resources which could be transferred to civilian production, and the quicker such transfers could be made, the better. Accordingly, it was decided that even if cancellation of contracts involved the sacrifice of expenditure already incurred, the completion of munitions of war which were no longer required would be a bad thing, particularly in view of the fact that the materials which would be used would be badly needed in civilian production. In many instances the Break clauses were not invoked, and negotiations for compensation instead began. The influence of the Treasury seems to have been reinforced by the attitude of Lord Inverforth, who succeeded Churchill at the Ministry of Munitions in January; in civilian life he was a merchant, and seems to have been very half-hearted about the advantages of using Government resources in the production of goods which could equally well be undertaken by private firms.<sup>2</sup>

Thus, at the beginning of 1919 considerable headway had been made in 'liberating' areas of industry from Government intervention, and rather an unsteady beginning had been made in the problems of social reconstruction about which Lloyd George felt so strongly. Addison was already making it plain to his chief that the socially orientated reconstruction plans, notably the Housing programme, were not as far advanced as they should have been. In addition, some industries were not finding the transition to peacetime production all that easy, mainly apparently

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1. P.R.O., Cab.23/8, W.C.491, 24 Oct., 1918.

2. Pigou, Aspects of British Economic History 1918-1925, pp.22-25.

because of uncertainty as to the future course of demand. These two factors, combined with the huge increase in employable labour caused by the rapidity of demobilisation, are demonstrated by the course of unemployment in the spring of 1919. The available figures are for those receiving out-of-work donation; these rose from less than 700,000 in January to over 1 million by April. The situation is complicated by the fact that virtually all those in employment in August 1918 were eligible for benefit, and it seems clear that numbers of women who had in fact no intention of reapplying for work after their war work ceased did draw the donation for the period to which they were entitled. But this would only account for part of the rise, and the situation soon began to give the Government cause for concern.<sup>1</sup>

The problem of unemployment was accompanied by a rise in industrial unrest, largely associated with agitation for improved wages, hours and conditions of work. There were strikes on the Clyde and in Belfast in January, and a violent Forty Hours strike in Glasgow early in February. Lloyd George was absent in Paris at the time, and as Hankey was with him Thomas Jones was acting as Secretary to the Cabinet in his place. He wrote to Lloyd George early in February, urging L.G. to reiterate his aims on social policy and to ginger up the activities of the departments on this. As usual at this period, the Bolshevik spectre rose in everyone's minds whenever the industrial situation began to look at all unpleasant, but in Jones' view Bolshevik propaganda in Britain was only effective where the men had genuine grounds for their grievances, and in such cases the Government should do all it could to remedy them. In his opinion the main trouble was that the Union leaders were out of touch with the men, and this was not helped by the Government's unavoidable policy of negotiating only with accredited leaders.<sup>2</sup>

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1. Pigou, Aspects of British Economic History 1918-1925, pp. 29, 32, 218.
  2. Thomas Jones, Whitehall Diary, Vol. I, 1916-1925, ed. K. Middlemass (London: O.U.P., 1969), pp. 73-74, T. Jones to Prime Minister, 8 Feb., 1919.

Strikes and unrest continued during February; Union recognition, notably for the Railway clerks and the police, were among the causes. Jones' letters to Hankey in France contain some amusing references to the stubbornness of employers in general, and the other-worldliness of some of the Ministers. Of a Cabinet discussion on a strike of Tube train drivers, he notes:

"...it was announced at the very outset that the Railway executive and the men had agreed to accept a particular formula, but, alas, this formula was unacceptable to the Cabinet, and we had the spectacle...of about 25 people trying to draft an agreement of two sentences long which would at once placate the managers and men and save the face of the Government...If a verbatim note of this discussion had been published last week the coalition would have collapsed...The whole wrangle was over the ordinary, reasonable physical requirements of the men and the precise number of minutes required to satisfy them, the estimate varying from none upwards. I am very curious to know whether or not Curzon and Long have ever been in a Tube and am thinking of referring the question to the Ministry of Research."<sup>1</sup>

Nevertheless, the industrial situation was clearly becoming serious, and Lloyd George decided to return to England to see for himself. The following day he received a memorandum from Sir Auckland Geddes on measures taken by the Government to provide for unemployment. Among these were housing schemes, to be undertaken by the Local Authorities, whose liability to the difference in cost between the market price and what could be obtained in rent from the tenants should be limited to 1d rate, the rest being met by the Government; public works, of which £10½ million-worth had already been sanctioned and a further £30 million worth of proposals were under consideration; and big extensions to the road system.<sup>2</sup> The Prime Minister was apparently anxious to hear how the detailed execution of these and other programmes planned by the individual departments were progressing, and he summoned a conference of all the Ministers concerned.<sup>3</sup>

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1. Jones, Whitehall Diary, Vol. I, 1916-1926, p.75.
  2. Lloyd George Papers, F/238, memo. by Sir Auckland Geddes, 11 Feb., 1919.
  3. Loc.cit., F/17/5/25, Lloyd George to Geddes, 14 Feb., 1919.

This conference was the first of a series; the original one was under the chairmanship of Lloyd George himself, but it was then decided to hold a number of meetings under Geddes, who would have power to make decisions in the name of the War Cabinet if necessary, and would produce a detailed report for Lloyd George as soon as possible.<sup>1</sup> Apparently there were doubts about the desirability of the Prime Minister's social policy in the minds of some of his Ministers; Jones says of the first Conference on Unemployment,

"...the P.M. was splendid on Tuesday. Several were drawing rather long faces and piling up the financial bogey and the P.M. forced the Ministers to tell him how much they could spend in the next twelve months. The bill came to £71,000,000. He then asked: 'Supposing the War had lasted another year, could we not have raised somehow or other another £2,000,000,000?' It was blank nonsense to talk of a bagatelle like £71,000,000 - a cheap insurance against Bolshevism."<sup>2</sup>

At this stage, with the King's speech newly drafted and approved by the War Cabinet for the opening of the new Parliament, containing a number of pledges on the Government's reconstruction programme,<sup>3</sup> and with rising unemployment in industry with numbers of soldiers still to be demobilised, Lloyd George's policy was undoubtedly expansionist. His views at this time seem to have been close to those of one of his Liberal Ministers, Edwin Montagu, who had written to him during the Election period, suggesting that Lloyd George should be his own Minister of Reconstruction and that this office and that of the Chancellor of the Exchequer would have to be the most important in the post-war Government. In Montagu's view, the Chancellor:

"must be a man who will not be afraid to spend money, perhaps (who knows?) as lavishly as during the war, to raise reconstruction or peace loans instead of war loans, who will not be afraid to face, as I think we shall have to, a levy on capital to get rid of heavy taxation."<sup>4</sup>

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1. P.R.O., Cab. 24/75, G.T.6820, 17 Feb., 1919.
  2. Jones, Whitehall Diary, Vol. I, 1916-1925, pp.79-80.
  3. P.R.O., Cab. 23/9, W.C.530, 10 Feb., 1919.
  4. Lloyd George Papers, F/40/2/24, Montagu to Lloyd George, 16 Dec., 1918.

Geddes performed his task rapidly, and the Committee reported at the beginning of April. The report was discussed by the War Cabinet on the 3rd, and the main result of this was the setting up of the Cave Committee on relations between Government and Industry.<sup>1</sup> The object of Geddes' exercise had been basically to act as a ginger group, to get the other Departments going, and in this he seems to have been largely successful. Schemes which had been some time in the planning began to come to fruition; during Lloyd George's short time in London in February and early March, for instance, the Cabinet discussed and approved Bills or Departmental action on Electricity Supply, Housing, Land Settlement, Transport and Health.<sup>2</sup> However, although finance for schemes evolved by local authorities had been eased in December, it was still subject to Treasury approval until April,<sup>3</sup> and Addison was still having difficulties with the Treasury over housing and public works finance, as the records of Geddes' committee show. Chamberlain was prepared to give immediate sanction to only a small part of Addison's schemes; he did not intend to give him carte blanche.<sup>4</sup>

In the early spring of 1919, therefore, the problems of unemployment and industrial unrest loomed large in everyone's minds, and the important thing seemed to be to get industry going again and to stimulate employment at all costs. By the time Lloyd George returned full-time to the London scene in August, (he had come back to Britain after the signing of the terms with Germany on the 26th June, to spend some time on holiday at Criccieth) the situation had changed. First of all, the unemployment

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1. P.R.O., Cab.23/10, W.C.553, 3 Apr., 1919.
  2. P.R.O., Cab.23/9, W.C.534, 19 Feb., 1919, W.C.536, 25 Feb., 1919, W.C.539, 3 Mar., 1919, W.C.541, 4 Mar., 1919.  
See also Jones, Whitehall Diary. Vol.I. 1916-1926, pp.79-80.
  3. Morgan, Studies in British Financial Policy 1914-1925, p.265.
  4. See, for example, P.R.O., Cab.27/58, G.237, 14 Mar., 1919. Report by Sir Auckland Geddes on Unemployment and the State of Trade, Appendix XLV.

bogey had for the time being been laid. From being over a million in March and April, the figures of those drawing unemployment donation fell rapidly to just over half a million in July; and while these figures do not truly represent the situation, because a number ceased to be eligible for benefit, they were virtually the only reliable figures of unemployment available. Further, the signs of increased prosperity were unmistakable; estimates of the dates at which the various sectors of industry experienced the beginning of the up-swing of the boom suggest that the majority of consumer goods producers were on the mend by early 1919, while the capital goods industries all started their recovery in the spring, mostly in March.<sup>1</sup>

#### Post-War Problems: the Economy Campaign

The upturn in employment, and the growing industrial prosperity, were not the only different features in the situation confronting Lloyd George on his return. Partly as a result of this improvement, the ordinary grumbles about government extravagance and expense had grown into a strong campaign. Throughout the debates on the Finance Bill during the summer session the recurrent theme is one of decrying the levels which government expenditure has reached, despite the fact that the war was over. One Member went so far as to call on the Chancellor to resign if he could not carry his colleagues with him on the need to recover control over expenditure. Chamberlain's answer to this was that Members themselves were not helping him in his task; despite their call for economy in general terms, there was always a majority in favour of spending money on any individual item.<sup>2</sup> In June, a Motion was proposed

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1. Pigou, Aspects of British Economic History 1918-1925, p.218.
  2. H. of C. Debates, 1919, Vol. 116, Col.16. Debate on the Second Reading of the Finance Bill, 20 May, 1919.

calling the attention of the House to the level of Government expenditure and advocating strict economy. Chamberlain again complained that the House was advocating economy with one hand and sanctioning new expenditure with the other.<sup>1</sup>

Public opinion as exhibited by the newspapers and journals reinforced the Members' complaints. The Economist ran a leader on some aspect of this theme in virtually every issue in 1919. In May, the paper took advantage of the Report of the Comptroller and Auditor General on the Ministry of Munitions to make a slashing attack on the department, on the counts of allowing its client firms to make excess profits when manufacturing and making excessive losses itself when trading.<sup>2</sup> It also frequently criticised the Treasury for its unwillingness to take over the traditional function of oversight of expenditure with regard to newly created Departments,<sup>3</sup> although this apparently had been remedied by May 1919.<sup>4</sup> When Chamberlain asked for Parliamentary sanction for a new loan in June, the Economist commented that it was a necessary and advisable step, and urged its readers to invest in it.<sup>5</sup> But when it proved not as successful as had been hoped, it reacted by remarking on a statement by Chamberlain that revenue was not coming up to expectations while expenditure was greater than had been hoped, that this justified those who had refused to contribute to the Victory Loan on the grounds that the funds would be used not for Funding but for further extravagance.<sup>6</sup> Again, in August, it commented on a speech of Lloyd George's which the Economist had hoped would give the nation a lead over the necessity for economy but failed to do so:

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1. H. of C. Debates, 1919, Vol.116, col.2159, 4 June, 1919.
  2. Economist, LXXXVIII, 17 May, 1919.
  3. Ibid., vol.LXXXVI, 2 Feb., 1918.
  4. H. of C. Debates, 1919, vol.CXV, col.1101, Statement by Chamberlain.
  5. Economist, LXXXVIII, 7 June, 1919.
  6. Ibid., 16 Aug., 1919.

"If verbal exuberance were a saleable commodity the Prime Minister would have given the nation a great example by his speech..."<sup>1</sup>

By midsummer, the behaviour of prices was reinforcing the public clamour for economy; it began to be apparent that the boom was underway. Both the Statist and the Economist index of wholesale prices rose by nearly 12% between April and the end of July, and the mean for August was 18 points higher than that for July: the July figure was 240.<sup>2</sup> The price of food rose nearly as fast; the Ministry of Labour index rose from 204 at the end of May to 217 at the end of July, 6% in two months.<sup>3</sup> This was a major factor in the postponement of the removal of food price and distribution controls.<sup>4</sup>

Nor was the Chancellor unaware of the growing public feeling. Throughout the early part of the summer, he was constantly protesting at Cabinet meetings about the extravagant habits of his colleagues. At one meeting in early July, he protested about the cost of the proposed Peace celebrations, on the grounds that the Government should set an example to the nation over expenditure. He told his fellow Ministers that at a meeting he had held to urge subscriptions to the Victory Loan, he had been expressly told by many businessmen that the public would not lend if it thought the money was being used extravagantly, and he eventually pledged that the money raised by the Victory Loan would be used, not for new expenditure, but solely for debt repayment. At the present rate of sanction of expenditure, he would not be able to keep to his pledge.<sup>5</sup> Again, during discussion on the future of the coal mines, Chamberlain drew attention to the extent to which revenue was not coming in to the extent he had hoped, and Government expenditure was exceeding estimates.<sup>6</sup>

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1. Economist, LXXXVIII, 23 Aug., 1919.

2. Pigou, Aspects of British Economic History 1918-1925, p.234. Average for 1913 = 100.

3. Ibid., p.230. Average for July 1914 = 100.

4. See above, pp. 139-140.

5. P.R.O., Cab.23/11, W.C.589, 8 July, 1919.

6. Ibid.

Jones commented:

"The Chancellor of the Exchequer drew a most lurid picture of the country's financial situation."<sup>1</sup>

Another feature of the situation which was causing grave anxiety for the Chancellor was the attitude of the Forces Departments to peacetime commitments. One problem was the Admiralty's plans for new ships; in Jones' view, the Sea Lords were aiming at equality with America, and he deliberately delayed consideration of the problem by the Cabinet until Lloyd George was able to be present.<sup>2</sup> Another thorny problem was that of Forces' pay. A Committee had reported to Cabinet suggesting new rates of pay for both Officers and other ranks in the Army and Air Force, and another on the Navy. The recommendations included large increases for all personnel, and the Service Departments, particularly the Admiralty,<sup>3</sup> were adamant that the increases were essential to national security. The subject was discussed at length and with some heat at the War Cabinet on July 15th, in the Prime Minister's absence. Bonar Law pressed for the debate to be adjourned until the Prime Minister could be present, but the Admiralty were determined that the matter should be postponed; nor would Long give way then over a proposal that a portion of the increase in pay should be accounted a Cost of Living Bonus, revisable in the light of changes in the cost of living. After some argument, during which Churchill became willing to agree to the cost of living scheme, and which involved Chamberlain and Bonar Law as the protagonists of economy with the members of the Service Departments ranged against them, it was agreed that discussion would be postponed until the next day.<sup>4</sup> By that time Long had

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1. Jones, Whitehall Diary, Vol.I, 1916-1926, p.89.

2. Ibid.

3. Long had apparently threatened to resign from his post as First Lord of the Admiralty if the pay scales proposed were not approved. Lloyd George Papers, F/23/4/59, Thomas Jones to J.T.Davies, 6 May, 1919.

4. P.R.O., Cab.23/11, W.C.593, 15 July, 1919.

apparently realised that it would be very difficult for him to push the matter against the combined opposition of Chamberlain and Bonar Law, especially as Lloyd George was known to be determined to keep Forces expenditure down. He agreed that 20% of the pay scales should be regarded as due to the high cost of living, and that the scales should be revised every five years with this proviso in mind. Churchill, who it will be remembered was responsible for both the Army and the Air Force, concurred, and after Bonar Law had obtained Lloyd George's approval over the telephone, the scales were agreed upon.<sup>1</sup>

Chamberlain and Lloyd George were now equally worried about the financial situation, and the latter asked the Chancellor to prepare a statement on the country's financial position. This he duly did, and it was circulated to the rest of the Cabinet accompanied by a letter from Chamberlain.<sup>2</sup> He urged his colleagues to pay heed to the extent to which expenditure was going ahead much faster than had been expected; current estimates exceeded Budget estimates by £134 million, and estimates of receipts were less than expected to the extent of about £70 million. Since a Budget deficit of £250 million was already planned for, if nothing were done the total deficit would be over £450 million, in the current year. The biggest increases in expenditure came from the Service departments. Between them the Army and Admiralty estimates showed an increase of £67.5 million, and the Air Force another £8 million. The only other domestic Ministry or individual item to increase by more than £5 million was the cost of the Coal subsidy, which would if continued at the present rate cost an extra £6.4 million, although the Cabinet could prevent part of this, depending on when the agreed increase in the price of coal was

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1. P.R.O., Cab.23/11, W.C.594, 16 July, 1919.  
2. P.R.O., Cab.24/84, G.T.7729, 18 July, 1919.

to take effect. The cost of Allied debts was the other big item to have increased; because of faulty estimating, this total was up £32 million from the estimates. As to the diminished receipts, this was mainly accounted for by the continuation of food rationing and control, which meant that instead of simply selling off stocks the Ministry of Food was having to lay out money on new purchases as well.

In the circumstances, Chamberlain's anxiety was hardly surprising. He had just finished drumming up support for the Victory Loan campaign; this had raised £450 million, of which £250 million would be required to cover the planned deficit. If no reductions in expenditure were made, the whole sum would disappear in this way. Chamberlain was in no doubt either as to the reaction he could expect from the public in this event, or the difficulties which his officials would experience in placing Government debt in the market as it came up for renewal.

"This is the road to ruin. In the present temper of the public, whether richer or poorer, no further issue would have the least chance of success. Every effort to secure support for the Loan was met by the cry of 'Government extravagance'." <sup>1</sup>

Two of the items of government expenditure which caused a great deal of public comment were Staff and Cars. The extent to which the staff of Government departments, swollen in numbers by the needs of war, had not been swiftly cut back as soon as the hostilities ceased, was a frequent cause of public agitation. Since most of the Ministries did in fact have nearly as much to do until the reconstruction and decontrol period was over, this was rather a strange attitude; but it was all part of the feeling that the Government should relinquish its hold on the economy as soon as possible. If the Government left the economy to get on by itself, it would not need so many staff to run its offices. The current image of the Civil Service as spending most of its time drinking cups of tea at the Taxpayers' expense

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1. P.R.O., Cab.24/84, G.T.7729, 18 July, 1919.

was a popular one. So was the feeling that the use of Government cars had become widespread and was unnecessary. Both these problems were discussed at the Cabinet in July, and Chamberlain continued to remind his Cabinet colleagues of the need for economy. At a meeting on July 22nd, on staff accommodation, he suggested that most decisions of that kind should await a considerable reduction in staff, and that it was not practicable to plan future accommodation needs on the basis of the present swollen establishments.<sup>1</sup>

The subject of government cars was discussed the following week, and again Chamberlain urged the importance on cutting down particularly on ostentatious items of expenditure such as this. It was eventually decided that individuals should no longer be allotted cars, and that each Department should let the War Office know its minimum requirements for transport, so that a pooling system could be operated.<sup>2</sup> The question of staffing came up again on the 31st, and this time the Prime Minister was present, having returned from Criccieth. It was decided that the Cabinet should hold an enquiry into the size of staffs in each Department relative to the pre-war establishment, and make suggestions as to how many could be dispensed with in the near future. Chamberlain produced some rough estimates of increased staffs, and Lloyd George was astonished at the extent to which it had not been possible to reduce staffs since the Armistice. In his view it should be possible to aim at reducing the numbers by about half in the succeeding six months. The Departmental replies were to be submitted by August 7th.<sup>3</sup>

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1. P.R.O., Cab.23/11, W.C.597, 22 July, 1919.

2. Ibid., W.C.602, 30 July, 1919.

3. Ibid., W.C.603, 31 July, 1919. Chamberlain felt that the Departments chiefly at fault were the Service Departments and the Ministries of Shipping, Pensions, Labour and Munitions.

About this time Chamberlain circulated another and more detailed memorandum on the financial situation, accompanied by a letter which not only spelt out the dangers of the position but which asked the Cabinet to consider how the situation could be remedied.

"The position grows daily more grave. No estimates hold good, and the Cabinet sanctions increase after increase with, as it seems to me, an insufficient appreciation of the aggregate result...If we cannot balance revenue and expenditure next year our credit - national and international - will be shaken and the results may be disastrous. Any estimate which is framed now must be largely hypothetical, but we are heading straight for a deficit of £200 million. Will my colleagues consider what this means and how it is to be provided for by new taxation...?"<sup>1</sup>

As we have seen, Lloyd George was effectively absent from Cabinet discussion for almost the whole of the period from January to the end of July 1919. Apart from short spells he had been in Paris most of the time until the Peace Treaty was signed at the end of June, and afterwards he had gone to Criccieth, his country home in Wales, for a rest before resuming his normal duties in full.<sup>2</sup> He decided to take advantage of his return to take a fresh look at Government policy in general. Accordingly, the first two weeks in August must have been some of the busiest some of his colleagues had encountered; there were six meetings of the Cabinet in secret session (those meetings which are recorded in the 'A' minutes) and seven in ordinary session in the first week alone. The first important session took place on Tuesday, August 5th, and there Lloyd George outlined at length the lines upon which he thought discussion should take place as to future policy.<sup>3</sup>

Lloyd George thought that there were two important factors affecting the economic life of the country, which were a change from pre-war. One was the increased prevalence of strikes, and the other was diminution of

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1. P.R.O., Cab.24/5, G.257, 26 July, 1919. Presumably he meant an extra £200 million - see above, p.183.
  2. Jones, Whitehall Diary, Vol.I, 1916-1925, pp.72-91.
  3. P.R.O., Cab.23/15, W.C.606A, 5 Aug., 1919.

output. Both were important from the industrial point of view, particularly as the need for increased production was obvious for both home and overseas markets. The trading position of the country was serious; we were now a debtor nation where before the war we had been a creditor nation (he apparently means simply in terms of having an overall deficit on the balance of payments for 1919, not on total capital assets basis). He then went on to outline some more particular problems needing decision, such as profiteering, nationalisation of coal, housing, and rural regeneration. On housing, Lloyd George was anxious that immediate steps should be taken to improve the stock of houses available.

"It was not that houses were bad, but the fact that houses were absolutely unobtainable...So far the people had seen nothing done. They saw Housing Bills, but every Government had Housing Bills. What they wanted was to see the houses actually being built."<sup>1</sup>

On the other hand, he was also anxious that the problem of the huge level of Government expenditure should receive attention.

"It looked as though our normal expenditure would be about four times what it was before the War, and all this expenditure was not re-productive. We could not go in as we had been doing, and it was necessary for us to realise that we could not have the best of everything."<sup>2</sup>

The Prime Minister felt that the main area in which economies would have to be made was in the expenditure of the Service Departments. It would be impossible for us to maintain a much larger Army than before the war, because if the Government did, people would say that either the war had been a failure, or else the country was arming to fight an imaginary foe. What the Government must do was to tell the Services what the military objectives for the next five or ten years were to be and then allow them to budget on that basis.

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1. P.R.O., Cab.23/15, W.C.606A, 5 Aug., 1919.

2. Ibid.

"In five or ten years' time it would be necessary to review the situation; but, so far as external foes were concerned, he [the P.M.] felt that risks could be taken. No risks, however, could be taken in respect of the health and labour of the people. We had to lay at once the sure foundations of national health and industrial prosperity."<sup>1</sup>

The Prime Minister's strictures about expenditure were discussed in conjunction with Chamberlain's paper on the economic situation and the estimates for 1919-20. Churchill, Secretary for War, said that he thought Chamberlain's estimates a little on the high side, and it was never taken into consideration the extent to which War Office expenditure had been dictated by events. Demobilisation was still proceeding, and there were larger garrisons to be maintained in many countries, notably Ireland and Mesopotamia. It was for the Cabinet to enable the War Office to make economies by deciding the future size of such garrisons. He also suggested that

"It was for the War Cabinet clearly to define the various responsibilities of the fighting services; in other words, they must state that there would be no great European War for the next five or ten years."<sup>2</sup>

This idea had already been put forward by Chamberlain,<sup>3</sup> and it was to be a cornerstone of British defence spending policy in the ensuing years.

Churchill seems at this time to have been taking a very conciliatory line about the expenditure of the Departments for which he was responsible. He suggested that the expenditure of 1914 should be taken as a datum line and that any amounts over that level should need special justification. The Admiralty, however, in the person of Long, the First Lord, was its usual stone-walling self. He stated that it was impossible for the Admiralty to reduce its expenditure at all unless its duties were reduced, and he was willing to circulate to the Cabinet a detailed resume of those duties so that the Cabinet might decide our future Naval policy.<sup>4</sup>

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1. P.R.O., Cab.23/15, W.C.606A, 5 Aug., 1919.
  2. Ibid.
  3. P.R.O., Cab.23/11, W.C.593, 15 July, 1919.
  4. P.R.O., Cab.23/15, W.C.606A.

After some discussion of the determinants of defence expenditure, Chamberlain brought up the question of Cabinet control of expenditure, and suggested that the Finance Committee, which had held a few informal meetings earlier in the year, should be reconstituted so that matters involving large sums could be properly discussed as to their financial aspects and implications before the matter came to the full Cabinet. Lloyd George was in full agreement with this suggestion, and pointed out that often when it came to Cabinet a matter involving large sums would often involve the Chancellor opposing other Ministers on his own. If such a matter had been decided upon by the Committee first, it would be useful to have those members to back him up. Chamberlain agreed, but stressed that the problem was not confined to extravagant expenditure. He said he felt that

"it was not extravagance which was our danger so much as that we were trying to carry into effect at one moment more schemes for the benefit of the country than we were able to afford." <sup>1</sup>

It was eventually decided that two Committees should be set up, one, an ad hoc body, on profiteering, and the other a permanent body on Finance, which was to consist of Lloyd George, Chamberlain, Milner, Auckland Geddes and Bonar Law, the first two being ex officio members. In addition, further discussions were to be held in the Cabinet on some of the matters already raised, and the Service departments were to be asked to draw up memoranda of the tasks they expected to be undertaken by their departments in the next five or ten years. <sup>2</sup>

Further meetings of the Cabinet held in the next two weeks concentrated heavily on coal, Trade Policy and Housing. The next important development in the economy campaign came on August 13th, when it was

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1. P.R.O., Cab.23/15, W.C.606A, 5 Aug., 1919.
  2. Ibid.

decided that in future the Cabinet, and the Home Affairs Committee, should not discuss proposals involving expenditure unless they had either been approved by the Treasury, or had been rejected by that body and the Department concerned had notified the Treasury that it wished to appeal to the Cabinet against the decision.<sup>1</sup> The Finance Committee also began to meet regularly, and at its second meeting on the 29th held a discussion on retrenchment. Details of the discussion are not available, except of a short statement by Lloyd George, who continued to show much anxiety over the levels of Government expenditure and public disquiet about the subject. He said that

"not only in view of the state of public opinion but because of the financial situation of the country, ruthless cutting down of expenditure was imperative. The difficulty the Committee had found itself in was to fix on the specific items of waste and extravagance which should be eliminated, and it was here the Treasury could help the Committee. The Committee should know what was being expended at the present time, the objects of the expenditure, and the persons directly responsible for the expenditure."<sup>2</sup>

A prolonged discussion followed, and it was eventually decided that the Treasury should be asked to prepare an analysis of abnormal and temporary expenditure by the chief spending Departments, and in particular the Service Ministries and the Ministry of Munitions. In the course of these submissions the Departments would be expected to explain and justify their expenditure, so that economies could be made wherever possible.<sup>3</sup>

On the same day as this meeting, the Prime Minister wrote a letter which was circulated to all Government Departments, setting out in detail the sentiments he had already expressed both in Cabinet and at the Finance Committee.

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1. P.R.O., Cab.23/11, W.C.613, 13 Aug., 1919.
  2. P.R.O., Cab.27/71, F.C.3, 10 Aug., 1919.
  3. Prime Minister's circular letter to all Government Departments, 20 Aug., 1919, p.1; copy in P.R.O., T.171/170.

"I wish to call the attention of my colleagues to the feeling which exists in the House of Commons, in the Press, and amongst all classes of the community as to the necessity for immediate cutting down of Government expenditure. A general feeling undoubtedly exists that expensive and needless establishments are being maintained, because of the reluctance of those at the head of the various branches of administration in the Government Departments to dismiss any of their employees."<sup>1</sup>

He went on to instance the recent grumbles about motor-cars, and to point out that in that case it proved possible to make considerable economies without damaging the efficiency of Government,

"or at any rate, with no harm to the public service commensurate with that which is inflicted by excessive expenditure."<sup>2</sup>

The chief place in which economy could and should take place was, in the Prime Minister's view, in the employment of staff. Establishments had been very little reduced since the Armistice, largely because the reduction of personnel is such an unpleasant task. But in Lloyd George's view the problem had to be tackled immediately and with vigour.

"The number still employed in the public services have, in the aggregate, hardly decreased perceptibly since the war. That cannot be defended. The state of the National Finances is such that only what is indispensable to sound administration ought to be maintained. Everything in excess of this must be ruthlessly cut down. In the interests of economy we must be willing to content ourselves with the second best where the best is too costly."<sup>3</sup>

In addition to the general letter to all Departments, the Ministries specially mentioned at the Finance Committee meeting, those with responsibility for the Services and for Munitions, received another letter, from Austen Chamberlain, asking for details, under a number of heads, of expenditure to the end of July, and expected expenditure to the end of the financial year. He requested that replies should arrive in not more than a fortnight, that is by the end of the first week in September.<sup>4</sup>

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1. Prime Minister's circular letter to all Government Departments, 20 Aug., 1919, p.2; copy in P.R.O., T.171/170.
  2. Ibid.
  3. Ibid., pp.2-3.
  4. P.R.O., T.171/155, Chancellor of the Exchequer to Ministers responsible for War Office, Admiralty, Air Ministry and Munitions, 22 Aug., 1919.

This, however, was not quick enough for Lloyd George, who wrote to his secretary, J.T. Davies, on the 28th, asking him to find out from the Treasury the progress which was being made on the decision of the Finance Committee to find out the situation in the Service departments.<sup>1</sup> Davies got in touch with Sir Warren Fisher, who circularised the Departments concerned in conjunction with Sir Michael Ramsay and Mr. George Barstow, who were in charge of the Establishment and Administrative Divisions of the Treasury respectively.<sup>2</sup> Fisher also wrote to Lloyd George, telling him of this, and explaining that he had asked the four Departments concerned to reply by the following Monday, September 2nd,<sup>3</sup> that is a week in advance of the time the Chancellor had stipulated.

It must not be thought that the Treasury had before the Prime Minister's initiative come been inactive on the subject of staff expenditure. Sir John Bradbury had held an inquiry into increase of Government staffs over the pre-war level which had reported in the spring; the procedure whereby huge sums of money were devoted to war expenditure after being given by Vote of Credit had been brought to an end; and when being asked to draw up estimates all the Departments had been reminded of the necessity of reducing staffs.<sup>4</sup> But as far as the big spending Ministries were concerned, and particularly the Service Ministries, their hands were to a large extent tied by two important factors. The first was that because of the accounting system in operation it was always much easier to obtain Treasury sanction for continuing commitments than for new ones, and for the payment of existing staff rather than for the

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1. P.R.O., T.171/155, Lloyd George to J.T. Davies, 28 Aug., 1919.

2. Ibid., Fisher to all Government Departments, 29 Aug., 1919.

3. Ibid., Fisher to Lloyd George, 20 Aug., 1919. Fisher addresses Lloyd George by his formal title, First Lord [of the Treasury]; this is the only example I have seen of the survival of this practice.

4. Evidence of Sir Thomas Heath before the Select Committee on National Expenditure, 1919 (May 8th); Copy of minutes in P.R.O., T.172/655.

engagement of new establishments. It is apparent from the evidence of the Treasury officers before the National Expenditure Committees in the latter part of the war and in 1919<sup>1</sup> that the Treasury rarely took the initiative about matters like cutting down on wages and salaries, and they had little power to enforce the reduction of existing staffs. The second problem was caused by the extent to which the Service Departments and the Ministry of Munitions had been allowed to engage staff at junior levels without Treasury sanction. As Sir Thomas Heath pointed out to the Committee on National Expenditure in 1919, when new Ministries were set up, the enabling Bills had usually a provision that the Minister could appoint such officers and servants as, with the consent of the Treasury, he might determine. In the creation of the Ministries of Munitions, Labour, Shipping, National Service and Food the rider 'with the consent of the Treasury' had been omitted, and thus the original staffs of the Ministries concerned had been engaged without Treasury supervision as to numbers. Besides this, the War Office had for a number of years been allowed to engage staff to a maximum salary level of £300 per annum without Treasury sanction as to numbers, and this privilege was extended during the war to the Ministry of Munitions, with salary exemption levels of £400 for ordinary and £500 p.a. for technical staff, and to the Admiralty for staff earning up to £250 p.a. In Sir Thomas's opinion the Treasury was now gradually regaining control over expenditure, but the extent to which estimates were still affected by the war would obviously prevent full control being resumed at once.<sup>2</sup> On the same day as Heath was giving his evidence, the Chancellor said in answer to a question in the House of

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1. Select Committee on National Expenditure, 1919, evidence of Sir John Bradbury, May 7th, and Sir Thomas Heath, May 8th. Copy in P.R.O., T.172/655.
  2. Evidence of Sir Thomas Heath before the Select Committee on National Expenditure, 8 May, 1919, QQ.420-1, 426, 460, Copy in P.R.O., T.172/655.

Commons that all war-time exceptions to Treasury control had by then been revoked.<sup>1</sup> But the problem of staff reduction still remained.

Fisher replied to Lloyd George's request for an interim report on September 3rd, with a 'bird's eye view' of expenditure, including a general appendix on the whole estimates position, a more detailed one on the military departments, and a third on small items which might but should not be overlooked as giving opportunities for reductions in expenditure. This series of memoranda he accompanied by a long letter setting out some of his own ideas on the subject of economy.<sup>2</sup> He pointed out that the scope for saving was only great where policy decisions were concerned, and that while some savings would prove to be possible in administration, large economies could only come through changes in government policy.

"The big money is of course in policy. The margin of difference between a government machine which is perfectly adjusted for the execution of that policy and a machine which is too large (because of bad organisation and management or of self-importance) is - in terms of cash - insignificant relatively [sic] to the huge figures of a modern Budget. The ill-effect of swollen Civil Service establishments is principally a moral one...the evils should be removed as quickly as possible, but the taxpayer's pocket will not be substantially relieved from this quarter, however much improvement may be made in the machinery as such."<sup>3</sup>

Fisher went on to point particular areas in which economy could and should be made. Firstly there was the Services; he thought it not unreasonable to suppose that since the recent war was supposed to have been waged against militarism, the scale of the post-war services could be less than pre-war, although prices and pay increases would still mean an increased money burden. Britain could not afford to spend large sums on a big standing army in many different parts of the globe.

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1. H. of C. Debates, 1919, Vol.CXV, col.1101. Chancellor of the Exchequer, 8 May, 1919.
  2. P.R.O., T.171/155, Fisher to the Prime Minister, 3 Sep., 1919.
  3. Ibid., para.2.

"As to the mission of Great Britain in the world, I cannot help feeling that we may overdo the part of fairy godmother and that the British taxpayer has better outlets for his energy and his coin than picking out of the fire chestnuts for other people. It is with diffidence that I express these crude opinions, but it seems to me that the country can only act as a Don Quixote if it is prepared for bankruptcy."<sup>1</sup>

On the domestic front, one area in which economies should be made was in subsidies. Fisher felt that in so far as the Government intervened in commercial affairs by providing services, these should be paid for at an economic rate, and that the various parts of industry dependent on the Government, such as coal and the railways, the Post Office and the production of bread, should be run on a commercial basis.

"...if a man wants to travel, to telephone, to send a letter or consign goods, why should he be allowed to do so partly at someone else's expense? And now that the Germans are beaten and there is no longer any question of our being forced to throw up the sponge for domestic reasons, why should a man be allowed habitually to feed at the expense (in part) of his neighbour?"<sup>2</sup>

Debt charges and the war pensions charges had obviously come to stay, unless there was to be any question of repudiating any of the debt.

This latter possibility Fisher does not go into at all. He then goes on to suggest that economies in Education grants by the central Government might be possible at the expense of rate-payers.

"...if local rates were treated as the principal instrument of finance, this would have ensured in a more effective fashion a contribution from the parents who benefit, the great majority of whom pay Education rates either directly or indirectly (in their rent) but pay nothing in the way of direct taxes to the Exchequer."<sup>3</sup>

Fisher recommended that the Unemployment Donation should be replaced as soon as possible by a contributory scheme, and that the new Departments which were a creation of war-time needs should be wound up as soon as possible. All in all, Fisher's suggestions were along the lines to be

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1. P.R.O., T.171/155, Fisher to the Prime Minister, 3 Sep., 1919, para.5.
  2. Ibid., para.3.
  3. Ibid....

expected; pull back from activity wherever it was possible to do so, and make activity commercially viable if at all feasible where it was not.

In addition to the Cabinet circular of August 1st, and Lloyd George's letter of the 20th, the Treasury had also sent out a circular requesting the Departments to make urgent efforts to reduce staff and asking for a return of staff employed in each Department.<sup>1</sup> The replies to these letters were collected into a series of papers on the current financial situation and the expectations for the Budget of 1920-1.<sup>2</sup> The main suggestions of the Treasury were much along the lines outlined by Fisher, and continued to emphasise the importance of cutting down Service expenditure, employment contributions, and subsidies. Detailed recommendations for particular Departments were included, among them the suggestion that while the proposal to turn the Ministry of Munitions into a Ministry of Supply might seem like an economy, the practical difficulties of getting its putative client Departments to work the scheme properly, without building up expensive stocks and expertise of their own and short-circuiting the Ministry wherever possible, were so great as to make it likely that the savings involved would be swallowed up in duplication of effort.<sup>3</sup>

The extent to which the Economy campaign was successful in individual Departments is extremely difficult to analyse. At the time it got under way, the expected deficit for 1919-20 was about £450 million. In the event, the actual deficit calculated on the same basis was £326 million, but the improvement was largely due to an increase of revenue rather than a decrease of expenditure. The Budget estimate of expenditure was originally £1,451 million, which was revised in October to £1,642 million,

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1. P.R.O., T.171/155, Treasury Circular, 36743/19, 26 Aug., 1919.
  2. P.R.O., T.171/170.
  3. Ibid., 20 Sep., 1919.

and in the event was £1,665 million. Revenue on the other hand was originally estimated at £1,201 million, revised to £1,169 million, and turned out at £1,340 million. So the reduction in the accounting deficit was entirely explained by the increase in expected revenue. But it seems likely that in any case the agitation came too late in the financial year to have any impact then, and its effects were felt much more strongly in the following year, when revenue rose to an all-time high of £1,426 million and expenditure fell by £470 million to £1,195 million.<sup>1</sup>

The points of greatest interest for this study seem to be two. Firstly, there was a tremendous change in emphasis in Government expenditure policy, and this almost entirely on Lloyd George's own part. In the early spring, he was seriously concerned about the possibilities of social upheaval generated by dislocatory unemployment after the war. At that stage he was talking in terms of rapidly expanding Government activity at almost any cost in order to mop up some of these unemployed and to get industry moving again. At the Conference he called to discuss Ministers' plans for dealing with unemployment he urged them, as we have already noted, to move with all possible speed and not to worry about financial problems. Jones expressed the tenor of Lloyd George's feelings at this time thus:

"It was blank nonsense to talk of a bagatelle like £71 million - a cheap insurance against Bolshevism."<sup>2</sup>

By the late summer, the 'mere bagatelle' had become a sum of considerable importance in the economy campaign. The change of mood was a swift one, and seems to have been actuated largely by public opinion and by influential

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1. Morgan, Studies in British Financial Policy 1914-1925, p.98; Revised Balance Sheet for 1919-20 in P.R.O., T.171/170, October 1919.
  2. Jones, Whitehall Diary, Vol.I, 1916-1925, p.80, quoted in Jones to Hankey, 27 Feb., 1919. The £71 million was the amount Ministers were planning to spend in 1919 on Public Works, and similar schemes.

people in business and the Press. The turn-round in Lloyd George's attitude was so swift that it took even Chamberlain, who had all summer been protesting at increased spending, by surprise. Commenting on Lloyd George's sense of urgency over the economy campaign, he wrote to Hankey:

"But he must give us a little time to produce results."<sup>1</sup>

Whatever may have been the influences upon Lloyd George, there is no evidence that in initiating the economy campaign he had any advice from the Treasury other than what Chamberlain might have been expected to give him. It seems that the most likely explanation lies in the fact that Lloyd George was out of the country for most of the first six months of the year, and as he said,

"When he was in Paris he could not pretend to be able to concentrate his mind on the great problems which were worrying his colleagues in this country."<sup>2</sup>

However, on his return he could not fail to be struck by the change in the mood of the country. No longer was heavy unemployment an immediate threat. Industry was gathering way, and the cry everywhere was for the Government to leave the economy alone to carry on in its accustomed fashion. In addition, and bound up with it, there was the strong public feeling about what was regarded as excessive expenditure by the Government, notably on staffs. The impetus for the economy campaign came largely, as we have seen, from outside the Government, and was imposed on his colleagues by Lloyd George.

While it did not play a part in initiating the economy campaign, the Treasury did play an important role in implementing Lloyd George's intentions, and, one might say, seized eagerly the chance presented to enforce its own ideas upon the other Departments. It was a common complaint of

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1. P.R.O., T.171/170, Chamberlain to Hankey, 31 Aug., 1919; underlining in the original.

2. P.R.O., Cab.23/15, W.C.606A, 5 Aug., 1919.

Treasury staff, before as well as during the war, that their function of overseeing expenditure was very much hampered by their being overworked and understaffed. As Fisher put it in his letter to the Prime Minister,

"Up to the present time...it [the Treasury] has always been undermanned and hopelessly overworked. Delay and insufficiency of time to think things out or to get a conspectus have resulted, and the office has therefore been prejudiced in the discharge of its business. At the same time Ministers in other Departments have been able to short-circuit the Treasury officials; who - impotent on that account to resist unreasonable demands alike on major issues and in the staff matters advocated by those Ministers - have perforce tended to direct their critical activities into somewhat meticulous channels."<sup>1</sup>

Coupled with the exceptions to Treasury control which had been introduced as war-time expedients, these problems made the Treasury's position after the war very difficult, the more so since the Service Departments, who had traditionally been least amenable to Treasury control, were also those which had had the most leeway allowed them, inevitably, during the course of the war. But whenever the opportunity presented itself, as we have seen, the Treasury endeavoured to exercise its traditional decontrolling functions, and when Lloyd George's realisation of the country's changed mood caused him to introduce the economy campaign, they took full advantage of the situation to restore their influence as far as was possible, so successfully indeed that not again during the inter-war period was there a Budget deficit.

Thus did the bulk of the controls and much of the projected reconstruction expenditure alike fall foul of the public feeling of the summer of 1919, and the public inclination was seemingly backed by the cheering signs of recovery in industry. But some of the plans came to fulfillment. Unemployment payments ceased to be automatic as they had been in the transition period, but the insurance principle for unemployment was

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1. P.R.O., T.171/155, Fisher to Lloyd George, 3 Sep., 1919, para.8.

extended to cover a considerably larger part of the working population than before the war, the Housing Scheme, while it ran into severe supply problems, and was eventually put right back in 1921, was still at this stage going ahead, and the Ministry of Health had at last been created after many years of struggle. But much did not come to fruition, and much that did fell to the Geddes Axe in 1922. As we saw at the beginning, the Government had no clearly worked-out plan for reconstruction spending, and when public pressure became heavy, it yielded, moving unsteadily but definitely in the direction of retrenchment and orthodox economic principles.

CHAPTER FIVE

INTER-GOVERNMENTAL DEBT AFTER THE FIRST

WORLD WAR: THE BACKGROUND TO THE BALFOUR

NOTE OF 1922

Among the problems which bedevilled the international scene during the inter-war period, one of the most important and intractable was that of inter-governmental debt. Prior to the First World War, the structure of international debt had been based on commercial relations. During the war, however, the Allied belligerents built up among themselves a complex structure of mutual indebtedness, which the main debtor countries hoped to dismantle by exacting reparation payments from Germany on a vast scale. As a result, all the belligerents emerged from the war either owing or being owed, or both, large sums on an inter-Governmental rather than a private level. Furthermore, these debts did not represent any tangible benefit to the wealth of the receiving countries; the money had been spent on the materials of war. The situation was further complicated by the unreal approach to the problem of virtually all the Governments concerned. The Allies who stood to gain from reparations payments, principally France and Italy, were bitterly anti-German; their opinion is neatly summed up in the popular cry, "Squeeze Germany till the pips squeak". Yet they refused to allow Germany the means of making reparation; much of her most valuable industrial regions were taken from her, the early reparations demands starved her of working capital, and the Allies did their best to "safeguard" their countries against German imports.

Thus the reparations problem was complicated by the desire of the victors, not only reparation, but for security. They wanted at one and the same time a Germany strong enough to pay huge sums in reparation, and a Germany so weak that she would be incapable of waging another major war in the foreseeable future. The situation with regard to inter-Allied debt was compounded by a somewhat similar attitude on the part of the United States. America was the only country to emerge from the war with credits and no debts relating to the waging of the war. All the other Allies owed her large sums. These they could only pay by increasing their exports to the United States. But this they were prevented from doing, at any rate

partly by the tariff wall behind which American industry sheltered. In addition, although during and after the war America's gold stocks increased considerably,<sup>1</sup> it was the Federal Reserve Board's practice to insulate the domestic price and credit system from this gold inflow. In other words they did not play the 'Gold Standard game',<sup>2</sup> and in consequence the domestic price level did not rise as far or as fast as it might have been expected to have done in pre-war Britain under similar conditions, and the benefits to imports which would normally have resulted did not occur.

The other main complicating factor in the American attitude to the problem lay in the United States Government's refusal either to accept any relationship between the amounts the debtors owed her and the amounts they received in reparation, or to treat her Allied debts in terms of the capacity of the Allies to pay. This latter was despite the fact that America had striven from the first to make France and Italy, and some of the British representatives at the Peace conference, see that the terms of German reparations must of necessity be linked to German capacity to pay.<sup>3</sup> The more harsh the terms, said the Americans, the less likely anyone is to obtain any benefit, because of the difficulty of enforcing such terms upon a whole people. But the U.S. persisted in treating the Allied debt to her as a normal commercial obligation, at any rate after the war.<sup>4</sup> The

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1. The United States' share of the world's gold stocks rose from 28% in 1913 to 45% by 1925. Sir Albert Feavearyear, The Pound Sterling (2nd edn: Oxford: Clarendon Press, 1963), p. 364.

2. See above, p. 115.

3. Hughes, Cunliffe and Sumner. The last two were widely known, ironically, as the 'Heavenly Twins': see Sir Roy Harrod, The Life of John Maynard Keynes (London: Macmillan & Co., 1963) p. 236; David Lloyd George, The Truth about Reparations and War Debts, (London: Wm. Heinemann Ltd., 1932), pp. 97-8, 102-3. Keynes, writing to Lloyd George on his (Keynes') resignation, said: 'I leave the twins to gloat over the devastation of Europe'. Lloyd George Papers, F/7/2/32, 5 June, 1919.

4. A United States Treasury statement dated 11 Dec., 1917 on United States loan policy stressed the wisdom of giving loans to the Allies since this enabled the Allies to do fighting which the U.S. would otherwise have to do. In addition little of the loans left the U.S., they were mostly used to finance internal purchases. See P.R.O., T.160/7. No trace of this realistic attitude remained after the war.

Allies however continued to regard reparations and inter-Allied debts as two sides to the same problem, and this divergence of view did not assist the relations between the European and American Allies. One further difficulty was the terms on which the loans had been agreed. They were all in terms of pre-war parities, that is in gold prices; since the currencies of all the Allied debtor countries stood at considerable discounts with the dollar after the war, the burden of the debt was markedly exacerbated. One of the most powerful arguments against those who wished the British authorities to return to the Gold Standard with a devalued pound was the extent to which this would increase the burden of the American debt.

Britain's position in this complex situation was a central one. On paper she emerged from the war a net creditor in terms of war debts. While she had borrowed large sums in the United States to finance purchases there, she had also lent her Continental Allies even larger sums to pay for supplies in this country. At the end of the war Britain owed an estimated £1,000 million to the United States and another £200 million to Canada and other countries. France, Italy and Russia were Britain's main debtors, owing her a total of £1,800 million. However, of this sum nearly £600 million had been lent to Russia before the Communist Revolution in 1917. The new regime having repudiated all pre-Revolutionary undertakings, it seemed unlikely that this sum would ever be repaid.<sup>1</sup>

British policy on inter-Allied debt seems from early days to have included ideas of all-round cancellation. Sir Basil Blackett, writing in 1920, stressed the impossibility of repayment by the Continental allies of their debts to the United States and Britain, and it is apparent that a

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1. E.V. Morgan, Studies in British Financial Policy 1914-25 (London: Macmillan & Co., 1952), pp.317, 320-321.

policy of debt reduction was advocated by the Treasury and adopted by the Government 'from the first'.<sup>1</sup> Lloyd George, in his book on reparations and inter-Allied debts, said:

"From the outset Britain, although she was more creditor than debtor, took the view that the best course with all these war-debts was to cancel them."<sup>2</sup>

Nor was this policy likely to be unpopular in the country; as early as April 1918, Sir James Hope Simpson, in evidence to the Cunliffe Committee, suggested that in the interests of France and Italy it might be necessary for the United States and Britain to consider

"whether they should not make common cause by cancelling their mutual indebtedness".<sup>3</sup>

Another course of action which Britain should consider, he suggested, was that of persuading the United States to accept part of our claims on our European Allies in payment of our United States debt, at a discount if necessary. Failing this he suggested the consolidation of all British debt to the United States in a single irredeemable Bond issue.

Academic support for cancellation came from Keynes, writing, in 1919, his great polemic on the Peace Conference. Keynes suggested that the war debts were an aberration in international finance.

"...the system [of international indebtedness] is fragile; and it has only survived because its burden on the paying countries has not been oppressive, because this burden is represented by real assets...and because the sums already lent are not unduly large in relation to those which it is still hoped to borrow."<sup>4</sup>

Further, he saw political as well as financial dangers if reduction is not achieved.

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1. P.R.O., Cab.24/97, C.P.584, 6 Feb., 1920, Blackett was Controller of Finance at the Treasury for the years 1918 to 1922.
  2. Lloyd George, The Truth about Reparations and Inter-Allied Debts, pp. 97-8.
  3. P.R.O., T.185/1, evidence of Sir James Hope Simpson before the Committee on Currency and Foreign Exchange after the War, 3 June, 1918.
  4. J.M. Keynes, The Economic Consequences of the Peace (London: Macmillan and Co., 1919), p. 263.

"It might be an exaggeration to say that it is impossible for the European Allies to pay the capital and interest due from them on these debts, but to make them do so would certainly be to impose a crushing burden. They may be expected, therefore, to make constant attempts to evade or escape payment... There is no European country in which repudiation may not soon become an important political issue...the creditor nations may soon find their interest inconveniently bound up with the maintenance of a particular type of government or economic organisation in the debtor countries." <sup>1</sup>

Most important of all, since Keynes never lost sight of two important objectives, namely that of remembering the link between inter-Allied debt and reparation, and of ensuring that reparation payments are fixed within the capacity of the conquered countries to pay, it would in his view almost certainly result in inequities if some cancellation of inter-Allied debt were not achieved. If no equitable settlement can be reached said Keynes,

"the war will have ended with a network of heavy tribute payable from one ally to another. The total amount of this tribute is even likely to exceed the amount obtainable from the enemy; and the war will have ended with the intolerable result of the Allies paying indemnities to one another instead of receiving them from the enemy." <sup>2</sup>

But the attitude of the United States Treasury was completely opposed to any suggestion of all-round cancellation, it seems partly from inclination and partly, to be fair, because it seemed unlikely in the extreme that Congress could ever be persuaded to sanction any such arrangement. Not all public opinion in the United States was so completely blind to financial reality; in September 1919 Lord Grey talked to 'an eminent American' on the subject, and reported the results of the conversation to Lloyd George. This American confirmed the British opinion that Congress was most unlikely to agree to all-round cancellation, and in his view it would in any case not be wise. It would be a bad precedent, and would be

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1. Keynes, The Economic Consequences of the Peace, p. 261.

2. Ibid., p.259.

a blow to international credit. He suggested that the best possible solution would be for Reparation payments and credits to be accepted by the United States and Britain in place of equivalent debt from other Allies. But he thought the United States Treasury would be unwilling to agree to such a plan.<sup>1</sup> Attitudes mellowed gradually during the inter-war years; by 1922 rumours that Britain was about to propose unilateral cancellation provoked an American newspaper, *The Globe*, to admiring comment,<sup>2</sup> and by the end of the period some American writers were strongly critical of United States Treasury policy on this point.<sup>3</sup>

The British attitude to the inter-Allied debt question was strongly affected by its views on reparations. Despite the anti-German mood of 1918, and the prevalence at the election of that year of slogans like 'Hang the Kaiser' and of echoes of Lloyd George's determination to make Germany pay 'to the uttermost farthing', opinion on the indemnity question was never as violent in Britain as on the Continent. As early as January 1918, the *Economist* published an editorial on the subject, quoting with approval a number of authorities advocating the necessity for equitable economic treatment of Germany after the war, and agreeing that an economic war should not follow the end of the military one.<sup>4</sup> Lloyd George himself performed a fascinating balancing act, between the popular anti-German fever of the moment, and what seems to have been his own feelings - certainly the ideas of his chief advisers at the Treasury were moderate ones. He had some big guns to contend with; among the strongly anti-German lobbyists were Hughes, the Australian Prime Minister, and Lord Cunliffe, past Governor of the Bank of England. The Treasury had, early in 1918, produced a detailed estimate of German liabilities and of their

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1. Lloyd George Papers, F/60/3/6, Lord Grey to Lloyd George, 29 Sep., 1919.
  2. Lloyd George Papers, F/86/5/7.
  3. See, for example, C.M. Fraser, British Policy on War Debts & Reparations (Philadelphia: Dorrance & Co., 1940).
  4. Economist, LXXXVI, 12 Jan., 1918.

capacity to pay; the former they estimated at £4,000 million, the latter on an optimistic basis at £3,000 million, or on a more cautious level at £2,000 million. Hughes, who was at that time a member of the War Cabinet, protested that this was a ridiculously small amount, and he was appointed Chairman of an independent committee, with which Lord Cunliffe was associated, to determine the correct sum. This body came up with a figure of £24,000 million, representing the full cost of the war to the Allies. Despite the fact that pre-war Germany had only maintained a balance in her external payments by means of a substantial earning on invisible account, which would now largely disappear with the disposal of her foreign investments and the impounding of her ships and colonial possessions, the Committee seemed to see nothing unreasonable in this demand. The Cabinet did not come to a decision on the matter and the British delegation took both reports with them to Paris.

The British Treasury representative in Paris was John Maynard Keynes. As main author of the Treasury report on Germany's capacity to pay, he was one of the principal British proponents of liberal treatment of Germany. But neither he nor any other Treasury representative was appointed to the Reparations Commission which was set up by the Peace Conference to determine Germany's capacity to pay. Despite Lloyd George's assertion that

"Mr. Bonar Law and I regarded the conclusions of this Report [of the Hughes Committee] as a wild and fantastic chimera. It was incredible that men of such position, experience and responsibility should have appended their names to it."<sup>1</sup>

he appointed Hughes and Cunliffe, together with Lord Sumner, a Judge without financial knowledge, to be the British representatives on the Commission. His motives for doing this would make fascinating study. However, the deliberations of the Commission at the Peace Conference were inconclusive, and the Treaty was signed without the inclusion of any

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1. David Lloyd George, Memoirs of the Peace Conference (London: Heinemann & Co., 1938), p.305.

specific sums in reparation. What was laid down were the guidelines on which further deliberations should take place. The dispute between the French and the Americans as to whether Germany was responsible for the full cost of the war or for reparation of damage only was settled by a compromise; financial recompense was to be for damage only but the Treaty would acknowledge the theoretical responsibility for the whole cost of the war (the 'War-Guilt' clause). Pensions and allowances were slipped into the account by Lloyd George at the suggestion of Smuts, not in order to increase the total, since at that time the Big Four were still thinking in terms of a 30-year time limit, but to increase Great Britain's share vis-a-vis France and the rest of the Continental allies. Afterwards the time-limit was dropped, and this insertion seemed harsher than was intended.<sup>1</sup>

A permanent Reparations Commission was therefore set up to determine the total to be paid under ten counts. In addition Germany was to reimburse Belgium for all sums borrowed by her up to the Armistice, to make deliveries of reconstruction materials, ships and dyestuffs, and to pay £1,000 million in a form to be decided by the Reparations Commission towards the cost of the Armies of occupation. Numerous conferences were held on this basis, at which the British consistently advocated a settlement based on German capacity to pay, while the French equally consistently demanded a much larger sum; partly in order to 'keep Germany down', partly to meet the twin costs of eventual repayment of the debt to the United States and Britain, and of restoring the devastated areas. Agreement was finally reached on the basis of a fixed levy based on German capacity to pay and a variable levy based on future prospects, at Paris in January 1921. The Germans refused this, and sanctions were

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1. This account is taken from Harrod, The Life of John Maynard Keynes, pp. 228-246.

applied, of which the main one concerning Britain was a levy of 50% (later reduced to 26%) ad valorem on German imports, under the German Reparation (Recovery) Act, 1921. Finally, the Reparations Commission arrived at a lump sum settlement which the Germans accepted in June 1921. This involved three main elements; the deposit with the Reparations Commission of three classes of bonds, to the total value of £6,500 million in gold, an annual annuity of £100 million also in gold, and a variable annuity of 26% of exports. The last two were to be paid quarterly. To begin with Germany paid regularly, but in December 1921 she gave notice that she would not be able to make the January and February payments due. Negotiations on a moratorium during the spring of 1922 were accompanied by a sharp fall in the mark. A partial moratorium was offered to the Germans in April, which they were unable to accept; discussions continued into the summer, and eventually the Germans applied for a moratorium to the end of 1924 to enable them to stabilise the mark and put the economy on a proper basis before attempting to make further reparation payments. Pending a decision on this, a Belgian plan for acceptance by the Reparations Commission of German Treasury Bills for payments due from August 15th was accepted despite French opposition on August 31st.<sup>1</sup>

Thus the period from the Armistice to the issue of the Balfour Note in 1922 was one in which Britain and France were in constant conflict over their attitudes to Germany, particularly on the Reparations question, and they became involved in a circular argument. France could not begin to pay interest on her debt nor to negotiate properly on the principal until the reparations question had been settled and she knew how much

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1. These, necessarily summary and incomplete, details are taken from a historical summary by a Treasury official, S.D. Waley, in February and September 1922, P.R.O., T.172/1476.

she might expect from Germany. Neither could she agree to reduce her demands on Germany to what the British regarded as a reasonable figure while she owed vast sums to Britain and the U.S. Britain could not, it seemed, break the deadlock; not only had she her own debt to the United States to think of, but she felt some obligation to follow a joint policy with the United States over her dues.

One imaginative attempt to aid in the reconstruction of Europe on the necessary scale had been made by Keynes while he was still at the Treasury, before the Treaty was signed, in April 1919. This was a proposal for a loan to Germany of £1,000 million guaranteed by all the Allies in proportions which reflected their international position after the war. This loan was to be applied as to four-fifths to reparation and as to the remaining one-fifth to the purchase of food and raw materials.<sup>1</sup> The plan was sent to Lloyd George by Chamberlain, the Chancellor of the Exchequer, with a warm recommendation.<sup>2</sup> Lloyd George also thought it a good scheme<sup>3</sup> and sent the plan to President Wilson, who turned it down, on the basis that since the Allies were forcing Germany under the conditions of the Treaty to give them £1,000 million in gold or goods in payment for the costs of the Army of Occupation. Since by this action the Allies were deliberately starving Germany of the necessary working capital, they could hardly expect the United States to help make good the deficiency.<sup>4</sup> Since the Germans were eventually declared to be in default of £600 million of this £1,000 million, and since Wilson apparently made no objection to the insertion of that clause into the Treaty, his refusal seems both harsh and mildly hypocritical.

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1. P.R.O., Cab.24/5, G.241, 17 Apr., 1919.

2. Lloyd George Papers, F/7/2/27, 17 Apr., 1919. He outlined the scheme to the War Cabinet on the same day, P.R.O., Cab.23/12, W.C.557, 17 Apr., 1919.

3. Lloyd George Papers, F/7/2/34, 2 July, 1919.

4. Ibid.

Keynes resigned from the Treasury in 1919, following the failure both of this scheme and of his ideas on reparation to gain any real success, and expressed his bitterness about the Treaty in 'The Economic Consequences of the Peace'. But the forces within the Treasury working for a just settlement of both the post-war international financial problems did not depart with him. Sir John Bradbury, Joint Financial Secretary, had departed to be British representative on the permanent Reparations Commission in 1918, where he continued the British fight for a liberal settlement, and his place on the financial side of the Treasury was taken by Sir Basil Blackett, who held the post of Financial Controller until he went to India in 1922. Blackett was in charge of Treasury negotiations with the United States Treasury on our debt to America, and was soon to come up with a constructive plan for dealing with all our Allied debt structure which might have had far-reaching beneficial consequences had it been adopted.

Before looking into his suggestions, we must trace the history of debt negotiation after the end of the war. The Continental Allies were much involved with reparation, as we have seen, and were unwilling to agree to a permanent settlement until the reparation question had been settled. The legal position was that the obligations of the British Government to the United States Government were theoretically payable on demand. This was manifestly unsatisfactory from every point of view, and it seems certain that this was a serious factor in the depression of the sterling exchange after the war. The United States Treasury alone had the legal right to arrange for funding without Congressional sanction, and the American Government was anxious to keep the debt settlement out of the political arena. Early in 1920 Mr. Rathbone of the United States Treasury came to London to discuss the problem, with the British apparently under the impression that mutual postponement of interest payments was to be the main topic for discussion, while Rathbone thought he had

come simply to discuss funding. It was later made clear that any proposal for postponement would have to be made explicit and public. However, the discussions made some progress, despite the feelings of the Treasury officials about the high-handed behaviour of Rathbone.<sup>1</sup>

Partly as a result of the early negotiations with Rathbone, partly from other pointers coming from America during 1919, Blackett became convinced that joint action by Britain and America over their creditors on the Continent was ruled out by the American attitude on any basis but one which treated the war debts as though they were commercial obligations. Early in 1920, therefore, he decided that if any progress on cancellation were to be made, Britain would have to go it alone. He devised a plan on this basis, which he submitted via Chamberlain to the Cabinet.<sup>2</sup> The substance of the proposal was that, as we have seen, official opinion in America, both in the Treasury and in Congress, was so vehemently opposed to what the British Treasury regarded as the most desirable course of action, namely all-round cancellation, that there was little or no likelihood of concerted action at the time Blackett was writing. But the gains to us of cancellation were likely to be so great, Blackett said, that we should go ahead on our own, separate the problem of our debt to the United States from that of our debt from the Allies, and cancel the latter unilaterally.

This plan of Blackett's, and the reasons he gives for advocating it, are of considerable interest and importance, both in the light of subsequent British policy on the subject, and for the way it indicates the broad lines of opinion in the Treasury and in the Cabinet on this subject. For these reasons, its study in detail is highly rewarding.

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1. This account is taken from a summary of negotiations by Sir Auckland Geddes, British Ambassador to Washington from 1920 to 1924, included in British Empire Delegation papers presented at the Genoa Economic Conference in 1922, P.R.O., Cab. 31/1, B.E.D.232, April 1922.
  2. P.R.O., Cab. 24/97, C.P.584, 6 Feb., 1920.

Blackett adduced two main reasons for advocating unilateral cancellation. Firstly, he said, the whole structure of our exchanges with the Continental countries is affected pejoratively by the debt of the Allies to us. Since their credit-worthiness was so low, the fact that the Allies owed us large sums, not only for war expenditure, which he proposed we should remit, but for post-war expenditure too, both at the Government and the private level, was a depressing effect on our international credit generally, and particularly on the sterling-dollar exchange. In view of the fact that the American debt was fixed in terms of gold, any improvement in the sterling-dollar exchange would *pari passu* lighten the American debt burden.

Secondly, and following on from this, with an improved credit standing the Allies would more easily be able to finance purchases of our exports, which they desperately needed in order to proceed with the reconstruction of Europe. In addition, though this is made plain by implication rather than explicitly, such a plan would help to improve the position of Germany too, since some remission of reparation demands might be expected if France and the other Continental Allies no longer had to think in terms of repaying their debt to us. Not only was this important from a moral standpoint, but from a commercial standpoint too; before the war Germany had been our second largest supplier and also our second greatest customer.<sup>1</sup>

To justify his advocacy of unilateral, rather than concerted, cancellation, Blackett began by setting out the original aims of British policy on inter-Allied debt:

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1. A.W. Kirkaldy (ed), British Finance 1914-1921 (London: Pitman, 1921), pp.370-373.

"From the first the general policy of the British Government in the matter of Inter-Allied debt has been to move as far and as fast in the direction of "Deflation of the world's balance sheet" as we could persuade the United States Treasury to go with us. Our idea has always been that ultimate repayment by the continental governments of their debts to the United Kingdom and the United States was in fact out of the question, that the existence of this mass of external indebtedness meanwhile lay like a dead weight upon the credit of continental Europe and made reconstruction even slower and more painful than it needed to be, and that the statesmanlike thing to be done was for the United Kingdom and the United States to make a "beau geste" by offering to wipe out the whole of such indebtedness with a stroke of the pen." <sup>1</sup>

Sir Basil's previous dealings with the United States Treasury had not led him to expect that his ideas would be received with any enthusiasm.

"...hitherto our efforts to co-operate with the United States Treasury have almost invariably meant that we have had to abandon without even putting on formal record policies which we have favoured whether in great matters or in small, and accept the views of the United States Treasury. Not only so, but the policies favoured by us have never reached beyond the individual officers of the United States Treasury with whom they have been discussed, and our attitude is almost invariably represented in the United States of America, because the United States Treasury's sole preoccupation is usually to persuade an unwilling congress to take a small step forward in the direction desired by the United States Treasury, and it frequently does the persuading by putting forward arguments which are from our point of view irrelevant and unfair." <sup>2</sup>

When Blackett's plan was proposed informally to the United States Treasury, his fears were confirmed. It was made quite plain that such joint action was at that time out of the question.

"The United States Treasury has from the first been horrified with even the mention of such a plan... [and] seems incapable of appreciating the position and Congress as usual is entirely ignorant of and untouched by the realities of the case." <sup>3</sup>

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1. P.R.O., Cab.24/97, C.P.584, pp.1-2. The term "beau geste" was also used by Lord Derby, British Ambassador to Paris 1918-20, in a letter to Curzon on the subject, saying that he still adheres to "the proposal I made to the Prime Minister for the reduction of France's debt to us as a beau geste which would do much to smooth away our present difficulties". Lloyd George Papers, F/53/1/40, 9 June, 1920. Anti-British feeling was at its height in France at this time.
  2. P.R.O., Cab.24/97, C.P.584, p.1.
  3. Ibid., p.2.

Subsequent negotiations with the United States had thus to be confined to questions of interest postponement and the possibilities of converting short-term obligations into long-term debts. But while the United States Treasury expressed continued anxiety for co-operation, the intention seems not to have been translated into action.

"...the United States Treasury abuses its position as our creditor and its inability or unwillingness to tell Congress the truth for the purpose of making us accept whatever the United States Treasury wants, and often goes further and demands that we shall put forward its views as if they were being pressed on it by us."<sup>1</sup>

On the specific question with which Blackett was at that time concerned, progress was no better.

"In order that we may secure postponement of all interest on inter-allied debts including interest on our debt to the United States of America, the United States Treasury demands that we should officially appear as authors of this policy (which seems to us only a pis-aller) and should appear in the somewhat undignified attitude of suppliants to the United States Treasury for relief."<sup>2</sup>

In view of the attitude and behaviour of the United States Treasury, Blackett suggested that the time had now come to reconsider the attitude of one-sided co-operation which the British Treasury officials had been forced to adopt. Since it was apparently beyond the vision of the United States Treasury to see what a beneficial effect such a magnanimous gesture as an offer of all-round debt cancellation would have; and since the United States Treasury was far too afraid of Congress even to suggest this course of action anyway, such a joint offer was out of the question. But independent action by Britain was not. Blackett went on to suggest a course of action which would in his view have considerable beneficial results both for Britain and for Europe.

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1. P.R.O., Cab. 24/97, C.P. 584, p. 3. As in the original; possibly the first 'and' should have been 'by' or 'in'.
  2. P.R.O., Cab. 24/97, C.P. 584, p. 3.

"...it is quite possible for us to say, without reference to any question of the debt of the Government of the United Kingdom to the Government of the United States of America, that we are prepared for our part, without any conditions whatever, to wipe out the debts owed to us by the Governments of our European allies...We should base our proposal on the necessity of doing something really useful towards setting Europe on its feet, and on the disadvantages which we see in remaining as a Government the creditor of other Governments." <sup>1</sup>

The paper noted two main considerations to be borne in mind if this policy were adopted, apart from the willingness of France and Italy to accept a gift of this magnitude.<sup>2</sup> Firstly there was the problem of the sterling exchange; this was allied to the second difficulty, the political effect involved in Britain taking a step in a direction in which the United States might not wish to follow. Blackett, recognising that the effect on the sterling exchange would be markedly affected by the course of action taken by the Americans as a result of the British carrying out the new policy, summed up the possible courses as follows. Firstly, the United States might simply do nothing. Secondly, she might cancel all Allied debts due to her including those of Britain. Thirdly, America might wipe out all her debts except those of Britain, saying that in doing so she was doing no less than the British. The effect of the second course upon the sterling exchange was not discussed, but it is probably legitimate to assume that this was not done because the benefits which would accrue to the exchange were so obvious as not to need mention or expansion. Blackett found it difficult to forecast what the results of either of the other courses of action would be for the exchange. He suggested that since there would be no increase in the

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1. P.R.O., Cab. 24/97, C.P. 584, p.4. There was a precedent for this; it is a recurrent theme in the Treasury documents on this subject that after the Napoleonic Wars we voluntarily forgave 90% of our Allies' debt to us. There was of course then no foreign debt owed by Britain to complicate the issue.
  2. Blackett noted that Russia should be excepted for the time being. Belgium was also a special case since her debt was to be converted into German bonds. Similar treatment to that accorded to France and Italy should be offered to the Dominions, P.R.O., Cab. 24/97, C.P. 584, p.5.

amount of currencies currently seeking a market in New York, only a small depression of sterling in New York might be expected, and, in the event of America following the third course, there should be a reduction in the discount on francs and lire so as to bring it fairly close to that on sterling. Blackett thought that in any case,

"the market for our exports in France and Italy would be improved, and we should be more likely to secure payment for those exports in case..."<sup>1</sup>

Obviously the main disadvantage of a scheme of all-round cancellation which did not include the abrogation of the British debt to the United States was that while Britain could no longer claim any capital sums from the Continent, such sums would still be due from her to the United States. However, Blackett believed that given reasonable time for payment, our debt to the United States could be honoured without too great difficulty, and incidentally might bring important compensations in the opening of the markets of America to our imports.

It is clear that while the economic aspects of the policy of cancellation of the Allies' debts to us were regarded as vital by Blackett, nevertheless he was also well aware of the international political possibilities.

"...we should surely have earned the gratitude of the world, by recognising now and at once the facts of the situation and restoring reality to the discussions of the economics of today, and by giving new hope to Continental Europe by clearing away, so far as we are able, the useless obstruction of a vast mass of paper indebtedness between Governments."<sup>2</sup>

Blackett's memorandum, which subsequently led to considerable discussions in the Cabinet, is intrinsically interesting, coming as it did from the Controller of Finance at the Treasury, and containing an imaginative plan for the partial solution of one of the most intractable of

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1. P.R.O., Cab. 24/97, C.P. 584, p.6.

2. Ibid.

post-war problems. It is also indicative of two noteworthy points about current official thinking on inter-Governmental debt in the 1920s. Firstly, the British attitude to such debt was more liberal than is often supposed; and secondly, the attitudes of the officials concerned with the problem on either side of the Atlantic were completely different, and in fundamental opposition. It is clear that the Americans regarded the debts incurred by the Allies as a purely financial problem; indeed, they saw the debts as commercial debts. In addition, there was apparently no conception in official circles of the unreality of the sums involved, nor of the benefits which would accrue to world trade in general, and to that of the United States, if the deflationary influence in the debtor countries of these debts were removed. It may be said that economic thought on these matters was not sufficiently advanced at the time for it to be reasonable to expect the American officials to be aware of these considerations. But the fact remains, as is clearly demonstrated in Blackett's paper, that in Britain some at least in official circles were aware of, even if they did not make explicit, propositions which have since come to be seen as almost self-evident. That is, that the debts of nations and of their governments are not, and cannot be considered to be, on a par with commercial international debts; and that debts incurred by governments in times of general warfare are of a different kind from those incurred by governments in peacetime.

Blackett's memorandum was submitted through Sir Warren Fisher, the Permanent Secretary, to whom all three Controllers were officially responsible, to the Chancellor. Fisher's attitudes were apparently in agreement with Blackett's; the latter's memorandum contains the sentence,

"The following is an attempt to put on record the views which you and I discussed together this morning." <sup>1</sup>

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1. P.R.O., Cab.24/97, C.P.584, p.1.

Sir Austen Chamberlain, who was Chancellor of the Exchequer at the time, took a relatively uncommitted stand. He submitted the memorandum to the Cabinet with a covering note which expressed the issues concisely without venturing a strong opinion on them:

"The Cabinet agreed that we should remit debts due to us by Allies if the United States would do the same to its debtors including ourselves. The United States Treasury is vehemently opposed to this proposal. Should we act without them?

If our Allies could pay us and if the United States did not follow our example, we should be the losers. But will our Allies ever be able to pay us and would America permanently refuse to follow our example if we had acted spontaneously?"<sup>1</sup>

Amplification of the Chancellor's views on the whole problem of Britain's financial position in the world is obtained from a dispatch<sup>2</sup> sent by him to a British representative in Washington just after he had circulated Blakett's memorandum to the Cabinet, early in February 1920. This confidential dispatch was in response to an indirect request from a member of the United States Treasury staff for a summary of the Chancellor's views on the international situation.

The substance of the dispatch is that if Britain's current position were viewed in isolation from that of the rest of the world, it would appear fairly comfortable; but such a view would be unrealistic. In order to sell enough British exports in 1920 to secure a surplus in the balance of payments, it would be necessary to advance considerable credits to Europe. Since the Government had set its face against further Governmental credits unless there were exceptional circumstances, these must be private credits. But Britain's own credit position was fairly tight, and it would therefore be necessary for Britain in her turn to borrow commercially in the United States. Therefore, the current banking crisis in the United States would be very harmful not only to Ameri

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1. P.R.O., Cab.24/97, C.P.584, introductory note.

2. Ibid., C.P.597, 9 Feb., 1920.

but also to the rest of the world. Another problem was the lack of credit-worthy Continental borrowers.

Turning to the problem of our relations with the United States, the Chancellor felt that the main difficulty in connection with the British debt to the United States was that, with the continued fall of sterling vis-a-vis the dollar, the debt was becoming more costly all the time.

"In my view this fall is almost entirely due to the credits, public and private, which we have been forced to give to Continental Europe, just as our debt to the United States is almost wholly due to loans we made to Allies during the War, so that dollar-sterling exchange is not really a measure of Anglo-American conditions but of Europe-American conditions. Thus any improvement in the credit of continental countries would pro tanto relieve the strain on us."<sup>1</sup>

The Chancellor went on to stress that it was because of the combined dangers of insolvency in Europe, and the lack of credit provision by the United States because of the banking crisis, that he would welcome the all-round cancellation of inter-Allied debts.

The telegram which had called forth this memorandum, together with the paper itself, were circulated to the Cabinet early in April 1920.<sup>2</sup> At the same time a preliminary discussion of the Blakett plan took place, with inconclusive results; the Cabinet noted that the plan had been circulated for information only, and that the Chancellor was not committed to Allied debt cancellation irrespective of American action.<sup>3</sup>

The memorandum<sup>4</sup> which Chamberlain had despatched to the United States Treasury received an uncompromising reply. Despite the fact that the paper did not contain a formal proposal on Allied debt cancellation, and was merely an expression of views submitted at the instigation of the

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1. P.R.O., Cab. 24/97, C.P. 597, p.4.

2. Ibid., C.P. 597.

3. P.R.O., Cab. 23/21, Minutes of Cabinet meeting 23(20), 26 Apr., 1920.

4. P.R.O., Cab. 24/97, C.P. 597.

United States Treasury, the Secretary of that Department felt it necessary to set out once again his Government's views on the subject and to read Chamberlain a barely disguised lecture on the subject of people who tried to shirk their debts.

"I feel certain that neither American people nor our Congress, whose action on such a question all-round cancellation would be required, is prepared to look with favour upon such a proposal.

Apparently there are those who have been labouring for some time under the delusion that the inevitable consequences of War can be avoided....I recognise that a general cancellation of such debts would be of advantage to Great Britain and that it would probably not involve any losses on her part...Such a plan does not involve mutual sacrifice on part of nations concerned. It simply involves a contribution mainly by the United States."<sup>1</sup>

Chamberlain was by this time becoming increasingly impatient with the American attitude,<sup>2</sup> and responded in dignified tones to this peroration:

"I fully appreciate attitude of United States to any proposal for mutual cancellation of International War indebtedness. I had no intention of renewing this proposal to which I referred only in order to respond fully to Leffingwell's request for my appreciation of general situation of Europe as well as of this country."<sup>3</sup>

Public opinion in this country was also moving towards the idea of separating our debt to the Americans from that owed to us, although still retaining the idea of working in concert with the Americans over our Continental Allies. In January 1920 a leading article in the Economist advocated the wiping out of Continental debts to the U.S. and Britain, and the funding of our debt to the U.S. over fifty years, with an interest-free period to extend over the next few years.<sup>4</sup> Between 1920 and the summer of 1922, when the Balfour Note appeared, opinion had moved further in this direction,<sup>5</sup> and it seems likely that by then, at any rate, the Blakett plan would have had wide popular acceptance as a realistic and statesmanlike proposal.

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1. P.R.O., Cab. 24/100, C.P.842, Secretary of United States Treasury to Chamberlain, 5 Mar., 1920.
  2. See below, p. 231.
  3. P.R.O., Cab. 24/100, C.P.842, Chamberlain to Secretary of United States Treasury, 11 Mar., 1920.
  4. Economist, Vol.XC, 10 Jan., 1920.
  5. See below, pp. 241-2, 262-3.

But opinion in the Cabinet was, as might have been expected, strongly divided over the merits of the plan, both at this time and in 1922. The paper had been circulated to the Cabinet in February 1920,<sup>1</sup> and evoked a number of papers in response from other members of the Cabinet.

As has been said, Cabinet opinion was sharply divided. The Foreign Office was strongly in favour of the proposal. Lord Curzon's memorandum added foreign policy arguments to the economic ones advanced by the Treasury.

"It is certain that a state of things under which our allies, who are impoverished while we remain relatively rich, have to discharge heavy obligations to us as the result of a victorious war, must promote bad feeling. It must be remembered that, as long as these debts remain, Germany is not much worse off, if at all, than France and Italy. True, she has to make reparation, but otherwise she has little or no external debt. And there is more...in practice, the exaction of our debts from our allies will mean that we...shall be the sole recipients of any benefits from German reparation payments... it is hard to see how, if we insist on our debts, we can fail to lose our old position in the European system, which depended upon our being felt to be neither oppressive nor unjust."<sup>2</sup>

He felt that, were we to renounce our debts, we should clear the atmosphere at once, and regain the moral leadership of Europe at a time when it was vital for Europe that we should do so, since only Britain had the economic strength to take the leadership in the facing of the problem of reconstructing Europe.

Not only were there considerable advantages to be gained by our abrogating our allies' debts; considerable dangers would attend our course if we did not do so.

"...the prevalent conviction that we have always 'done well' out of wars will...crystallise into forms of extreme bitterness. No continental Government under present conditions is likely to be strong enough to resist the temptation to increase the bitterness and to use it for its own ends."<sup>3</sup>

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1. P.R.O., Cab. 24/97, C.P. 584.

2. P.R.O., Cab. 24/103, C.P. 1093, 17 Apr., 1920, p.2.

3. Ibid., pp.2-3.

Curzon recognised that the American reaction to such a change in British policy might at first be one which would result in a worsening of Anglo-American relations.

"The first impulse in America would almost certainly be to regard it as a characteristically 'slim' move, designed to force the hand of the United States."<sup>1</sup>

But Curzon thought that this would only be a passing mood.

"For the moment the American conscience as regards Europe seems dead, but conscience does not die in so sentimental and idealistic a people; it is only numb; and, if the British action were prevented on the loftiest ethical grounds, a revulsion of feeling would quickly follow, which would not merely affect Anglo-American relations, but would profoundly affect the whole American attitude towards Europe. The result might well be similar action on the American side before a year was out."<sup>2</sup>

Thus, for similar reasons, although from a different stance and in rather more extravagant language, Lord Curzon concurred in the Treasury view. He was supported by Sir Laming Worthington Evans, who added the suggestion that instead of the policy coming as the initiative of the British Government, acceptance of the policy by other countries might be considerably eased if a less direct method were used. An International Financial Conference under the League of Nations was soon to take place. Sir Laming suggested that it might be arranged for the conference to recommend that the cancellation of inter-Allied indebtedness was necessary for the rehabilitation of Europe. Britain could then accept this recommendation. While this would mean that Britain lost some of the appearance of taking the initiative, the likelihood of the United States taking offence would be lessened.<sup>3</sup>

The principal opposition to the Blakett plan came from the Board of Trade and from the Secretary of State for War. The President of the Board of Trade issued two memoranda. The first, in February, was written

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1. P.R.O., Cab. 24/103, C.P.1093, p.3.
  2. Ibid., p.3.
  3. P.R.O., Cab. 24/104, C.P.1153, 25 Apr., 1920.

by Sir Auckland Geddes; the second, after Sir Auckland's appointment as Ambassador in Washington, was by Sir Robert Horne. Geddes' objection was based partly on the difficulty of the American attitude; he thought it likely that the policy would seem in America to be an attempt to force America's hand, and that she might well remit the Allies' debts and not ours. This would put France particularly in a very advantageous position, and it might be that, by 1930, France would be prospering, as a result, to a greater extent than Britain. Geddes was also more optimistic about the chances of the continental Allies getting some benefit from reparations, than were the Treasury or the Foreign Office.<sup>1</sup> Sir Robert Horne, Geddes' successor, went further with the suggestion that France would as a result of all-round debt cancellation be considerably better off than Britain in the end. He adduced figures which purported to show that if one took levels of war-time taxation into account, the contribution of the British taxpayer would per capita be considerably greater than that of the French if her debts were remitted.<sup>2</sup>

The Secretary of State for War at that time was Sir Winston Churchill. He was strenuously opposed to the new proposal, and he too circulated two memoranda.<sup>3</sup> He felt that the correct policy would be to say to the United States that we were willing to remit our debts from our allies if she would do the same for us. He expressed his comments in what one has come to regard as typically Churchillian language:

"It would, I am sure, call forth a violent outbreak of anger in this country if it were known that while we are taxing ourselves more than double as much as the French, we are nevertheless forgiving them their debt, and at the same time allowing the United States, which has already pillaged us of twelve hundred millions of our securities, to continue to exact from us payment to the uttermost farthing of a debt contracted for a common cause."<sup>4</sup>

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1. P.R.O., Cab.24/98, C.P.621, 12 Feb., 1920.
  2. P.R.O., Cab.24/105, C.P.1202, 1 May, 1920.
  3. P.R.O., Cab.24/104, C.P.1156, 23 Apr., 1920; Cab.24/106, C.P.1316.
  4. P.R.O., Cab.24/104, C.P.1156.

In his second memorandum Churchill adduced a hitherto unmentioned argument. He stressed that an important element in British policy on the matter was the connection with reparations, and that we had always been concerned to exact a just and reasonable settlement. He regarded the offer of debt remission as a bargaining counter which we should use to persuade France and Italy to agree to a reasonable settlement with Germany; to offer this remission unilaterally would be to throw away the chance to influence the French in this and to produce a viable reparations settlement.<sup>1</sup>

Blackett's second memorandum, circulated in May 1920,<sup>2</sup> was concerned with retailing the course of negotiations with the United States over the Anglo-American debt, and with setting out the actual monetary transfers which would be involved if Britain simply waived the negotiations and paid up. That this course could be seriously contemplated, in view of the drain of exchange and the strain on our financial resources for some time afterwards, was due largely, it seems, to the importunities of the United States Treasury. Blackett quoted an extract from the draft agreement drawn up by Rathbone, the Assistant Secretary of the United States Treasury:

"...the Secretary of the Treasury has desired to aid in the stabilisation and rehabilitation of the financial and economic conditions of Europe. His willingness to accord liberal terms...to the Governments whose demand obligations are held by the United States is conditioned on reparation matters under treaties with enemy and ex-enemy countries, and other questions involving the financial and economic stability of the world being arranged so that in the judgment of the Secretary of the Treasury the aforesaid purposes may be realised...preferential tariffs and discriminating concessions must be avoided, [and] ...each Government should refrain from granting to other Governments, or from asking or accepting from other Governments, any such tariffs or concessions. Accordingly, no exchange of obligations as contemplated will be actually made and concluded unless and until determined by the Secretary of the Treasury."<sup>3</sup>

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1. P.R.O., Cab.24/106, C.P.1316.
  2. P.R.O., Cab.24/105, C.P.1259, 11 May, 1920.
  3. Ibid., pp.2-3.

Blackett went on to say that in addition the Americans were most anxious that Britain and America should treat their Continental debtors alike.

"...hitherto it has meant simply that the British Government has subordinated its views of how to deal with the problem to those of the United States Treasury - or rather to those which the United States Treasury feels strong enough to defend before the United States Congress."<sup>1</sup>

In view of the high-handed attitude of the Americans, and the fact that up to that point 'co-operation' with the United States had been for the Treasury officials from this country a matter of subordinating Britain's views and interests to those of the United States, Blackett believed that the time had come for Britain to 'go it alone'.

"If the British Government is prepared to give up the attempt to co-operate in this matter with the United States Government, and to inform the latter that it is at liberty to make what terms it thinks fit with France, Italy, &c., and that the British Government proposes to deal with the debts owed to it by those countries on its own lines, indicating that those lines will be more liberal than the United States proposes, it will then be possible to separate this problem of the Allied debts from the particular problem of Britain's debt to the United States Government."<sup>2</sup>

Moreover, in Blackett's view, it was not simply that positive gains would result from a change of policy by the British. In his view the advantages of continuing the current negotiations with the United States on funding and deferment of interest were so comparatively negligible as to be not worth the apparently inevitable humiliations involved in obtaining any concessions from the Americans.

"It is submitted that the inconveniences of attempting to reach a joint policy with the United States Government regarding the Allied Governments' debts are so great as to justify the British Government in taking its own course, and that, as the advantages offered by the United States Treasury in regard to postponement of interest on the British Government's debt are negligible under the terms now suggested, it is not worth while to negotiate further as regards such postponements."<sup>3</sup>

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1. P.R.O., Cab. 24/105, C.P.1259, p.3.
  2. Ibid., p.3.
  3. Ibid., p.3.

The remainder of the memo is concerned with the details of the sums which would be due in the immediate future were Britain to suspend negotiations with the United States forthwith. He assessed the sums due as about \$400m. for each of the next two years and \$200m. annually thereafter, and regarded the payment of such sums as a difficult but not impossible task for Britain.

This paper of Blackett's was circulated to the members of the Cabinet by the Chancellor of the Exchequer, accompanied by a short memorandum by the Chancellor himself, dated May 12th 1920.<sup>1</sup> From taking a neutral stance in his accompanying memo. to Blackett's earlier paper, Chamberlain had apparently become by then convinced that the course which Blackett suggested was the right one, and he said so in no uncertain terms.

"I have changed my mind on this question in consequence mainly of the intolerable pretensions of the United States Government. I have told Mr. Rathbone privately, and as one individual speaking to another, that I would sooner pay if I could, and default if I could not, than sell my country into bondage by signing any document containing language like that quoted from his draft by Mr. Blackett.

I am now in favour:

1. Of releasing our Allies from their debts to us after setting off anything due us by them.
2. Of similarly releasing the Dominions if they desire it...
3. Of informing the United States Government of our intention in this respect, and at the same time of our intention to provide back interest, interest and sinking fund on our debt to them on the lines suggested by the Controller."<sup>2</sup>

Immediately prior to the Cabinet discussion of the subject, there had taken place an inter-Allied conference at Hythe on the subject principally of reparations, but it had been agreed that the matter of inter-Allied debt was closely connected with this and should be urgently considered. France and Britain had issued a short joint statement, which

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1. P.R.O., Cab. 24/105, C.P.1259, p.3., Covering letter by Chancellor, 12 May, 1920.
  2. P.R.O., Cab. 24/105, C.P.1259, p.1.

among other things expressed the desirability of joint Anglo-French action over inter-Allied indebtedness, and over the connected problem of reparations.

"The two Governments are further of the opinion that...it is important to arrive at a settlement which will embrace the whole body of the international liabilities which have been left us as a legacy of the War, and which will at the same time ensure a parallel liquidation of the Inter-Allied War Debts and of the Reparation Debts of the Central Empire."<sup>1</sup>

A report on the Conversations at Hythe was given to the Cabinet at a meeting on the 19th of May,<sup>2</sup> at which Lloyd George was not present.

Arising out of the discussion on these conclusions, a discussion of the inter-Allied debt problem took place, apparently at the instigation of Winston Churchill.<sup>3</sup> The attention of the Cabinet was drawn to the importance of avoiding any final settlement of our debt to the United States independently of the settlement of our loans to France and Italy, and the payment of reparation by Germany. The view was that any settlement with the Continental Allies along the lines of cancellation should be contingent upon the Americans offering us a similar release. As a result of this statement, the Chancellor of the Exchequer felt it necessary to tell the Cabinet that the Prime Minister had been fully acquainted with the British Treasury's views as outlined in Blackett's second paper,<sup>4</sup> and that he did not approve of the adoption of a policy of unilateral cancellation at the present time. Since there was no other course open to us, the Chancellor was proceeding with the negotiations for meeting our demand obligations with America by giving the Americans interest bearing Bonds, payable at fixed dates. This would not prevent the United States from dealing more generously later on if circumstances became more propitious.

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1. P.R.O., Cab. 24/105, C.P. 1297, 17 May, 1920, p.3.
  2. P.R.O., Cab. 23/21, Cabinet meeting 29(20), 19 May, 1920.
  3. The Cabinet conclusions contain only a summary of the discussion, with no names mentioned. The details given here are taken from Lloyd George Papers, F/24/2/36, Hankey to Lloyd George, 19 May 1920; see below, pp. 233-4.
  4. P.R.O., Cab. 24/105, C.P. 1259.

The summary of the Cabinet discussion is brief, and it ends by saying,

"The Cabinet were impressed with the importance of the issues raised by the discussion, which had arisen without notice..."<sup>1</sup> and notes the conclusions of the Cabinet, which were that pending further discussion, which should take place as soon as possible, the Chancellor should suspend further negotiations with the United States Treasury.

Lloyd George was out of London at the time, and in accordance with custom, Sir Maurice Hankey, Secretary to the Cabinet, sent him a copy of the Cabinet minutes, accompanied by a letter giving some amplification of the discussion.<sup>2</sup> Hankey said that the question of inter-Allied debt was raised by Winston Churchill, without notice, following the discussions of the Conversations at Hythe. Hankey described Churchill as apprehensive of any mention of French debt remission at this stage. He suggested that we should tell France that we should like to see some debt of Germany remitted by her; that in return we are prepared to remit some French debt, provided we can obtain similar treatment of our American debt from the United States.

"His idea is to mobilise the whole sequence of debts in this order, so as to put America in an invidious position before the world if she refuses to take a part."<sup>3</sup>

This despite the fact that it was very clear from Blackett and Chamberlain's experiences with the United States that it was most unlikely that the United States could be 'shamed' into cancellation. As we have seen Chamberlain was then obliged to explain the position with regard to the discussions between the two Treasuries. Hankey went on:

"There was a very general feeling in the Cabinet that any arrangement of this kind [i.e. funding] might prejudice the general question of Inter-Allied indebtedness."<sup>4</sup>

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1. P.R.O., Cab. 23/21, Cabinet meeting 29(20), 19 May 1919.
  2. Lloyd George Papers, F/24/2/36, Hankey to Lloyd George, 19 May 1920.
  3. Ibid.
  4. Ibid.

He added that a further Cabinet meeting on the subject had been requested, and that there was a general wish for Lloyd George to preside.<sup>1</sup>

The requested Cabinet meeting took place on May 21st,<sup>2</sup> and those present had before them all the papers to which reference has been made. The matter was introduced by the Chancellor, who made a lengthy statement, which consisted of a summary of the proceedings with the Americans to date, and of his views and those of his staff as expressed in the memoranda, which have already been discussed at some length.<sup>3</sup> Thereafter discussion centred on two main points. The first was that since Britain had just issued a joint statement with France stressing the importance of joint action and of taking the problem of inter-Allied debt in conjunction with that of reparations, it would hardly be reasonable or consistent of Britain to proceed at once to independent action on inter-Allied debt. Not only was joint action with France and Italy over their debts to one another advisable; much was to be gained by a joint approach on the part of the three countries to the American problem.

Secondly, the current political situation in America was abnormally confused; Presidential elections were imminent, and the moment was thus highly unpropitious for an approach of this kind to the United States. The summary of this discussion is contained in single page of foolscap in the Cabinet records - surely rather a cursory treatment of such an important problem - and the substance of the discussion may be summed up by the final sentence:

"Everything was to be gained by postponing a decision."<sup>4</sup>

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1. Lloyd George Papers, F/24/2/36, Hankey to Lloyd George, 19 May 1920.
  2. P.R.O., Cab.23/21, Cabinet meeting 30(20), 21 May, 1920.
  3. Ibid.
  4. Ibid.

The conclusions of the Cabinet are recorded as being that, in future, negotiations on inter-Allied debt should take place at Government, rather than Treasury, level, in view of the "questions of high policy" raised; that the Prime Minister should write to President Wilson on the subject; and that the Chancellor should notify Rathbone of the Cabinet's decision.<sup>1</sup>

Since the practice of Cabinet meetings at this time was for the discussion to be summarised by the Secretary without names being given, it is not possible to determine from the Minutes who was principally responsible for the Blakett plan's rejection. However, it is clear from the minutes of the previous meeting on the subject,<sup>2</sup> and from Hankey's letter to Lloyd George,<sup>3</sup> that at any rate Churchill and Lloyd George himself were against the plan. The policy of joint action with France, one main stumbling block, had been agreed at Hythe during discussion between the Prime Ministers of the two countries.<sup>4</sup> The decision that discussions should subsequently take place at Government level, although recommended at the earlier discussion at which Lloyd George was not present, was apparently very much his own policy as well; Chamberlain's letter to Rathbone telling him of the change of negotiation machinery contains a pointer to this:

"Discussions on the subject took place at an earlier stage between President Wilson and the Prime Minister and the Prime Minister proposes now to resume these discussions..."<sup>5</sup>

In addition, the letter which Lloyd George eventually sent to Wilson as a result of the Cabinet meeting,<sup>6</sup> makes it clear that he was

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1. P.R.O., Cab.23/21, Cabinet meeting 30(20), 21 May, 1920.
  2. Ibid., Cabinet meeting 29(20), 19 May, 1920.
  3. Lloyd George Papers, F/24/2/36.
  4. P.R.O., Cab.24/106, C.P.1382, 2 June, 1920.
  5. Ibid., my underlining.
  6. P.R.O., Cab.24/114, C.P.2037, 5 Aug., 1920.

convinced that a one-sided remission of Allied debt by Britain would be a disaster politically:

"...British public opinion would never support a one-sided arrangement at its sole expense, and...if such a one-sided arrangement were made it could not fail to estrange and eventually embitter the relations between the American and the British people with calamitous results to the future of the world."<sup>1</sup>

Thus it seems clear that, while he had some support in the Cabinet, the decision not to implement the plan for unilateral cancellation was fundamentally Lloyd George's own. All the concrete evidence we have suggests this. Finally, although the Cabinet Minutes do not provide direct confirmation of this at the main discussion,<sup>2</sup> the evidence of the earlier meeting, coupled with the content and brevity of the second discussion, seem conclusive. For the discussion on May 21st was not only extremely brief. Despite the fact that in their written memoranda the holders of two of the highest offices in the State, and those most nearly concerned in the question, namely the Chancellor of the Exchequer and the Secretary of State for Foreign Affairs, were firmly and wholeheartedly in favour of the plan, the minutes of the discussion do not record a single word said in favour of the plan. No influence other than Lloyd George's could have been responsible for that. So the initiative was lost; a plan which could have resulted in an immediate lightening in the economic clouds over Britain and the Continent was rejected, apparently on the grounds of political expediency and from fear of public opinion.

Following the Cabinet decision on May 21st 1920, Lloyd George eventually wrote to President Wilson in August of that year. The delay was due partly to the pressure of business, and partly to the fact that

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1. P.R.O., Cab.24/114, C.P.2037, p.2.

2. P.R.O., Cab.23/21, Cabinet meeting 30(20), 21 May, 1920.

Lloyd George wished to delay writing until after the Conference at Spa, at which the European Allies decided what proportions the German Reparation should be divided among them.<sup>1</sup> The letter was in fact written and rewritten in draft several times during July and early August.<sup>2</sup> The passage on inter-Allied debts was embodied in a letter on more general matters. The substance of the passage was that difficulty had arisen over the reparations problem, since the French would only be willing to accept limitations on Reparation payments based on German capacity to pay if her Allies were to treat her debts in the same way. But Britain could not remit Allied debt unless some of the United States debt were remitted by her; as we have already seen, in Lloyd George's view the British taxpayer would not stand for a one-sided arrangement.<sup>3</sup> Lloyd George is at pains to make it clear to Wilson that the breaking off of inter-Treasury negotiations was not due to an unwillingness on the part of Britain to pay, but to a belief that a general settlement would have much more lasting value than a piecemeal one.<sup>4</sup>

The letter was eventually despatched on August 5th 1920, but President Wilson did not reply until November, presumably because of ill-health.<sup>5</sup> Meanwhile, the British Ambassador in Washington was growing anxious about the possibility that the new Administration which would take power in January 1921 would be more hostile to Britain than the present one. He sent a telegram to the British Government to this effect,<sup>6</sup> which was discussed by the Cabinet in November 1920,<sup>7</sup> but Cabinet opinion was not wholly in agreement with his view. It was eventually decided to

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1. P.R.O., Cab.31/1, B.E.D.232, p.5, memo. by Sir Auckland Geddes.

2. Lloyd George Papers, F/60/1/28.

3. See above, p.235.

4. P.R.O., Cab.31/1, B.E.D.232, p.8., memo. by Sir Auckland Geddes, Annex A.

5. P.R.O., Cab.23/23, Cabinet meeting 59(20), 3 Nov., 1920.

6. P.R.O., Cab.24/114, C.P.2039, 23 Oct., 1920.

7. P.R.O., Cab.23/23, Cabinet meeting 59(20), 3 Nov., 1920.

do nothing for the time being, and to hope that the new Administration would in fact be more kindly inclined. Further discussion took place in December, by which time a reply from President Wilson had been received.<sup>1</sup> The terms of this reply were uncompromising. The legal position of the United States Government, he pointed out, was that the only thing it could authorise the United States Treasury to do was to arrange for funding and for deferment of interest payments as part of a funding agreement. It had no Congressional sanction for remission of debt in whole or in part, and it was most unlikely that Congress would grant such sanction. Wilson suggested that unless funding took place soon, a "misunderstanding" would result. He also repeated the dogma that the United States could not recognize any connection between reparation and inter-Allied debt.<sup>2</sup>

Geddes again telegraphed the Government on the subject in December, along much the same lines, although he included mention of the opinion of Colonel House, Wilson's personal representative at the Armistice discussions, that America would eventually be driven to cancel British debt by economic necessity. But Geddes thought House was wrong, and once again suggested further negotiations. He thought that if these were not forthcoming the United States Government would eventually demand the right to sell our obligations on the market, and any hope of remission would then be gone for ever. This telegram was circulated to the Cabinet by the Chancellor, with an accompanying note to the effect that he would like the Cabinet to look again at Blackett's plan:

"I plead again and most earnestly for a beau geste, and that without delay."<sup>3</sup>

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1. Lloyd George Papers, F/60/1/31, 3 Nov., 1920. Wilson's letter does not appear to have been circulated to the Cabinet.
  2. Ibid.
  3. P.R.O., Cab.24/116, C.P.2214A, 3 Dec., 1920.

These documents were discussed by the Cabinet in late December, and it was decided that Lord Chalmers should be asked to go to Washington to conduct negotiations.<sup>1</sup> Lord Chalmers' visit was, however, postponed. Meanwhile, the Republicans under Harding came into power in the United States, determined to 'solve' the problem of inter-Allied debt.<sup>2</sup> The powers of the United States Treasury to deal with the problem were severely limited, and the new Government brought in a Bill to extend those powers. This Bill was introduced into Congress in June 1921, and received Presidential assent in February 1922. During this time negotiations were naturally largely in abeyance. But the Commission which the United States Funding Act provided for was set up in the spring of 1922, and this fact, added to the fact that the agreement made in 1919 for the postponement of interest on United States debt for three years was due to expire in October 1922, made it imperative that a British decision on the American debt be taken.<sup>3</sup>

As a preliminary, the British Treasury expressed the opinion that America should be asked what basis she wished to discuss the problem, whether the British debt were to be the sole topic of discussion or whether a joint attitude to all the other Allied debtors would also be under discussion. The Treasury also suggested that a special mission with wide powers should be sent to Washington to negotiate with the Commission.<sup>4</sup> As a result of all this activity the subject of inter-Allied debt again came up for discussion in detail in the Cabinet in the summer of 1922.

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1. P.R.O., Cab.23/23, Cabinet meeting 72(20), 17 Dec., 1920.
  2. Frasure, British Policy on War-Debts and Reparations, p.21.
  3. P.R.O., Cab.31/1, B.E.D.232, p.6, memo. by Sir Auckland Geddes.
  4. Ibid., p.7.

But before going into this in some detail it is worth noting that although American public opinion had if anything hardened since the last serious moves took place in 1920, British public opinion was becoming much more insistent on the need for mutual cancellation of debt and for the fixing of Germany's obligations within her capacity to pay. In November 1921 the Westminster Bank Review carried an article on resolution by the British National Committee of the International Chamber of Commerce. This resolution urged on the Government the desirability of negotiations on inter-Allied debt,

"in order to obtain the benefits which...would accrue if the debts of the Allied Nations to Great Britain, incurred as a consequence of the War, were either reduced or cancelled on terms to be agreed."<sup>1</sup>

The leader writer approved of this resolution saying that

"it [the resolution] gives authority to the great mass of public opinion that is slowly coming round to this view."<sup>2</sup>

But the Review did not feel that the American debt is in the same category, since Britain has not been devastated by the war in the same way as the Continent, though Britain must be given time to pay.<sup>3</sup>

Nor was it still true that the majority of the British public, as had been the case immediately after the war, thought that Germany could or should be made to pay to the uttermost farthing. Opinion in the City, particularly, tended to be that German economic recovery was essential to Britain.<sup>4</sup>

Thus opinion on reparations and inter-Allied debts tended to vary from, on one side, those who still thought in terms of heavy German reparation payments, through those who felt that whether Britain received anything from the Germans or not, our debt to the United States was a

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1. Westminster Bank Review, No.101, Nov., 1921, leading article.

2. Ibid.

3. Ibid.

4. See, for example, the Report of the Chairman of Westminster Bank, Westminster Bank Review, No.103, Feb., 1922.

sacred trust which we could not in any circumstances abrogate, to those who felt that the reparations payments were hindering the recovery of Germany and therefore of Europe, and those who felt that since the loans had been incurred in the process of prosecuting a long war for the survival of all the countries involved, whether they entered the field of actual battle early or late, the debts were of a special kind and might with honour be repudiated. One advocate of the latter view, writing in the Economic Journal, suggested that war debts were in essence inequitable, since those who had made vast contributions of men to the common cause now owed huge sums to those who had only contributed material goods. The logical answer, the writer says, is cancellation all round, unilaterally if necessary.<sup>1</sup>

Few people in this country concurred in this view. The majority of the banking and economic journals took the view that at any rate our debt to the United States was inviolate and must remain so.<sup>2</sup> Some, like the Economist, concentrated on the necessity for relieving both Continental and European trade from the constricting problems of international debt and reparations. To this end, the Economist strongly criticised the deterrent which reparations were to German recovery, not believing that all the European nations could become prosperous again without allowing Germany a share in such recovery, nor that the other continental countries could once again prosper while Germany remained devastated and divided. The Economist also tended to support any measure which might relieve the similar burden on world trade in general by easing both the burden of inter-Allied debt and the currency troubles and inflation in Central Europe. Thus in the same edition in April 1922 this magazine was promoting

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1. R. Trouton, "The Cancellation of Inter-Allied Debts", Economic Journal, XXXI (1921).
  2. See above, pp. 239-240.

both a scheme by Sir Robert Horne, by now Chancellor of the Exchequer, and a similar one by Goodenough, one of the Bank chairmen, for the transfer of both reparations and inter-Allied debts to bonds to be issued to private individuals with Government guarantees, and one by Keynes in the Commercial Supplement to the Manchester Guardian. This latter proposed that any currency which was at a level more than 10% below the pre-war parity should be stabilised at an agreed lower level. The Economist thought this a sensible proposal, but with little likelihood of success until political stability returned to Europe.<sup>1</sup>

Keynes had other observations to make on the international debt problem. We have already noted his remarks on the economic madness involved in retaining the structure of deadweight debt.<sup>2</sup> In his second book on the Peace Treaty, which came out in 1922, he had some wry and highly illuminating observations to make on the American attitude to European debt problems.

"The average American, I fancy, would like to see the European nations approaching him with a pathetic light in their eyes and cash in their hands, saying, 'America, we owe to you our liberty and our life; here we bring you what we can in grateful thanks, money not wrung by grievous taxation from the widow and the orphan, but saved, the best fruits of victory, out of the abolition of armaments, militarism, Empire and internal strife, made possible by the help you freely gave us.'"<sup>3</sup>

Presented thus with repayment by a grateful ally, Keynes goes on,

"And then the average American would reply: 'I honour you for your integrity. It is what I expected. But I did not enter the War for profit or to invest my money well. I have had my reward in the words you have just uttered. The loans are forgiven. Return to your homes and use the resources I release to uplift the poor and unfortunate.' And it would be an essential part of the little scene that his reply would come as a complete and overwhelming surprise."<sup>4</sup>

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1. Economist, LXXIV, 15 Apr., 1922.

2. See above, pp. 208-9.

3. J.M. Keynes, A Revision of the Treaty (London:Macmillan & Co., 1922), p.183.

4. Ibid.

The idea that the American attitude to Europe was a combination of a desire not to be put upon by the wily nations of the Old World, and of a psychological need to feel superior to them, is an interesting one, which finds echoes in the paper which Sir Edward Grigg wrote to Lloyd George urging him to reconsider his decision to issue the Balfour Note.<sup>1</sup>

But the American attitude was met with little sympathy or understanding on this side of the Atlantic; perhaps hardly surprising in the circumstances. This was, after all, America's first real sally into world politics; and she had throughout behaved in an extremely high-handed fashion, obviously regarding herself as the saviour of European civilisation. This attitude could hardly be expected to recommend itself to the European Allies, least of all Great Britain.

Be that as it may, against a background of confusion in policies and opinion alike, the next important period in the reparations and inter-Allied debt situation began to unfold. Reparations were discussed at length in Cabinet during May 1922, in view of the imminent default of Germany on her obligations, and the necessity of helping to arrange a moratorium so that Germany would not formally be declared in default, with the consequence of inevitable military action by France. It is interesting to note that the Cabinet was becoming aware of the inconsistencies in the allied, and particularly French attitude to the Germans. Lord Balfour is quoted in the summary of the discussion as saying:

"...Germany ought to be pulled up, but on the snaffle and not the curb. The misfortune was that we had an Ally who at one and the same time wanted Germany rich enough to pay indemnities, and also a Germany that was ruined."<sup>2</sup>

The immediate solution to the German problem, and that suggested by Sir John Bradbury, the British representative on the Committee of Experts

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1. See below, pp. 254-6.

2. P.R.O., Cab.23/30, minutes of Cabinet meeting 29(22), 23 May, 1922.

who had the settlement of the reparations problems and the supervision of that settlement in their charge, was for a large loan to be arranged. But with or without a loan France was unlikely to receive enough from Germany to pay her own annual allied debt charge, and the problem of inter-Allied indebtedness would once again be raised. At this point, the Prime Minister said that he was in favour of endeavouring to relieve the situation by collecting debt on a "quid pro quo" basis. He did not see how, with a considerable national debt and a large number of unemployed it was possible to forgive France and the other Allies their debts while at the same time continuing to acknowledge the American debt in full. He then went on to say that he was

"...all for the 'Blackett plan' (i.e. to say to our debtors we will only collect from you the same proportion of your debts to us as the United States collects from us)."<sup>1</sup>

In view of the actual substance of the Blackett plan, as set out in detail above,<sup>2</sup> it is difficult to see how Lloyd George could have placed such an interpretation on Blackett's plan for a cancellation of our European credits regardless, if necessary, of what the United States was prepared to remit of our debt to her. The lapse of two years between Lloyd George's statement and the original mooted of the plan is hardly sufficient explanation; that Blackett's 1920 Plan was indeed the one the Prime Minister meant is obvious from a Treasury memorandum drawn up during 1922.<sup>3</sup> This was addressed to Sir Otto Niemeyer, who was soon to succeed Sir Basil Blackett as Controller of Finance; Blackett was at this time busy with reparations problems and spending much of his time in Europe. The memorandum was apparently drawn up to assist Niemeyer in giving advice to the Chancellor on current inter-

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1. P.R.O., Cab.23/30, minutes of Cabinet meeting 29(22), 23 May, 1922.
  2. See above, pp.217-221.
  3. P.R.O., T.172/1288.

Allied debt policy, and sets out in detail Blackett's 1920 Plan, calling it a 'Beau Geste', the nickname it had apparently acquired, in view of its unilateral generosity. The 'Beau Geste' Plan is so different, both in detail and in summary, from the 'do-as-you-are-done-by' policy which Lloyd George appears to think the Blackett Plan consists in, that such confusion seems inexplicable.

No decisions on the Allied debt problem were arrived at at that meeting of the Cabinet, as it had been primarily concerned with the immediate and pressing problems of reparations. But the subject was given detailed consideration by the following meeting, and it was this meeting which effectively commissioned the drawing up of the Balfour Note. The basis for discussion on this occasion was a memorandum circulated by the Chancellor of the Exchequer, Sir Robert Horne.<sup>1</sup> Horne, it will be remembered, was in 1920, when the Blackett Plan was first discussed by the Cabinet, President of the Board of Trade, and an opponent of the plan.

The memorandum began by setting out the events of early 1922 on the matter. These were that the United States Congress had passed an Act setting up a World War Foreign Debt Committee, the Act being signed by the President on February 9th 1922, and the Secretary of the United States Treasury being Chairman; and that this Committee had passed at its first meeting a resolution inviting all countries owing war debts to the United States should submit proposals for funding. This proposal reached this country formally in April 1922, together with a semi-official suggestion that a delegation be sent from London to discuss funding with the Commission. Further, it was announced in the House of Commons during the Budget speech that Britain would begin paying interest on the debt to the United States Government in October 1922.<sup>2</sup>

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1. P.R.O., Cab.24/137, C.P.4020, 8 June 1922.

2. Ibid., p.1.

The memorandum went on to mention the reaction of Sir Auckland Geddes, British Ambassador in Washington, to the news of the American request for Britain to despatch a funding mission. Sir Auckland stressed the importance of sending such a mission without delay.<sup>1</sup>

He took the view that

"the United States Government intends that their note should be looked upon as an official proposal for the commencement of negotiations for 'settling or funding' and that the United States Government has no intention whatever of making any new or wider proposal with regard to a discussion of reparations or debts, at any rate before we have discussed the question of the British debt with the Commission..."<sup>2</sup>

Sir Auckland emphasised that the Commission was strictly limited by law in the negotiations it may carry out, a point which Horne himself confirmed later in the memorandum, and continues:

"...it would be futile for me to try to get them the Commission to agree to negotiations being commenced on any other matter save that of refunding. Should any circumstances exist which would absolutely preclude us from agreeing to any solution which the Commission's mandate would allow it to offer...I consider that it would be far better fully to inform the United States Government of the fact when answering their note, rather than to despatch a delegation whose prospects of success would ab initio be non-existent."<sup>3</sup>

Horne agreed with Sir Auckland about the nature of the delegation, if one were sent out to the United States:

"...if a delegation were sent out it would have to confine its official action to discussing with the Commission (not the United States Government), the particular problem of exchanging the existing demand obligations by which the British debt is represented into bonds or other obligations maturing on or before June 15th, 1947...which would have to be in form at any rate marketable securities."<sup>4</sup>

The implications of the transfer of the British Government debt into privately marketable debt were obvious and ominous.

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1. See also above, pp. 237-238.
  2. P.R.O., Cab.24/137, C.P.4020, p.1.
  3. Ibid., p.2.
  4. Ibid.

"Once the terms of the funding had been settled and the bonds issued, it would be practically certain that every dollar of the British debt to the United States Government would be exacted, with interest, without reference to what Germany may pay by way of reparation or to what terms may be given by the United States Government to France and her other debtors or by the British Government to the Allied debtors."<sup>1</sup>

Horne went on to summarise the arguments for and against funding. The strongest argument against sending a funding delegation to the United States at that time was that if Britain came to a funding agreement with the United States unilaterally and before the settlement of any other inter-Allied debt problem,

"...we are giving up our strongest weapon for forcing the United States of America to take part in a round-table discussion of inter-Allied indebtedness arising out of the War, unless we proceed, *pari passu* with our negotiations for funding our debt to the United States of America, to demand that our Allied debtors, especially France and Italy, shall take immediate steps to fund their debt to ourselves and at least begin paying interest in cash."<sup>2</sup>

Horne regarded the situation with regard to extracting cash payments of any kind from our Allies as hopeless at that time. He thought it would be necessary to wait at least two years before expecting any payments at all, and that in any event Britain would have to make considerable concessions over these debts.

"If, therefore, we proceed now to fund our debt to the United States of America, we must do so without reference to the rest of the inter-Governmental debt problem. We must make up our minds that our debt to the United States Government is going to be paid in full, and that for the present, at any rate, we can count on no counter-balancing receipts from our German or Allied debtors...By agreeing to fund our debt to the United States Government we accept the certainty that we must make these concessions to our Allies without ourselves getting any benefit of the concessions which ultimately the United States will have to make to Europe."<sup>3</sup>

Despite this formidable argument against sending a funding mission to the United States at that time, Horne nevertheless believed that this

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1. P.R.O., Cab.24/137, C.P.4020, p.2.

2. Ibid., pp. 2-3.

3. Ibid., p.3.

should be done, and this was the course of action which he recommended to the Cabinet. He gave a number of reasons. Firstly, the agreement

"expressed on the face of the demand obligations by which the debt is at present represented requires us to convert these obligations into long-term bonds 'if requested by the Secretary of the Treasury of the United States of America.'"<sup>1</sup>

Further, Horne believed that it would not be remotely politically possible for the United States within the next two or three years to remit, cancel or exchange for French or German obligations any part of the British debt to America. Neither did Horne believe that Britain has anything to lose by stabilising at once, if it be accepted that Britain would have at some point to pay the American debt in full.

On the contrary,

"by funding now we will be hastening the date at which it will be possible to stabilise sterling finally at par."<sup>2</sup>

Once again, the importance of the British commitment to return to the Gold Standard at the pre-war parity at the earliest opportunity is obvious to British policy in other, connected matters.

Horne also felt that to refuse the United States demand for funding could have unpleasant consequences, since to turn Congress against Britain when it was about to discuss the Tariff and Shipping Subsidy Bills would be most unwise, for unfavourable Bills could permanently damage Britain's trading position with the United States, and affect in the process her ability to repay the American debt at any time. Furthermore, a settlement of the Anglo-American debt problem would leave Britain more free to follow her own policies over European reconstruction and German reparations; and in addition,

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1. P.R.O., Cab.24/137, C.P.4020, p.3.

2. Ibid.

"...once our debt to the United States Government is funded there is much more chance that sentiment in the United States will move in favour of cancellation or writing down of the debts of France and the other Allies, and the United States Administration may at last find itself able to co-operate effectively in European affairs."<sup>1</sup>

Horne was no optimist about the likelihood of American initiative in Europe serving any useful purpose unless the British agreed to act first over funding:

"If the restoration of order in Europe and the settlement of the problem of reparation has to wait for American initiative, there is little hope for Europe or for our unemployed."<sup>2</sup>

He also said that an element in financial circles feels strongly that our credit would lose more than our finance would gain by an cancellation of our debt to the United States. But he finishes his memorandum, much of which seems sound and well-reasoned, with words which emphasise in a most interesting way the difference between ways of thought in Horne's effectively pre-Keynsian economic environment and those current in our own:

"...this country's prosperity depends on its being able to find markets for the surplus products which its people must be employed in making...we must be able not only to find markets for an amount of our goods and services sufficient to pay for the food and raw materials and luxuries which we wish to obtain from abroad, but also to find means of placing abroad surplus capital in order to enable our customers to absorb more of the goods and services which we produce. From this standpoint it makes little difference whether we lend the capital abroad or use it to pay the interest and principal of our external debt. The difference arises mainly in the degree of comfort and luxury of some of our own people, who get interest on their foreign investments in the one case, and in the other case pay additional taxation to enable the State to pay the foreign creditor."<sup>3</sup>

There are a number of notable points in this statement, which is why it has been quoted at length; not least of which must be the reductio ad absurdum of suggesting that the sole difference to this country of either

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1. P.R.O., Cab.24/137, C.P.4020, p.3.
  2. Ibid.
  3. Ibid., p.4.

investing capital abroad or using surplus on revenue to service and pay off external debt would be that a few surtax payers would either be making more in dividends or paying more in taxation, and that even this would only affect the individuals concerned!

Be that as it may, the final paragraph of Horne's memorandum recommended that the Cabinet agree to the despatch of a funding mission as soon as possible to Washington, and this memorandum was the primary focus for the discussion which took place in Cabinet on June 16th 1922.<sup>1</sup>

It is only occasionally that Cabinet minutes give names to opinions; the usual practice is for the different strands of opinion and the general tone of the discussion to be outlined without individuals being mentioned, and this was the case on this occasion, so there is no means of attributing opinions to particular ministers. The first half of the Cabinet's recorded discussion consists in what appears to be a summary of the Chancellor's own paper, so much in accord with its sentiments are they. But the Chancellor's views about the necessity of sending a funding mission to the United States, while concurred with by most members of the Cabinet, were only accepted with an important rider by one member, who urged;

"...that while, no doubt, the British Government had agreed to the funding of the debt and to the payment to the United States Government or its assigns, it was still open to the British Government to negotiate with a view to preventing, if possible, the funded debt being placed on the open market."<sup>2</sup>

The view that Britain could not without considerable dishonour and loss of prestige refuse to pay had considerable support:

"...it was inconceivable that Great Britain would ever place herself in the humiliating position of being in fact a defaulter to America."<sup>3</sup>

On the other hand, it was urged:

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1. P.R.O., Cab.23/30, Cabinet meeting 35(22), 16 June, 1922.
  2. Ibid.
  3. Ibid., Cabinet meeting 29(22), 23 May, 1922.

"...that Great Britain should take up the position that in no circumstances ought she to be given a less favourable treatment than that accorded by the United States Government to her other European debtors...Europe should present to America a United front...the latter should not be allowed to settle with her debtors individually. Even if the United States would not relax her demands upon Great Britain, she might possibly be persuaded, as the result of a general settlement, to give more lenient treatment to her other debtors."<sup>1</sup>

The suggestion was then made that as a result of the United States demand the most practical course would be to draft a despatch to the various European allies setting out the nature of the demand made by the United States, and indicating that while Britain thought the American policy mistaken, Britain would nevertheless be obliged in consequence to exact some payment from the Allies in respect of their debts to Britain. The importance of such a communique being carefully worded was stressed. In addition, it was suggested that a despatch to the United States also be drafted, saying that Britain would need to carry out certain consultations with her Allies before responding to the American demand for British funding of her debt to the United States.

In support of such a policy, it was stressed that:

"...public opinion in Great Britain would severely criticise any proposals which would have the effect of compelling the British taxpayer to satisfy the American debt while at the same time obtaining very little, if any, satisfaction out of the European debtors."<sup>2</sup>

Further discussion, no details of which are given, followed, and was concluded by a suggestion that:

"...public opinion in the United States of America had had little or no opportunity of learning the strength of the British case and that it was most important that the United States should realise that by insisting on the payment of the debt she would be making herself in effect the tax-gatherer and rent-collector of the civilised world."<sup>3</sup>

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1. P.R.O., Cab.23/30, Cabinet meeting 29(22), 23 May, 1922.
  2. Ibid.
  3. Ibid.

Eventually, the Cabinet agreed to the drawing up of two despatches, one to the European Allies, and one to the United States, along the lines suggested in the discussion. The communication to the Allies was to refer to

"...the demand made upon the British Government by the United States Government, recognising the obligation of the British Government in the matter, and stating in full the reasons which made it necessary for Great Britain to take similar measures against her European debtors...and should emphasise the necessity for similar treatment being accorded by the United States to all her European debtors."<sup>1</sup>

The despatch to the United States was to acknowledge Great Britain's obligations to her Government and to inform that Government

"...that Great Britain was not in a position to make proposals for the funding of her debt until certain conversations with her Allies on the kindred question of her European debts had been completed."<sup>2</sup>

Further Cabinet discussion took place on the Note during June and July,<sup>3</sup> and centred on two main questions: firstly, whether or not a mission should be sent to Washington in the near future charged with funding the British debt to the United States, and secondly on the terms of the despatch to be sent to the Allied debtors. The decision to undertake a funding mission was taken and announced to the public during July,<sup>4</sup> but discussion on the Allied despatch was reopened by the Prime Minister in July following the catastrophic fall in the mark.<sup>5</sup> Following this, the question was given a full hearing at a Cabinet meeting on July 25th,<sup>6</sup> and contrary to normal practice the Secretary was allowed to make a detailed record of the discussion. It is therefore possible to give names to opinions on this occasion at least.

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1. P.R.O., Cab.23/30, Cabinet meeting 29(22), 23 May, 1922.

2. Ibid.

3. Ibid., Cabinet meetings 36(22), 30 June, 1922, 38(22), 7 July, 1922, 40(22), 20 July, 1922.

4. Ibid., Cabinet meeting 40(22), 20 July, 1922.

5. Ibid.

6. Ibid., Cabinet meeting 42(22), 25 July, 1922.

In 1920 the principal proponents of the 'hard line' with regard to our Continental Allies had been Lloyd George and Churchill. The discussion in 1922 showed the same pattern; neither seems to have changed their views at all.<sup>1</sup> The supporters of more generous terms had in 1920 been Austen Chamberlain, backed by the Treasury, and Curzon at the Foreign Office. In 1922 Curzon was away ill, leaving Lord Balfour in temporary charge at the Foreign Office. Balfour was largely in favour of the policy of Lloyd George. Austen Chamberlain, by this time Lord Privy Seal, still strenuously opposed anything but unilateral cancellation by a 'beau geste'. The Chancellor of the Exchequer was in favour of a funding mission, but was very wary of the attempts being made by Lloyd George in particular to 'shame' America into behaving more liberally. Thus once again the Ministers who were to some extent influenced by the Treasury took a more liberal, and at once more realistic line than the rest of the Cabinet.<sup>2</sup>

During the earlier discussions in May and June<sup>3</sup> Horne, the Chancellor of the Exchequer, had deprecated any suggestion that America should be held up to obloquy in the despatch which it was proposed to send to our debtors, and he was not happy with the first draft which Balfour presented to the Cabinet.<sup>4</sup> Backed by Sir Auckland Geddes, Ambassador to Washington, who was present at and made a considerable contribution to the second meeting at which the draft was discussed, the Cabinet decided to allow these two to assist Balfour in vetting the document for any phrases that

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1. In addition to his natural inclinations, Churchill's support of Lloyd George at this time probably owes something to the pact between himself, Lord Birkenhead and Lloyd George. See Lord Beaverbrook, The Decline and Fall of Lloyd George (London: Collins, 1963), p. 101-2.
  2. P.R.O., Cab.23/30, Cabinet meeting 36(22), 30 June, 1922.
  3. See above, pp. 244-250.
  4. P.R.O., Cab.23/30, Cabinet meetings 36(22), 30 June, 1922, 38(22), 7 July, 1922.

might be taken amiss by American opinion.<sup>1</sup> As a result, one important change was made, in the penultimate sentence of the Note. This had earlier read:

"They [the British Government] content themselves with saying that, so deeply are they convinced of the economic injury inflicted on the world by the existing state of things that, if any general plan were proposed by which the question could be dealt with as a whole, Great Britain would be prepared for her part to abandon any claim to repayment of the loans she has made, and all her rights in German reparation, provided similar treatment was meted out to her."<sup>2</sup>

The crucial phrase was, of course, contained in the last eight words of the passage quoted. The moral blackmail on the United States would have been much resented by her, as indeed the implication of it alone was to be, to a lesser extent.<sup>3</sup> Geddes and Horne insisted that this be changed, so as to imply that a general settlement involving cancellation might be possible even if the Americans were not prepared to co-operate. The sentence as finally drafted read:

"They content themselves with saying that, so deeply are they convinced of the economic injury inflicted on the world by the existing state of things that, Great Britain for her part (subject to the just claims of other parts of the Empire) would be prepared to abandon all her rights to German reparation and all her claims to repayment by her Allies, provided that some general plan were proposed by which this great question could be dealt with satisfactorily as a whole."<sup>4</sup>

In addition to the discussion in the Cabinet, and the opposition of Chamberlain and Horne to his policy, Lloyd George had other dissenters to contend with. His own private secretary, Sir Edward Grigg, was firmly in favour of Britain being an 'honest debtor' vis-a-vis the Americans, and a magnanimous victor and ally to the Continental countries, along the lines of Blackett's 'beau geste'. He wrote a letter to the Prime Minister on the subject on July 7th, supporting Blackett and suggesting that City opinion enthusiastically concurred with his ideas.

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1. P.R.O., Cab.23/30, Cabinet meeting 38/22, 7 July, 1922.
  2. Ibid., Appendix III.
  3. See below, p. 262.
  4. P.R.O., Cab.24/138, C.P.4112, 17 Feb., 1922, p.4.

The substance of Grigg's thesis was that the Americans regard us as both a superior and a clever people: the former is one reason why they lent us so much in the first place, rather than doing more lending direct to the Allies;<sup>1</sup> the latter is responsible for the fact that they did not trust us diplomatically to be plain-speaking, and would not believe our pleas of poverty. He suggested that all mention of the United States should be removed from the Balfour Note, and we should send a copy to the United States accompanied by a letter offering to send a funding mission at once. Grigg regarded any suggestion of default with horror:

"...not to fund and pay it [the U.S. debt] would be a blow to British credit and a slur on British character almost as intolerable as if we had shirked the War in 1914."<sup>2</sup>

He talked in terms of 'demeaning ourselves by saying our credit is dependent on the European bankrupts'. He believed that what he calls 'manoeuvring' - the policy advocated by Churchill and Lloyd George - is not worth it either from a moral or a financial standpoint.

"Blackett tells me that the whole City would rather pay every penny of our debt than face the loss of credit of trying to manoeuvre ourselves out of it."<sup>2</sup>

On the subject of the Allied debts, he said:

"Everyone knows we do not mean to collect them...we can fairly therefore use them to set an example and give a lead. That is the only kind of appeal to which the U.S.A. will respond...this is a question in which the City of London, that fortress of reaction, actually desires and demands the liberal course!"<sup>2</sup>

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1. Britain had always asserted that the only reason we needed to borrow in the United States was because the Allies borrowed so much from us. In a sense this is true, since Britain was a net creditor on War account; but the Allies borrowed from us to purchase supplies here, in sterling, while we borrowed dollars from the United States to purchase supplies there, so a further problem might have resulted even if the Allies had been more solvent.
  2. Lloyd George Papers, F/86/2/4, 7 July, 1922. This correspondence, together with the editorials of the time, seem to dispose of the suggestion that City anger at the Balfour note was due to the fact that the bankers expected still to wring large sums from Europe. See W.N. Medlicott, British Foreign Policy Since Versailles, 1919-1963 (2nd edn; London: Methuen & Co., 1968), pp.45-49.

Grigg was so sure of the importance of his views that he took the unusual step, after informing his chief that he was doing so, of sending a copy of his memorandum to Lord Balfour, with a covering note, in which he emphasised that, by manoeuvring,

"we present ourselves to Europe and to the U.S.A. as an insincere and dishonest middleman, at a moment when a great example is the only chance of saving collapse -- not to say the only course worthy of a great nation."<sup>1</sup>

He went on to repeat that in reality we did not intend to collect the debts of the Allies, and we did mean to pay the United States.

"We are therefore abandoning the great and generous line, not to avoid any real loss or danger, but simply in order to manoeuvre."<sup>1</sup>

As might be expected, Sir Basil Blackett was a strong critic of the policy outlined in the Balfour Note. He was apparently not available at the Treasury in May to assist in the briefing of the Chancellor -- the relevant memoranda<sup>2</sup> were submitted through Niemeyer, who was to succeed Blackett as Controller later in the year -- but in July Blackett wrote direct to Lloyd George on the subject.<sup>3</sup> He also, as we have seen, made his views plain to Lloyd George's private secretary.

Blackett's memorandum is a sound and reasoned critique of the Balfour Note, as different from Grigg's impassioned pleading as it would be possible to imagine, and yet by no means lacking in warmth and sincerity. He appealed to Lloyd George to reconsider the Cabinet decision which led to the first draft of the Note. He regarded the policy as fundamentally insincere, since it could not be carried out, and suggested that there were two choices, and two only, facing the Government. Either Britain could agree to fund and pay the United States debt, leaving her a free hand to deal with Europe; or she could say that she cannot deal with the

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1. Lloyd George Papers, F/86/2/5, 8 July, 1922.

2. P.R.O., T.172/1288.

3. Lloyd George Papers, F/86/2/8, 12 July, 1922.

United States debt separately from the whole inter-Allied debt structure. The policy set out in the Balfour Note was a third line, and an impossible one. The Note said, we will only attempt to collect from our Allies what we need in order to pay the Americans what they demand from us. But, Blakett asserted, we cannot collect from the Allies what we owe America. Even assuming a favourable funding of the United States debt, we could not have expected better terms than to pay £850 million at  $4\frac{1}{2}\%$  over 25 years.<sup>1</sup> This meant an annual payment of £57 million. Even if the United States were content to receive payments over fifty years, this would still involve an annual payment of £43 million.

Thus even on the most favourable assumptions, Britain was committed by the Note to demanding £43 million each year from the Continent. France was already committed to demanding £1,500 million from the Germans for herself, to cover sums already laid out in costs of occupation and of repairing the devastated areas; without the receipt of this sum the French budget could never be balanced. Thus Germany would in any case be liable for this £1,500 million. In addition, the Allies would say that they could not pay anything to Britain unless they first receive reparation from Germany of the same amount. Thus the Germans would be liable for the French £1,500 million, and for the £850 million Britain was demanding. Making a moderate allowance for other claims this gave a total of about £2,750 million. This does not include any provision for Continental debt to the United States. But this figure alone would require annual payments by Germany of £184 million over 25 years, or £139 million over 50 years.

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1. The settlement eventually reached involved us in an annual payment of £33 million for the first ten years and £38 million thereafter. But this simply involves reducing Blakett's estimates of the Germans' consequent liability by £10 million p.a., not a considerable sum in the context. See Sir Albert Feavearyear, The Pound Sterling (2nd edn; Oxford: Clarendon Press, 1963), p. 357.

Blackett went on to point out that even the present Schedule of Payments did not demand a sum as large as £184 million in the years before German exports revive; and the smaller sum was only a little smaller than the sum due in the current year, which was proving quite beyond German capacity. Since, he said, we are committed to persuading the French to accept a big reduction in reparations payments in the interests of European civilisation, could we really pretend to expect Europe to pay over the equivalent of our debts to the United States? But this question of the financial feasibility of the Balfour Note in the absence of American concessions had not really been discussed by Cabinet. It was becoming clearer that the Note was really a version of the 'Big Stick': to be used to belabour American meanness on the one hand, and French selfishness over reparations on the other. Blackett regarded this attitude as wholly mistaken and likely to have harmful effects.

"A sincere policy of funding our debt to the U.S.A. preparatory to a settlement with Europe designed to rescue Europe from Chaos might well bring the U.S.A. in to our help. An insincere policy will have the reverse effect. And if we really mean to try and save Europe and are merely venting our preliminary grumble before doing so, is it worth while to begin by pillorying American selfishness?"<sup>1</sup>

Thus when the Cabinet discussed the matter again at length at the end of July, Lloyd George had before him not only the advice of his Cabinet, but also that of some influential outsiders. In addition, as we have noted, there was the influence of the fall in the German mark, which had become serious; from 771 to the pound on January 1st 1922 it had fallen to 1188 by June 1st, 1750 by July 1st, and during July and August experienced another catastrophic fall to 5725 on September 1st. By the end of the year it had fallen to 3400<sup>0</sup>/<sub>2</sub>. Thus the problem of European reconstruction had reached a critical stage. But it is apparent

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1. Lloyd George Papers, F/86/2/8, 12 July, 1922.
  2. P.R.O., Cab.24/140, C.P.4348, 5 Dec., 1922, p.2.

from the Cabinet's deliberations that the combined effect of all these influences had had no effect at all on Lloyd George.<sup>1</sup>

Lord Balfour began the discussion by saying that there had originally been unanimous approval of the policy of the Balfour Note, but subsequently there had been some doubts, partly about the wisdom of this method of treating America, and partly because of the current position of the mark.<sup>2</sup> Horne objected to this, saying that he had always been in favour of treating American demands on a basis of equality, and not pleading poverty; but he had been alone in his opinion, Chamberlain being absent on that occasion, and since the policy had been accepted by the Cabinet he had confined further criticism to the exact form of the draft dispatch. Horne went on to say that he regarded Lloyd George's avowed determination to 'rebuke' America as a profound mistake, and likely to have serious effects on public opinion there.<sup>3</sup>

Horne then went on to say that he felt that the fall in the mark profoundly affected the situation. It made it still more imperative that we should persuade the French to scale down the reparation demands; but the French would retort that they cannot let Germany off if they are expected to pay Britain and America.

"In effect Germany would become the sole debtor, and her position would be made much worse. The Mark would fall still further, and we should see Germany travelling in the track of Austria."<sup>4</sup>

Lloyd George's reply to this was that if that happened, America would be primarily responsible. But Horne stressed that in his view the American bankers cared little for Europe, and the policy embodied in the despatch would make the situation infinitely worse.<sup>5</sup>

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1. P.R.O., Cab.23/30, Cabinet meeting 42(22), 25 July, 1922.

2. Ibid.

3. Ibid.

4. Ibid.

5. Ibid.

At this point Churchill saw fit to remind the Cabinet that the policy itself had already been discussed twice and approved by an overwhelming majority. The first part of the policy, that of informing Washington that we intended to send a funding mission in September, had already been carried out. He thought it hardly satisfactory that the despatch, which constituted the second part, and an integral one, of the same policy, had been withheld. He did not agree that the despatch would have any harmful effect, other than causing a little irritation to the Americans at first. He urged the Cabinet not to go back on the policy:

"It would be a cruel wrong to the British people to force them to give up all that was owing to them while at the same time compelling them to pay every farthing they owed."<sup>1</sup>

On this occasion Chamberlain, by now Privy Seal, was present; and he backed Horne to the hilt. He said that he fully agreed with his colleagues in their dislike of the American attitude. It was selfish, even insolent. But it would not change overnight.

"We had invited the United States to join in a general treatment of the problem. They had refused, and had declared that it was not their policy to do so; it was the duty of borrowers to pay..."<sup>2</sup>

Having made this suggestion and had it rejected, Chamberlain regarded it as undignified and incompatible with our position as a world power

"...to ask again, and as a favour, what had been refused to us when advanced in the interests of world peace."<sup>3</sup>

In addition, Chamberlain was afraid that, unless the idea of remission came at the Americans' own instigation, life would not be worth living, since it would be possible

"...for Americans on every suitable occasion in future to boast that they had let us off."<sup>4</sup>

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1. P.R.O., Cab.23/30, Cabinet meeting 42(22), 25 July 1922.
  2. Ibid.
  3. Ibid.
  4. Ibid.

He thought that the subsequent loss of credit would be disastrous. He also thought that the despatch would have a serious effect on public opinion in the United States, and in Europe. Far from being grateful at being let off part of their debt, he thought that the attitude of the European Allies would be similar to ours to the United States, but with added bitterness. He agreed with the Chancellor of the Exchequer that publication of the despatch would add to the disasters of Europe.

"We would be regarded as gibbeting the United States before the world. They might deserve that, but it was a mad policy to pursue; it would destroy our good relations with the United States, and would increase the dislike (already considerable) felt for England in France and Italy."<sup>1</sup>

Lloyd George, however, while conceding that it was sensible to discuss the policy of the Note itself again in the light of the currency crisis in Germany, stated that his view had not altered at all. He felt it should be made clear the extent to which we were being generous to Europe, and that we should stand up to America and state the situation exactly as we saw it. Nothing was to be gained by cringing. Nor was it fair to allow the British people to undergo penal levels of taxation while the European Allies got off scot-free; he was not convinced that we should not get something from France.

"...our policy should be put forward as an attempt to wipe out international indebtedness in order to give the world a fresh start. The Americans were ignorant of some of the great facts of the War. They had no idea of the magnitude of the war effort of the Allies...The publication of this document, and the controversy to which it would give rise, would have important educational results on American opinion."<sup>2</sup>

Unfortunately, Lloyd George and Churchill, with their arguments about equity, were missing the point. Everyone agreed that the behaviour of America was selfish, and that the French were making a very bad job of acting the poverty-stricken indigent. That was not in dispute. But

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1. P.R.O., Cab.23/30, Cabinet meeting 42(22), 25 July, 1922.

2. Ibid.

Britain had done all she could to influence these nations to her way of thinking, without success. The only hope was for Britain to espouse a policy which did not depend on the other Allies for success. Be that as it may, the Cabinet was influenced by Lloyd George and Churchill, not by Horne and Chamberlain, and the draft despatch was approved, subject to certain minor amendments aimed at toning down the references to the United States and at stressing the amount which Britain was in fact remitting. However, Sir Robert Horne and Austen Chamberlain asked that their disapproval be formally recorded.<sup>1</sup>

The despatch was published on the 1st of August, and reactions from British and foreign sources were quickly forthcoming. On the whole the Note was universally ill-received, although European reaction was somewhat modified later.<sup>2</sup> The French continued to insist that the claims of the Devastated areas ought to come before there was any question of repaying Allied debt incurred for the common cause. The Italians continued to press for all-round cancellation with or without the United States. There is some evidence that American attitudes towards the British hardened following the Note, and one correspondent reported that while it was becoming clear to the Americans that the debt of the Continental Allies was a write-off, that of Britain was not so regarded, and it was important for the British Government to realise this.<sup>3</sup>

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1. P.R.O., Cab.23/30, Cabinet meeting 42(22), 25 July, 1922. The despatch was published in this country as Cmd.1737 (London:H.M.S.O.,1922).
  2. P.R.O., T.160/114/4399/1.
  3. Times, 3 Aug., 1922. Lloyd George had had an early indication of the acclaim which unilateral cancellation might have brought him. Apparently a report that Britain was proposing to remit some Allied debt in return for a reduction in reparation demands reached America early in July 1922, and was hailed enthusiastically by the American press. The Globe said: "with one magnificent stroke Great Britain has cut through the web of hatred, selfishness which is keeping Europe prostrate". Lloyd George Papers, F/86/5/7.

In Britain, criticism centred on the implication that America was being pilloried. The Economist thought that the Note would have an unfavourable effect in America, since it placed at her door the responsibility for all-round cancellation. It would have been better to cancel the Allied debt anyway, and hope for American clemency; the main thing was to get the tangle unravelled.<sup>1</sup> The leader writer thought that Lloyd George had missed an opportunity by tying everything to the United States debt, and that the Balfour Note was worse than useless in Lloyd George's interpretation.<sup>2</sup>

It is interesting to note that, while on the whole public opinion on reparations and inter-Allied debt seems to have mellowed between 1920, when the Blackett plan was first discussed, and 1922, when the Balfour Note was despatched, the attitude of Cabinet members had on the whole hardened. Blackett's plan was barely mentioned during the 1922 discussions; the Cabinet was unanimous except for Horne, and, when he was present, Sir Austen Chamberlain. It is possible that had Curzon's illness not removed him from the fray, in favour of Balfour, who applauded the Note which bears his name, the more liberal policy might at least have had a few more adherents. But it seems that the Cabinet was becoming increasingly impatient with the intransigence of its European Allies, particularly the French. The Cabinet's approach in 1920 had at least partly been distinguished by an eagerness to assist in European reconstruction for its own sake. By 1922, the mood had become one of disgruntled resignation to the importunities of the Continental Allies. For Blackett himself it must have been a considerable irony that one of his last acts as Controller of Finance, before leaving for India in October 1922, was to draw up a detailed memorandum to show the way in which the Balfour Note was to be implemented.

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1. Economist XCV, 5 Aug., 1923.

2. Ibid., 12 Aug., 1922.

As a counterpart to the Balfour Note, the Cabinet also agreed to send a funding mission to America, headed by the Chancellor, Horne. The fall of the Coalition in October, 1922, and the imminence of a General Election changed the situation, however, and in the event it was Baldwin, Chancellor in the new Conservative administration, who went to Washington<sup>1</sup>. He was accompanied by his private secretary from the Treasury, Grigg, and by another Treasury official, Ernest Rowe-Dutton, as well as by the Governor of the Bank, Montagu Norman. It is notable that the Treasury officials who accompanied the party were of junior status; the mission was to be conducted at Ministerial level, with the role of the officials being confined to the clarification of technical details when requested. In effect, the Departmental Treasury had no policy-making role to play at this stage.

Under the terms of the Funding Act, the American Debt Commission was authorised to negotiate funding at  $4\frac{1}{4}\%$  interest. Opinion in the Cabinet held that this was an inordinately high rate for a long-term loan of complete security, and indeed Bonar Law, the new Prime Minister, was encouraged by Harvey, the American Ambassador in London, to believe that the Commission might be prepared to disregard its instructions to the extent of negotiating a settlement on a  $2\frac{1}{2}\%$  basis. Accordingly, Bonar Law instructed Baldwin verbally to settle as he thought fit, provided the annual payment did not exceed £25 million.<sup>2</sup>

The mission formally consisted of Baldwin, Norman and Geddes, the British Ambassador in Washington. At the early meetings with the Commission, the atmosphere was relatively favourable, and Geddes told Baldwin that he thought the Commission might be prepared to agree to an annuity of about £30 million. Baldwin telegraphed

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1. P.R.O., T.172/1288.

2. J. Barnes and K. Middlemass, Baldwin (London: Weidenfeld and Nicolson, 1969), p. 136.

Bonar Law for authority to agree to such a proposal, since it was £5 million more than Bonar Law had originally suggested.<sup>1</sup> Bonar Law agreed, on condition that the period of payment was not more than fifty years.<sup>2</sup>

Informal discussions and meetings continued for several days, until on the 12th of January the Commission announced that it had a definite offer to make. This involved an interest rate of  $3\frac{1}{2}\%$ , together with amortization of the principal over 61 years, making an annual payment of \$181 million for 61 years. Baldwin told the Commission that he had been given authorisation to agree to a maximum annual payment of \$140 million, and that if the Commission could not make a better offer he would have to consult further with London.<sup>3</sup>

Bonar Law's reply, when Baldwin told him of the Commission's offer, was unyielding. He felt that the terms were quite unreasonable, both as between two friendly nations, and as between debtor and creditor, and that the proposal was more harsh than a commercial firm would have employed with a customer. He concluded,

"If a settlement is not obtainable on terms which seem to us reasonable, you have no alternative but to ask for further time for consideration and return."<sup>4</sup>

Baldwin was most unwilling to leave matters in this state, because he believed it would be disastrous if negotiations were broken off at that point. He had further discussions with Geddes and Norman, from which it emerged that Geddes believed the Commission might go as far as a 3% basis with 66 years amortization. Baldwin thought that he should be authorised to proceed on that basis, and that even if the Commission refused to accept this proposal it was one which would seem fair to most Americans, and would enable the mission to withdraw honourably and without danger of damaging relations between Britain and the United States. He accordingly telegraphed Baldwin to ask for his agreement to this plan.<sup>5</sup>

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1. P.R.O., T.160/365/557/1, Baldwin to Bonar Law, 8 Jan., 1923.

2. Ibid., Bonar Law to Baldwin, 9 Jan., 1923.

3. Ibid., Baldwin to Bonar Law, 12 Jan., 1923.

4. Ibid., Bonar Law to Baldwin, 13 Jan., 1923.

5. Ibid., Baldwin to Bonar Law, 13 Jan., 1923.

Bonar Law was unable to call a Cabinet in time to reply to Baldwin's request before the next meeting with the Commission. He did, however, agree to put the proposal to the Cabinet if in addition the arrears of interest were remitted. But he was reluctant to go even this far:

"...I believe we both think the proposal is most ungenerous, we might easily pay too big a price for a momentary increase in goodwill between the countries...There would also be the strongest possible objection to making such a proposal unless it were certain to be accepted as it would be almost impossible to attempt to improve it in the future. For this reason if you are not to succeed would it not be better to end (the) discussion on their proposal rather than commit ourselves to (a) plan."<sup>1</sup>

On receiving this telegram, Baldwin had a private conversation with Mellon, the Secretary to the American Treasury, and on his advice made a formal proposal to the Commission on the basis of Bonar Law's authorisation. The Commission, however, would reduce the rate of interest from  $3\frac{1}{2}\%$  to  $3\%$  for the first ten years only, and the only other concession they made was to offer to recalculate the back interest at  $4\frac{1}{4}\%$  instead of  $5\%$ , whereas Bonar Law had proposed that it should be remitted altogether. Baldwin, however, agreed with his colleagues that these were the best terms which they could hope for, and recommended their acceptance to Bonar Law.<sup>2</sup>

Bonar Law's reply, which had the support of the small group of the Cabinet which was all that could be called in the time available, was wholeheartedly against acceptance. He told Baldwin that the Cabinet had decided to instruct him:

"...to inform the American Government that the terms which they put forward go far beyond anything contemplated by you when you left England, and that you are not empowered to accept them, but that you must return at once to discuss the matter with His Majesty's Government in person."<sup>3</sup>

In a private telegram sent the same day, Bonar Law urged Baldwin not to defer too much to the Americans:

"Is it not possible that you are too much under the influence of Washington which is not even the New York atmosphere? What would you have thought of such proposals before you left?"<sup>4</sup>

1. P.R.O., T.160/365/557/1, Bonar Law to Baldwin, 13 Jan., 1923.
2. Ibid., Baldwin to Bonar Law, 15 Jan., 1923.
3. Ibid., Bonar Law to Baldwin, 16 Jan., 1923.
4. Barnes and Middlemass, Baldwin, p. 142.

It was impossible for Baldwin to ignore such explicit instructions, and he conveyed them to the Commission. It was decided that Baldwin should state formally at the next meeting of the Commission that he wished discussions to be adjourned while he returned home for discussions with the Cabinet. The mission left for home on the 20th of January. When the boat docked at Southampton, Baldwin was assailed by journalists with a multitude of questions, and, whether through inexperience or naivety, was more frank than was advisable, both about the stage negotiations had reached and about the vagaries of American opinion. This, together with the fact that the terms finally offered by the Commission had been made public in America, served to harden the situation and to put the British Government in a rather difficult position.<sup>1</sup>

On his return, Baldwin had a private interview with Bonar Law attended only by Harvey, the American ambassador; apparently Baldwin made no attempt to defend himself or his actions, and was silent virtually throughout. The formal discussion with the Cabinet came a little later. No official record was kept of this meeting; the Cabinet minutes merely record the fact that discussion took place.<sup>2</sup> But Viscount Davidson, then J.C.T. Davidson, Bonar Law's private secretary, has given an account of the proceedings.<sup>3</sup>

The majority of the Cabinet felt that the settlement was the best that was likely to be obtained, and supported Baldwin in his wish to accept the proposals. Bonar Law found himself almost alone in his opposition, but made it clear that he would resign if his colleagues insisted on the settlement. Eventually the discussion was adjourned until the following day.

The next morning, the whole Cabinet with the exception of Bonar Law met in Lord Cave's room at the House of Lords; the Ministers were almost unanimous that default on the debt would now be even more serious than Bonar Law's resignation,

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1. Barnes and Middlemass, Baldwin, pp. 143-4.

2. P.R.O., Cab. 23/45, Minutes of Cabinet meeting (6)23.

3. Barnes and Middlemass, op. cit., p. 144.

and since default was the only real alternative to accepting Baldwin's settlement, the difficulties which would follow Bonar Law's resignation would have to be faced. A small group was deputed to go and see Bonar Law and tell him of the feeling of his colleagues, and to try to persuade him not to resign. Bonar Law relented, partly on the recommendation of McKenna, who had originally advised against accepting the settlement, and then changed his mind on the grounds that City opinion was strongly in favour.<sup>1</sup> Bonar Law, however, took the unprecedented step of bitterly attacking the policy of his own government in an anonymous letter to the Times.<sup>2</sup>

In the event, it has been estimated that Britain was the only Allied country to pay out more than she received on account of war debt. The funding mission of 1923 committed Britain to paying £33 million annually for the first ten years and £38 million annually for the next fifty-one years.<sup>3</sup> When Britain's debtors finally settled up their payments gave rise to an annual flow of £42 million, so that when these payments were at their height Britain had a small surplus on this account. But since Britain started paying first, overall she paid out approximately £134 million more than she received, whereas France benefitted on balance by about £163 million.<sup>4</sup>

As for the Americans themselves, their heavy investments in Germany in the nineteen-twenties permitted the flow of reparation payments, and default was postponed until indemnity payments were finally repudiated by Hitler in 1933. Throughout the period 1924-32 Germany was receiving large sums of long-term capital, and until 1929, except for 1926, she was a net receiver of short-term capital as well. The inflow reached a peak in 1927 and 1928, when receipts of about \$1,000 million of short- and long-term capital were recorded.<sup>5</sup> The United

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1. Barnes and Middlemass, Baldwin, p. 147.

2. A.J.P. Taylor, English History 1914-1945 (Oxford: Clarendon Press, 1965), p. 203.

3. Feavearyear, The Pound Sterling, p. 357.

4. A. Youngson, The British Economy 1920-57 (London: George Allen and Unwin, 1960), p. 52.

5. International Capital Movements during the Inter-War Period (New York: United Nations, 1949), p. 19.

States was a net lender almost throughout the 'twenties: in all the years 1924-8 her outflow of long-term capital exceeded \$500 million and in 1928 the total capital outflow was over \$1,100 million.<sup>1</sup> This despite the fact that during this period Britain and the Continental Allies repaid a total of about £450 million loaned to them by the United States.<sup>2</sup> Britain also consistently lost capital during this period; there was a net outflow in every year from 1924-30 except for 1926, the amounts varying from \$574 million in the highest year, 1929, to \$112 million in the lowest, 1930.<sup>3</sup> France also experienced a net outflow in every year from 1924-28.<sup>4</sup>

Thus throughout the nineteen-twenties, although there were some receipts from the Allies, on balance Britain paid out more than she gained, and in any case there was a considerable outflow of capital on other accounts as well. This was only possible because by 1924 she had brought her current account back into the healthy surplus which it sustained in every year up to 1931, except, once again, for 1926, the year of the General Strike.<sup>5</sup> But it is arguable that the policy of all-round unilateral cancellation advocated by the Treasury and the Chancellors of the Exchequer would probably have cost Britain no more in money terms, and would certainly have contributed much to the restoration of Europe. It is certainly feasible to maintain that the fact of being forced to make large reparation payments, which were only in fact possible because of American loans, had a disastrous effect on the reputation and coherence of the embryonic democratic government in Germany.

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1. International Capital Movements during the Inter-War Period, p. 18.

2. A. Youngson, The British Economy 1920-57, p. 52.

3. International Capital Movements, p. 19.

4. Ibid.

5. Ibid.

CHAPTER SIX

DEBT REDEMPTION AND INTEREST RATE POLICY

1920-5

## Treasury Monetary Policy after the War

One of the most notable changes brought about by the war in the financial and economic fields was the enormous increase in Government influence on monetary policy. Before the war governments really had no need of a monetary policy as such;<sup>1</sup> changes in Bank Rate were a matter for the Bank alone, and the volume of central government debt was very small.<sup>2</sup> The floating debt in particular was of insignificant size.<sup>3</sup> The course of the war wrought a complete change in this picture. Not only did the size of the National Debt increase to ten times its pre-war figure, and the floating debt rise from £15 million in Treasury Bills at the outbreak of the war to £1,095 million in Treasury Bills and £455 million in Ways and Means advances by December 31st, 1918.<sup>4</sup> In addition, the methods by which the National Debt was managed operated to make Bank Rate ineffective, since interest levels tended to relate rather to the Treasury Bill rate while these were being issued on tap; this practice continued in full until April 1921, for 12-month Bills until August 1921, and in a minor way which made it much less important for rate structure throughout the inter-war period.<sup>5</sup> Thus the Government became the largest single borrower in the market and the effective arbiter of money rates in the post-war period.

Government operations in the market tended to be governed principally by the idea that this all-importance of government policy in this field was a temporary phenomenon, and that the sooner conditions returned to normal the better. In this field as in the other areas of economic life, Government and Treasury policy was devoted to a 'return to normalcy'.

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1. U. Hicks, The Finance of British Government 1920-1938 (London:O.U.P., 1938), p.310.
  2. Total debt outstanding on 31 Mar., 1914 was £649,800,000. E.V.Morgan, Studies in British Financial Policy 1914-25 (London:Macmillan & Co., 1952), p.107.
  3. £13 million on 31 Mar., 1914. Ibid., p.107.
  4. Economist (London:1919), Vol.LXXXVIII, 4 Jan., 1919.
  5. Morgan, op.cit., p.146.

It was of course realised firstly that repayment on a really large scale of the total war debt was not a practicable possibility in the very near future, and that Government stocks would continue to form a large part of any investor's portfolio for some time to come, and secondly that any attempt at rapid repayment would have disastrous consequences and might lead to a financial panic. But the main aims of debt policy in the period 1920-5, of funding or repaying the floating debt, and of converting the large quantities of short-dated stock into longer-term securities, not only satisfied the Treasury's desire to ease its own burden of debt management, but also conformed to another purpose which the central monetary authorities felt strongly about; that is, the bringing about of deflation of the currency and of credit. The two were of course inter-dependent; repayment of the floating debt would per se reduce the credit base and thus the volume of credit; and this was recognised by the Treasury officials. As we have seen, they were alive to the dangers of too hasty a deflation, although they varied in the importance they gave to this problem.<sup>1</sup> But their desire for deflation as a good thing in itself reinforced their natural wish to rid themselves of the cumbersome weight of floating debt.

One of the difficulties in discussing post-war deflation is that the terms inflation and deflation are often used in varying ways not only among the bankers but in the Treasury files. The most frequent confusion is between the symptoms and the causes of inflation. On the one hand, there is an instance of Blakett condemning any attempt to increase purchasing power (towards the end of 1921) because it would lead to inflation, by which he says he means rising prices. This despite the fact that the numbers of unemployed at this time make it clear that any rise in prices would be due to a temporary lag of production behind the

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1. See above, pp. 47, 49-50, 58.

increased demand, rather than a genuinely inflationary movement caused by too much purchasing power chasing too few goods in a situation where supply could not readily be increased.<sup>1</sup> On the other hand, in another memorandum evidence of the small decline in the total of currency notes and Bank deposits is adduced to show that there has been little or no deflation.<sup>2</sup> In the first instance the Treasury is concerned with what is really evidence of inflation, not inflation itself. In the second, it is concerned with an element in the causation of inflation, namely the quantity of purchasing power. It is clear that without a definition of inflation difficulties of exposition will arise, just as they did for the officials concerned. The definition used by the Economist in this period seems to be as useful as any; that inflation occurs when demand for goods and services, expressed in the tendering of purchasing power, exceeds supply, and deflation occurs in the reverse situation.<sup>3</sup> Increases in purchasing power or in its velocity of circulation, or decreases in the quantity of goods available, are a necessary concomitant of the process, of inflation, and rising prices are evidence that it is occurring.

The chief means by which deflation was to be accomplished were by reducing government expenditure to less than the revenue in order to achieve a budget surplus, to be used for debt redemption; and by high interest rates, that is by increasing the price of money. Deflation, bringing with it a fall in prices, was an essential plank in another government financial pre-occupation in the post-war period, the return to the Gold Standard; and one of the means by which deflation was to be

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1. P.R.O., T.172/1208, memo. by Blackett, dated 8 June, 1921.
  2. Ibid., memo. by Niemeyer on financial policy in response to a question by the Colonial Secretary, 5 Oct., 1921.
  3. Economist, Vol.LXXXVI, 12 Jan., 1918.

achieved, dear money, was also an essential instrument in the policy of effecting the appreciation of the sterling exchange. Unfortunately the process of deflation increased the real burden of servicing the debt, and had the effect of throwing the burden of adjustment of prices onto those sections of the community who were, on the whole, least able to bear it, that is the wage and salary earners. For those whose income was fixed in money terms saw their income appreciate considerably during the post-war period. In addition, it seems probable that this deflation acted to depress industry in two main ways: firstly, a long period of falling prices did not encourage industrial optimism about the future course of demand and of profits; secondly, the fact that one important element in deflation involved a perpetuation and indeed an increase in the relative burden of debt service, which in turn meant a transfer of purchasing power from the poorer, consuming members of the community to the wealthier, investing members, implied that this lack of optimism about effective consumer demand would be justified.

Thus the main aims of Treasury monetary policy in the immediately post-war period were the reduction of debt, particularly the floating debt, and the funding of this floating debt and of the large amounts of short-dated securities outstanding at the end of the war, together with an adjustment of the price-level to bring it into line with the countries which remained on the Gold Standard, notably the United States. The deflationary effects of the first part of this policy, together with the high interest rates which were necessary for it to be achieved, were the main factors in the partial success of the second part of this policy. The third aim, to relieve the burden of debt service wherever possible by favourable conversions, took second place to the first two aims; and indeed the policy of deflation was partly in direct conflict with this aim, since deflation, depression and unemployment tended to depress the revenue at the same time as falls in the price level increased the real burden of debt service.

## The Influence of the Cunliffe Committee

The origins of the Treasury's monetary policy are to be found in the recommendations of the Cunliffe Committee, but these were reinforced not only by Treasury officials' own opinions and experience, but by virtually all those, both in Parliament and outside, who commented on the question. Stanley Baldwin, speaking in the House of Commons in July 1919, told Members that the Government was aware of the importance of checking currency and credit expansion, and that no further investigations into the subject (the setting up of a Select Committee of the House had been suggested) were necessary.

"The principles on which the matter must be dealt with are, I think, generally understood and agreed, and the questions for decision are how and when and to what extent the necessary measures should be applied, regard being had to the conditions of credit, trade and industry, from time to time."<sup>1</sup>

Endorsement of government deflationary policy was common in the speeches of Members of Parliament on the need for economy and for reductions in government expenditure, which are so notable a feature of Parliamentary and public debate immediately after the war. The representatives of commercial interests were of course anxious that business credit should not be restricted if possible, but all were united in condemning government waste and further expansion of the floating debt. Outside Parliament the story was much the same. A leading article in the Economist, written in November 1919 after an announcement that the Budget for 1919-20 was not being balanced and that further borrowing would be necessary, was highly critical of government inaction over inflation:

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1. H. of C. Debates, 1919, Vol. CXVIII, col.1814, 28 July, 1919.

"What is wanted is real control over the money market, and a restoration of the system under which a limit could be placed on the expansion of credit. When we had a gold standard, and a really convertible currency, that limit was imposed by the gold stock. Now our credit system is based upon the inability of the Government to pay its way, and on the enormous power which the huge mass of floating debt gives to the banks to call for fresh legal tender currency, by demanding repayment of maturing Treasury Bills. The Chancellor of the Exchequer has told the House that he intends to finance his deficit by increasing the floating debt. As long as he is allowed to continue this wastrel's course, rises in Bank Rate can do little good, and will certainly do harm."<sup>1</sup>

To begin with, the Government was wary of proceeding too fast, and in particular was unwilling to pay much attention to the problem of deflation during the period of dislocation immediately following the Armistice.

Chamberlain, in his speech on the Budget in 1919, said:

"Lord Cunliffe's Committee, which examined the problem very completely and came to conclusions which, if they err, do not err on the side of heterodoxy, clearly recognised that a policy of drastic currency restriction is impracticable until the conclusion of the period of demobilisation and the cessation of war borrowing."<sup>2</sup>

Treasury officials, too, were aware of the dangers inherent in too speedy a deflation. An unsigned memorandum, written as late as November 1919, demonstrates this point:

"The governing factor [in inflation] is the creation of credit; once the credit is there, it can be turned into legal tender on demand, and the banks must be supplied with the money they need. If their requirements are to be reduced, the very delicate operation of a contraction of credit must be entered upon. To effect this too suddenly might be disastrous. A collapse of values, bringing widespread bankruptcy and extensive unemployment, would be too heavy a price to pay."<sup>3</sup>

In the same memorandum it is noted that a fall in prices can be effected as well by increasing production as by curtailing purchasing power, and in this connection the experience of the United States after the Civil

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1. Economist, Vol. LXXXIX, 8 Nov., 1919.
  2. P.R.O., T.171/156.
  3. P.R.O., T.171/171, dated 26 Nov., 1919. The reference in the last sentences is to the Gold Standard; deflation and a fall in prices were essential to its restoration.

War is cited, when America achieved an improvement in the dollar exchange from a 30% discount to par without restricting currency but by stimulating increased production.<sup>1</sup>

#### Changes in Attitude during the Post-War Boom

But the events of early 1920, when it had become apparent that the post-war boom was reaching fever-pitch, altered the situation. By March 1920 the Treasury's anxiety over the inflationary situation was considerable, and Chamberlain was appealing for, and apparently getting, the help of the bankers in controlling the situation.<sup>2</sup>

"That brings me to the fact that I require co-operation in every quarter in order to maintain the policy on which the Government have set their hearts, of first stopping further inflation and then beginning gradually to deflate."<sup>3</sup>

The desire for deflation in order to reduce the price level was reinforced as far as its implications for debt management were concerned by the difficulties which the Treasury experienced in placing its Bills during the middle of 1920. The Treasury Bill rate was raised to 6½% in April 1920, yet despite this penal rate there was still considerable difficulty in placing all the Bills and Ways and Means advances remained alarmingly high.<sup>4</sup> From this point on the tone of Treasury comments on the situation became much more strongly deflationary, and even though some of the officials' utterances still indicate wariness over encouraging too drastic a deflation,<sup>5</sup> on the whole the difficulties over the floating debt weigh the most heavily on their minds. Their attitudes played a part in influencing the British policy on monetary problems as

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1. P.R.O., T.171/171.
  2. S. Harris, Monetary Problems of the British Empire (New York: Macmillan & Co., 1931), pp.179-180.
  3. H. of C. Debates, 1920, Vol.126, col.2075.
  4. Morgan, Studies in British Financial Policy 1914-1925, p.146.
  5. See, for example, Blakett's evidence to the Committee on War Wealth, H. of C. Papers, 1920, No. 102 (London:H.M.S.O., 1920), Q.1546.

outlined at the Brussels Conference in October 1920, and the Recommendations of that Conference were orthodox in the extreme. Floating debt must be funded, inflation arrested, a gold standard restored wherever possible, and most important, Governments must never forget that a country which has a Budget deficit is

"treading the slippery path which leads to general ruin."<sup>1</sup>

The Conference also urged care with policies of deflation. By this time the British Government was beginning to feel that this was an important point. In December 1920, Chamberlain, answering a question in the House on inflation, said:

"My policy, therefore, in that respect, is to avoid renewed inflation and, if it be in any way possible, gradually, very gradually, to deflate as opportunity offers, and as the conditions of the time permit with safety; and as regards debt reduction, my policy has been that when we could redeem debt, we should redeem all the debt that we could, just because I saw that the good times would not always last and that we must try and lighten the load before the bad times came upon us."<sup>2</sup>

The onset of the depression in the latter part of 1920 also toned down, as was to be expected, the general clamour for deflation, although on the whole falls in prices and the Government's attempts to reduce the debt were still welcomed by public opinion in general. There were, however, some dissident voices. As early as March 1920 an article was published in the Nation objecting to a policy of deflation brought about by the contraction of credit on the grounds firstly that falls in the price level would increase the real value of the National Debt and of the interest on it, and secondly that a reduction in economic activity would lead to a fall in revenue, which would make the burden of debt service and repayment still more onerous.<sup>3</sup> Reginald McKenna, addressing the General Meeting of the Midland Bank, of which he was chairman, in

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1. P.R.O., Cab.24/112, C.P.1967, p.6.

2. H. of C. Debates 1920, Vol.135, col.2495.

3. Nation (London 1920), Vol. XXV, 17 Mar., 1920.

January 1921, criticised the Treasury policy of deflation through dear money on the grounds that the preceding inflation was neither temporary nor due to rash behaviour by the financiers, but a permanent feature of the economy resulting from the war. To treat as a temporary inflation one which was in fact evidence of fundamental changes was inappropriate and harmful.<sup>1</sup> The force of McKenna's criticism is somewhat mitigated by the fact that at the time he spoke there was still some idea that it might be possible to aim at regaining, not only the same relative price level as we had had pre-war, that is to restore the sterling/dollar exchange to par, but the absolute price level of 1914, which would have meant a much more severe deflation than in fact occurred. But the principles behind his comments were on the whole sound.

However, in the early 1920s such voices were lone and faint; even Keynes, soon to be such a powerful opponent of deflation in inappropriate circumstances, was more concerned at this time with the problems of inflation abroad.<sup>2</sup> Treasury opinion continued to favour maintenance of the policy of debt redemption and deflation, even when the industrial situation became serious. This is demonstrated by a series of memoranda written in response to requests from the Chancellor as to the effects of deliberately inducing a mild inflation in order to reduce unemployment and increase production. This followed Lloyd George's conferences on the subject at Gairloch in the summer and early autumn of 1921.<sup>3</sup> One of the suggestions had been that the Government should undertake some borrowing in order to finance relief works. This suggestion was met by Niemeyer, at his most uncompromising, with strenuous objections, the

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1. Midland Bank Review (London:1921), Feb., 1921.
  2. Sir Roy Harrod, Life of John Maynard Keynes (London: Macmillan & Co., 1951), p.314.
  3. T. Jones, Whitehall Diary, Vol.I, 1916-1925, ed. K. Middlemass (London: O.U.P., 1969), pp.169-174.

chief of which was that the volume of debt which would mature in the near future was so great that considerable difficulty would be experienced in dealing with it, without making matters worse by trying to initiate new borrowing.<sup>1</sup> His opinion was reinforced by Blackett, in another paper written attacking a proposal to pump an additional £200 million of currency notes into circulation. This would of course have been an extremely clumsy way of trying to reflate, but Blackett's criticisms were equally applicable to any more sophisticated methods which might have been suggested. Blackett felt that such an increase in purchasing power would only result in a rise in production after the elapse of quite a considerable period of time. In the interval, he said, prices would rise, and imports would increase while exports would fall. This would lead to a depreciation of the exchange which would tend to counteract this movement, but the resulting increases in the prices of raw materials and of food would lead to wage demands which would set off a further price rise. Furthermore, Blackett suggested that the most difficult period of adjustment was nearly over, and that Government should 'stick to its guns', as trade revival was just round the corner.<sup>2</sup>

#### Effects of Treasury Policy

It has been suggested by some that Treasury policy was not responsible for any but a small part of the post-war deflation,<sup>3</sup> and more recently that they did not understand the extent to which a deflationary policy was inappropriate at a time of severe depression.<sup>4</sup> In view of the strongly deflationary tendencies inherent in Britain's overseas trade

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1. P.R.O., T.172/1208, memo. by Niemeyer on additional government borrowing, 10 Oct., 1921.
  2. Ibid., memo. by Blackett on currency expansion, 8 June, 1921.
  3. Harris, Monetary Problems of the British Empire, pp.175-176.
  4. Hicks, The Finance of British Government 1920-1936, pp.341-342. See also Morgan, Studies in British Financial Policy 1914-1925, pp.142-144.

position after the war it seems impossible to doubt that considerable difficulty would have been experienced in any case. But there seems little doubt that the almost uncontrolled release of internal purchasing power in 1919 and the early part of 1920, followed by the strong measures taken by the authorities in the early part of 1920, helped to make the depression more severe than it might have been, and it certainly seems clear that Treasury policy on the desirable course of price changes, and the continued stress on debt repayment, during the early 1920s, played a major part in prolonging the slump. The possibility that the officials did not know that they were pursuing a deflationary policy seems to be conclusively disproved by the evidence of the Treasury files. Hicks' criticism, that the Treasury continued to pursue a deflationary policy long after such action ceased to be appropriate, is in a sense justified. But there is one important point which should be remembered. The continuation of deflationary policies after the end of 1920 might well be judged quite wrong in the sense that contra-cyclical policy would have dictated the opposite course. But it is clear that to have pursued a contra-cyclical policy at this stage would have had the effect of retarding, perhaps preventing altogether, the fundamental alterations in the price level required for sterling to regain its pre-war parity with the dollar. It is indeed quite clear from the Treasury files that the officials were well aware that their policy would for the time being continue to make matters worse. But the eventual gain to the economy of regaining the Gold Standard would be worth the effort.

Evidence for this view is to be found in a file from which some comments have already been quoted. It contains memoranda written during the autumn of 1921 when the unemployment situation was giving rise to considerable concern, and various unorthodox methods of dealing with the situation were being proposed. The paper in question sets out the origins

of the current deflationary policy, identifying the main sources as the Reports of the Cunliffe Committee and of the Financial Facilities Committee, endorsed by the decisions of the Financial Conference at Brussels. This policy has as its central plank the aim of pursuing a slow deflation in order to restore the Gold Standard. Deflation is necessary to induce a fall in prices; this in turn will stimulate our exports and lead to an appreciation of the exchange. Any attempt to interfere with this process will lead to a return of inflation, and will retard the process of wage adjustment which is an essential ingredient of a falling price level. It is because this fall in wages and prices has not gone sufficiently far that unemployment exists.

"Experience has shown that the earnings of British industry are not sufficient to pay the present scale of wages all round. Consequently if present wages are maintained a certain fraction of the population must go without wages."<sup>1</sup>

In their attitude on this question the Treasury officials were at one with the official position of the Bank of England, as represented by the Governor, Montagu Norman. We have already seen how totally incapable he was of allowing decisions on finance and Gold Standard policy to be affected by considerations such as the volume of unemployment.<sup>2</sup> In so far as he regarded the domestic economy as being within his concern at all, he felt that the best thing for the economy would be for Britain to return to the Gold Standard. Prosperity would then return to the export industries, and the problem of unemployment would solve itself. During the autumn of 1921 Hilton Young, then Financial Secretary to the Treasury, was occupied, on Lloyd George's behalf, with sounding out opinion on the unemployment situation and on economic problems in general.<sup>3</sup> One of those

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1. P.R.O., T.172/1208, memo. by Niemeyer on financial policy in response to request for information from the Colonial Secretary, 5 Oct., 1921.
  2. See above, p. 108-9.
  3. Hilton Young was at this time acting as go-between from official circles in London to Lloyd George in Gairloch. See above, p. 279.

he consulted was Montagu Norman. The record of Young's conversation with him is preserved in the Treasury files, and it is an illuminating document. Young asked Norman for his views as to the causes of unemployment; Norman replied that they were the refusal of production costs to fall, resulting in a cheapening of exports, and the inability of Continental countries to buy because of reparations. If countries could get goods from Germany for next to nothing they would not pay inflated prices for our exports. Young asked why it would not be a good thing for Britain to gain advantages for her exports in the same way as Germany, that is by allowing the exchanges to depreciate. Norman replied:

"Why should you, by depressing the standard of living, diminish the economic efficiency and well-being of a whole people, in order to benefit a small unemployed proportion?"<sup>1</sup>

Since the fall in production costs which Norman said was essential could in his view only be brought about through falls in wages, there would be 'temporary' hardship not only for the unemployed, but also for other wage and salary-earners in the period in which prices were adjusting to the new lower wage levels, so his assessment is not entirely accurate. A policy which meant 'temporary' unemployment for some, and reduced wages for millions of others, in order to achieve an adjustment in relative international price-levels, did not go uncriticised entirely. Even the Economist, a staunch upholder of the financial orthodoxies most of the time, wrote in 1919:

"If it is a question of the gold standard, or of the standard of life of those who do the hardest, dreariest and dirtiest work for us - without which we could none of us live - the gold standard would have to go, unless by losing it we struck a blow at our commercial position which would, in the end, make their lot worse than before. Nobody favours the gold standard as an end in itself.

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1. P.R.O., T.172/1208, record of Hilton Young's conversation with Montagu Norman, appended to a letter to the Prime Minister at Gairloch, dated 27 Sep., 1921.

It is a piece of machinery by which some of us believe the national wealth is increased. If we are right, then its restoration will increase the fund out of which wage-earners can be paid better wages than they have earned in the past. But if its restoration means...that the wage-earners have to go back to something like the pre-war standard, in spite of all that we have learnt about our powers of production during the war, then it would seem that the gold standard must be a clog upon industry, and that the many advocates of its abolition are right."<sup>1</sup>

But there was little sympathy in the Treasury, and none at the Bank, for even this sort of mild scepticism about the mystical qualities of the Gold Standard. Still less attention was paid to the more determined critic, Reginald McKenna, who regularly expressed his doubts about the Gold Standard in his speeches, and who as chairman of the Midland Bank must have been a party to, if not the author of, the numerous leading articles in its monthly review on the subject. There is an interesting example in the issue of November 1923:

"Apparently any sacrifice, in the way of trade depression and social disorganisation, is not too big a price to pay for the taking of a single step in the direction of parity with the dollar. If some magic power were attached to the ratio \$4.86 to the pound there might be good ground for holding such a view, but under present conditions any ratio, so long as it is moderately stable, is of equal practical utility."<sup>2</sup>

Be that as it may, deflation as an instrument in preparing the economy for the return to the Gold Standard at the pre-war parity, and brought about by a combination of high interest rates, and credit restriction through the contraction of the cash base and of liquidity, is the hallmark of Treasury policy in the 1920s. To the means by which this deflation was accomplished we must now turn.

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1. Economist, Vol.LXXXVIII, 26 Apr., 1919.
  2. Midland Bank Review, November-December, 1923.

## Government Borrowing During and Immediately After the War

There seems little room for argument in two assertions which can be made about Government finance during the war; that they made conditions after the war worse than they need have been, both by raising less of the cost of the war than they could or should have done by taxation, and that some of the methods by which borrowing was undertaken left a good deal to be desired in the context of their time of issue and of their post-war management. Over-all the Government financed less than a third of the cost of the war out of revenue, and the rest had to be found through borrowing. This had two main results; one was that the amount of borrowing that went on was needlessly large, and the other was that the practice of leaving large amounts of purchasing power in the hands of the public when production of consumer goods was sharply cut in order to devote the maximum resources to the production of war materials led to a considerable amount of inflation. Indeed, in a situation where the current account deficit on internal expenditure rose to one third of the national income in 1915-16 and to 40% in 1917-18 it could hardly be otherwise.<sup>1</sup>

The acceptance as inevitable of huge current account deficits came quite early in the war, and was enshrined in an interesting piece of dogma by McKenna in his Budget speech in April 1916. He based his Budget on the 'principle' that the revenue should be expected to cover the cost of pre-1914 expenditure plus the service of current debt and that to be incurred in the coming year.<sup>2</sup> So that a great burden of debt service and repayment was incurred, a good deal of it needlessly and even harmfully. Nor is this the verdict of hindsight; there was considerable criticism at the

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1. Morgan, Studies in British Financial Policy 1914-1925,

p. 105.

2. Ibid., p.92.

time of the extent to which the Government was mortgaging the future. For instance, McKenna received a deputation of leading bankers, traders and manufacturers at the Treasury in 1915 who urged drastic increases in taxation.<sup>1</sup> Several of the City journals urged this course, notably the Economist, which urged this course vigorously almost throughout the war, both in order to raise more revenue, and to check inflation. This criticism did not end with the war; as late as the Budget of 1920 this paper was criticising the Government for not increasing taxation sufficiently.<sup>2</sup>

Be that as it may, the problem which confronted the Treasury at the close of hostilities was a serious one. The total National Debt had risen from £649.8 million on March 31st 1914 to a total for the internal debt alone of £6142.1 million five years later. The value of Treasury Bills had risen from £13 million to £957 million, and temporary advances on Ways and Means from zero to £455 million, in the same period.<sup>3</sup> The first serious effort to reduce the large volume of floating debt, which was accompanied by the repayment of the banks' Special Deposits, followed the Funding Loan and Victory Bonds issue of June/July 1919. During the succeeding months considerable reductions were effected in the floating debt. This proved to be largely temporary, partly owing to the boom conditions in the market in the spring of 1920, and Treasury Bill borrowings remained at a high level until the summer of 1921.<sup>4</sup> In addition to the large volume of floating debt, the war-time policy of issuing whatever sort of securities seemed to be most likely to attract investors, without much planning of maturity dates and so on, had resulted in a large volume

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1. Midland Bank Review, June 1920, verbatim report of a speech by McKenna at the Annual Dinner of the National Union of Manufacturers.
  2. Economist, Vol.XC, 24 Apr., 1920.
  3. Morgan, Studies in British Financial Policy 1914-1925, p.139. See also below, Appendix, Table 4.
  4. Morgan, op.cit., p.147; see below, Appendix, Table 3.

of short- and medium-term debt which was to exercise the minds of the Treasury officials considerably during our period. In March 1919, the total of debt with a redemption date of not longer than nine years but not less than one was £1887.3 million. By 1925 it had been reduced to £1329.2 million, and the floating debt was less than half its March 1919 figure; while the figure for debt with maturity dates exceeding 20 years had risen by over £1,000 million.<sup>1</sup>

These operations did not, even when the small budget surpluses which were applied to actual redemption are taken into account, lead to a reduction in the nominal value of the debt; there was in fact a small increase, from £6142.0 million in March 1919 to £6524.8 million in March 1925.<sup>2</sup> The burden of debt service also rose, from £348.2 million in 1919-20 to £393.6 in 1924-5.<sup>3</sup> Since G.N.P. was falling at the time, from £5,860 million in 1919 to less than £4,500 million in every year from 1922 to 1925, the interest on the National Debt represented an increasingly large proportion of both government expenditure and of G.N.P. during the period 1919-1925.<sup>4</sup>

Thus the forms of Government borrowing underwent a substantial change during the years after the war; there was a much reduced reliance on floating debt than had been the case during the war, small Budget surpluses were encouraged and were used to repay some debt, and the structure of the remainder of the National Debt was shifted decisively towards the longer end of the maturity spectrum. As has been said, this involved a process of deflation at a time when such a policy was inappropriate as far as domestic considerations in terms of the immediate future were concerned.

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1. Morgan, Studies in British Financial Policy 1914-1925, p.107; see below, Appendix, Table 3.
  2. Morgan, op.cit., p.107.
  3. Ibid., p.101.
  4. A. Peacock and J. Wiseman, The Growth of Public Expenditure in the United Kingdom (2nd edn; London: George Allen and Unwin, 1967), pp. 153, 184.

## Debt Redemption and Funding, 1920-25

The two methods of lightening the burden of floating and short-term debt, funding and repayment, were both used during this period. For each of the financial years from 1919-20 to 1924-5 there was a small surplus, to be devoted to debt redemption. This varied from about £109 million in 1919-20 through a maximum of £276 million in the following year, to approximately £71 million in 1924-5.<sup>1</sup> At the same time, a steady programme of funding was maintained. As has been noted, the first large reduction in the floating debt was made in the autumn of 1919, following the Funding Loan and Victory Bond issue. The total of floating debt, Treasury Bills and Ways and Means together, fell from a peak of £1,531 million in June to £1,187 in August, when it started to rise again, reaching £1,411 million in January 1920. The total remained around the £1,300 million mark for most of the time until the middle of 1921, when it reached another peak of £1,360 in June. From this time on the total fell steadily until the spring of 1923 when it was £783 million in May, and thereafter varied between £750 and £850 million approximately for the rest of our period.<sup>2</sup>

Within this pattern of change in the total, there was considerable variation in the individual components. Sales of Treasury Bills were much affected in the summer of 1919 by preparations for the Funding Loans, and their value fell from £1,019 million in May to £671 million in July. Then Bills began to rise fast, indeed at a faster rate than the total of floating debt, because a strenuous effort was being made to <sup>e</sup> repay the Bank Ways and Means advances. These fell from a peak of £513.8 million

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1. Morgan, Studies in British Financial Policy 1914-1925, p.104. These are Morgan's adjusted figures, which are based on the dates when expenditure and revenue actually was spent or received, not when it was taken into account.
  2. Ibid., p.147.

in July, just before the big Loan issue, to £8.9 million in March 1920. At this point they began to rise again; the Treasury was having considerable difficulty in placing Bills because of the boom conditions in the market, and although the Bill rate was raised to 6½% in April the Ways and Means figures only twice went below £40 million for the rest of the year.<sup>1</sup> Bills, on the other hand, having risen fast to over £1,200 million in January 1920, did not again rise above £1,100 million until December of that year.<sup>1</sup> It has indeed been estimated that the holdings of the Banks and the money market fell by about £100 million in the spring of 1920.<sup>2</sup> As Morgan says,

"It is small wonder that Treasury officials did not want to live through this experience again and were extremely anxious to see the floating debt reduced."<sup>3</sup>

Just how anxious they were is demonstrated by the official memoranda, and by the evidence of Blackett before the Select Committee on the Increase in Wealth (War). This Committee had been set up by the House of Commons to consider the desirability and feasibility of a capital levy on war fortunes, the proceeds of which would be used to repay part or all of the floating debt. Feeling was running high at this time that a good many people who had stayed comfortably at home had made a good deal of money out of the war, and public opinion was strong in the evils of the 'profiteers'. One is reminded of Baldwin's comment on the Parliament elected at the 1918 election that it contained a lot of 'hardfaced men who looked as though they had done well out of the war', and Austen Chamberlain's description of these members as 'a selfish, swollen lot'.<sup>4</sup> However, this same House set up a Committee to consider the desirability of a capital levy in the

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1. Morgan, Studies in British Financial Policy 1914-1925, pp.146-7. The rise in the Bill rate was apparently at the direct instigation of the Bank of England: H. Clay, Lord Norman (London: Macmillan & Co., 1957), pp.127-128.
  2. Morgan, op.cit., p.146.
  3. Ibid.
  4. Quoted by A.J.P.Taylor, English History 1914-1945 (Oxford: Clarendon Press, 1965), p.129.

autumn of 1919, and its recommendations were discussed by the Cabinet in June 1920.<sup>1</sup> Chamberlain was on the whole opposed to the idea on practical grounds. The Committee had suggested a levy of £500 million, of which £350 million would be yielded in the first two years of its operation and £150 million in the following ten years. This would be accompanied by a reduction in the Excess Profits Duty to 40%. The Chancellor felt that to collect so large a sum would be highly dislocatory and would produce a financial panic, because the great majority of financiers and industrialists were against the scheme. Those members of the Cabinet who favoured the scheme countered with a number of arguments: their object in proposing the levy was to equalise the sacrifice undergone for the sake of winning the war, and to reduce the burden of the debt, particularly the floating debt, at a time when the value of the debt was comparable to that at the time it had been borrowed. In addition it was urged that it would be difficult to reject a recommendation of a House of Commons Committee on the subject. But the majority of the Cabinet felt that in the only form in which it would be feasible the levy would be extremely unfair, since it would penalise only those who had saved considerable sums out of their war fortunes, not those who had earned them and spent them. Because of the discouragement to enterprise, the injustice, and the dislocation which would be caused, the Cabinet rejected the proposal.<sup>2</sup>

They also rejected a proposal by the Governor of the Bank of England, for a forced long-term loan instead of a levy; this would have raised £750 million, of which £250 million would have been taken in existing Government securities valued at current prices.<sup>3</sup> This proposal echoed

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1. The Report was published as House of Commons Papers, 1920, No. 102, and circulated to the Cabinet under a memo. by Chamberlain, the Chancellor, as C.P.1319, in P.R.O., Cab.24/106.
  2. P.R.O., Cab.23/21, Cabinet meeting 31(20), 2 June, 1920, and Cabinet meeting 32(20), 4 June, 1920.
  3. P.R.O., Cab.23/21, Cabinet meeting 32(20), 4 June, 1920.

a similar one which Norman suggested prior to the Victory issues in 1919, by which the voluntary loan would have been replaced by a forced one to which all income tax payers would have been obliged to contribute. Norman set out his objectives in a memorandum to the Chancellor on April 15th 1919:

"All floating debt was incurred as War expenditure, and should be treated as such without delay. Its existence paralyses the money-policy of the Treasury. The ordinary method of a public invitation to subscribe to a loan with or without the big drum will not produce the desired result...Nor can we contemplate loading the Banks again. Therefore the Government must, as it were, underwrite the issue.

The scale is, of course, too great to admit of any voluntary scheme. So the income-tax payers must stand by and take firm the requisite total, pro rata to their Income Tax returns. They will not like it, but they (and the Community) will suffer less than by any other method of raising (or failing to raise) such a loan at this stage."<sup>1</sup>

Chamberlain did not feel this proposal to be politically feasible at that time, and it did not reach the Cabinet. Norman's second attempt did, but was rejected, on the grounds that a dangerous precedent would be created; people might be willing to believe that a capital levy was such a drastic remedy and so difficult to achieve administratively that it was generally a once-for-all proposal, suggested only as a last resort for dealing with the extraordinary financial difficulties thrown up by the war. But a forced loan through the income tax system, while equally drastic in its impact, might be thought to create a precedent for the future since it was comparatively easy to administer. The summary of the Cabinet discussion of the proposal occupies only a short paragraph in the minutes, and the decision seems to have been unanimous.<sup>2</sup>

Thus at the end of 1920 the Treasury was confronted with the twin problems of the existence of a huge load of floating debt, mainly in the form of Treasury Bills, which it had experienced considerable difficulty

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1. Clay, Lord Norman, pp.117-118.

2. P.R.O., Cab.23/21, Cabinet meeting 32(20), 4 June, 1920.

in renewing that year, and of a large volume of securities with maturity dates in the near future.<sup>1</sup> That the Treasury was alarmed at the size of the floating debt even before the difficult period of early 1920 is obvious. Blackett's evidence to the Select Committee on Increase in Wealth (War) is a case in point. He was before them in March 1920, when Bank Ways and Means were at their lowest for the year and the position was not nearly as difficult as it was to become after the peak period for revenue collection was over. Nevertheless, when asked by the Chairman whether it was the opinion of the Treasury that a reduction of debt was vital at the present moment, Blackett replied:

"I should say it was very definitely the opinion of the Treasury that it is almost impossible, without some very special provision for a very large reduction in the floating debt, to get back to a sound position either in the general economic position of the country or in the position as regards the Exchequer...At the present moment there are outstanding something over £1,000 million of Treasury Bills and about £200 million of Ways and Means advances in addition. Until those have been funded in some way, or else paid off, it is impossible to put a stop to the present vicious circle which you have, first of all, a new creation of credit by the Government, followed then rises of prices, then higher wages, further issues of currency, and then again new credit creations by the Government."<sup>2</sup>

Because of this, Blackett was in favour of a capital levy by which the floating debt might be substantially reduced. He realised, however, that to obtain a really large sum in cash at once, and to use it all to redeem the floating debt, would have disastrously heavy deflationary effects. He envisaged that whatever sum might be raised by such a levy the amount by which it would be safe to reduce the floating debt in a single year would be from £300 to £500 million.<sup>3</sup> He was asked why, apart from the sheer volume of the sums involved, it would not be possible to effect a reduction of the floating debt out of taxation instead of by a

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1. See below, Appendix, Table 5.
  2. H. of C. Papers, 1920, No. 102, Q.1533.
  3. Ibid., Q.1631.

levy, that is by the normal process of achieving a substantial surplus of revenue over expenditure. He answered:

"The urgent necessity, as I put it, is to get taxation in cash available to reduce the floating debt. I do not suggest that the whole of the floating debt could or should be reduced..; such a very sudden deflation would create more trouble than it would allay. On the other hand, the importance of a large sum to my mind rather lies in the fact that as you effect deflation you increase the burden in terms of commodities of the debt that you leave. That is a very strong reason for not deflating without any reduction of debt, in which case you would have the debt at its present figure,...representing a considerably heavier burden in terms of commodities after you had reduced prices. If at the same time as reducing prices by deflation you were reducing the debt by a very considerable sum, you would ease the position of the future taxpayer very much more and make it very much easier to deal with the debt that remained than if you tried to do it gradually out of revenue after you had effected deflation..."<sup>1</sup>

This last passage is interesting in view of the fact that the policy which it condemns is precisely that which was carried out, after the Cabinet had rejected the proposed levy, and the events of 1920 had shown just how accurate the fears of the officials about the floating debt were. But the fact remains that Blackett was aware of the importance of repaying a large amount of the debt before prices fell so far that the burden of the debt was markedly increased. Another criticism, that repayment of the debt would be of more benefit to its holders than to the rest of the nation - that the active were being penalised to assist the inactive - was dealt with in a similarly optimistic and humane manner.

Q: "If you reduce your debt very considerably...it will not benefit the trader...and...the workman?"

Blackett: "Surely the whole country will be immensely benefitted if we can get rid of the vicious circle of increasing prices that causes so much unrest...The workman will, if he manages to maintain the present scale of wages, have a much better real wage than he has at present. That is one of the great hopes. If you could secure deflation and stabilisation of prices with money wages, as they have been during the war, considerably increased...the real wage of the workman is stereotyped at a better figure."<sup>2</sup>

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1. H. of C. Papers, 1920, No. 102, Q.1539.  
2. Ibid., QQ.1585-1587.

Unfortunately the 'great hope' was not realised, and by 1921 Blakett and Niemeyer were both supporting the parties in favour of a reduction in money wages as a necessary forerunner of a fall in prices.

Blakett in his evidence refused to support the idea of a forced loan as an alternative to the levy; he was of the opinion that it would be a very cumbersome way of funding and would severely affect security prices.<sup>1</sup> But he felt very strongly, as we have seen, that some measure by which the floating debt could be swiftly reduced before a great fall in prices took place was as essential as was that fall itself. - This comes out very clearly in the written memorandum which Blakett submitted to the Committee.

"...steady deflation would necessarily reduce imports and release for exports goods and services at present being consumed at home and would thus simplify the problem of dealing with the external debt. Deflation should moreover improve our credit abroad, while if it is accompanied by a big reduction of gross debt its effect in improving our credit would be very great indeed. In view of the magnitude of our external debt,...this is a very important point in favour of special taxation for reduction of debt. Since therefore deflation is the only alternative to a continuation of high prices and of the heavy discount on sterling in terms of dollars, the choice if there is one must be between a) increasing the burden of the present debt by deflation without any current reduction of debt by special taxation and b) deflation by special taxation which simultaneously pays off debt at a time when prices are high and when the burden of paying a given amount of taxation is therefore less heavy."<sup>2</sup>

Blakett's views as expressed in this evidence have been dealt with at length because they not only indicate the views of the Treasury at the time he was speaking, but when compared with the tone and words of the memoranda on the subject written in 1921<sup>3</sup> provide a useful indication of the extent to which Treasury opinion had hardened on deflation and debt funding following the events of 1920.

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1. H. of C. Papers, 1920, No. 102, QQ.1668-1670.
  2. Ibid., Appendix II to Report of Select Committee on Increase in Wealth (War), para. 9.
  3. See above, pp. 280, 282.

New National Debt issues, 1920-25

During 1920 a new issue of Exchequer Bonds was made to cover those falling due in the course of the year, and a new series of Treasury Bonds was also issued in May. The latter was a signal failure; together with a second issue in October the total received was only £23 million.<sup>1</sup> In view of the level of interest rates prevailing at the time any large issue was in any case out of the question. But the problem of war and Exchequer Bond issues coming to maturity was becoming pressing, particularly in view of the fact, noted by Blackett in February 1921, that these Bonds tended to come into the hands of the money market anything up to a year before their maturity dates.<sup>2</sup> This meant that offers of conversion to longer dated stock were unlikely to be successful if made within a year of maturity. Blackett wrote a memorandum to the Chancellor on the subject, listing all the debt in terms of its maturity date,<sup>3</sup> and proposing that in view of the noted tendency for the Bonds to leave the hands of 'genuine' savers a year before their maturity, strenuous efforts should be made at once to deal with the large volume of such Bonds maturing in the next few years. This paper was the background to the issue in April 1921 of the  $3\frac{1}{2}\%$  Conversion loan. The stock was issued to holders of National War Bonds maturing up to 1st September 1925 at varying terms; those applicable to the Bonds maturing in 1922 gave about 5.6% in interest alone, while yielding a true rate of 6.8% at the earliest redemption date. Since the stock was for not less than 40 years, and the interest was exempt from Corporation Profits Tax, this conversion operation was an expensive one and assumed a continuation for a very long period of high

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1. Morgan, Studies in British Financial Policy 1914-1925, p.117.
  2. P.R.O., T.171/196, memo. by Blackett on funding, 14 Feb., 1921.
  3. See Appendix, Table 5..

interest rates. Yet despite the fact that the terms were very favourable only just over a quarter of the eligible bonds were converted.<sup>1</sup>

This issue has been described as both unnecessary and expensive.<sup>2</sup> The reasons why it was made at this time are set out in Blackett's memorandum, which in fact anticipates this criticism. To the charge that it was unnecessarily expensive Blackett stated that he felt it would be impossible for the Government to borrow more cheaply until some of the nearer maturities were out of the way, and that although the cost of this Conversion Loan was high, the improvement in Government credit which would result would mean that eventually the Treasury would be able to produce a more than compensating reduction in the total of both the interest on the floating debt and the cost of funding it. Certainly Blackett felt that a Conversion issue was an essential preliminary to any attempt to fund the floating debt.<sup>3</sup>

Further attempts to fund the Exchequer Bonds were made during 1921, and a series of Treasury Bond issues were made both for this purpose and for cash. Market conditions were beginning to move in favour of the Government, contrary to Blackett's expectations, and total cash subscriptions amounted to about £300 million more than maturities of Exchequer and National War Bonds. This together with that part of the budget surplus which was not needed for the various statutory sinking and depreciation funds, and to cover payments of Excess Profits Duty in Government securities, was used to reduce the floating debt, from over £1,350 million in the summer of 1921 to £1,038 million by March 1922.<sup>4</sup>

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1. Morgan, Studies in British Financial Policy 1914-1925, p.118.
  2. Ibid., p.118
  3. P.R.O., T.171/196, memo. by Blackett on funding, 14 Feb., 1921.
  4. Morgan, op.cit., p.119.

The continued depression in the economy helped to keep the situation easy for the Treasury, and conversions and floating debt redemption continued during 1922, with offers of conversion into  $3\frac{1}{2}\%$  Conversion Loan being made to holders of maturing Bonds, and considerable conversion of National War Bonds into 5% War Loan taking place (this option was contained in the original conditions of sale but only became attractive to holders at this time). Further sales of Treasury Bonds were made on improving terms, and the proceeds of this and of the small available Budget surplus were again used to redeem some floating debt.<sup>1</sup> The total fell from £1,038 in March 1922 to £821 million a year later, and Treasury Bills fell from £908 million to £643 million in the same period.<sup>2</sup> By March 1922 Bank Ways and Means had been repaid completely, and they resumed their pre-war function of easing purely temporarily dislocations in Government payments and receipts. For the rest of our period the sums under this heading never exceeded £16 million, and only twice, in June of 1922 and 1924, did they exceed £10 million; for a third of the remainder of the period they were zero, and for another third were under £2 million.<sup>3</sup> Repayment of Treasury Bills continued during 1923 and 1924, though at a much slower rate, the figures for March in 1923, 1924 and 1925 being £643, £594 and £571 million respectively. Sales of Treasury Bonds and conversions of maturing Exchequer Bonds into 5% War Loan and into Treasury Bonds continued.<sup>4</sup>

#### Resulting Changes in the Structure of the National Debt

Thus a considerable change in the structure of the National Debt took place. A considerable reduction was effected in the liquidity base of the market, and by virtue of the continuing budget surpluses a

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1. Morgan, Studies in British Financial Policy 1914-1925, p.120.

2. Ibid., p.147.

3. Ibid.

4. Ibid., pp.120-121.

significant transfer of purchasing power from tax payers to holders of Government stock was effected. At the time, this transfer was seen as a wholly admirable thing, since the stock of savings was thereby increased. Keynesian theory would in any case contest this desirability of a shift of this kind during a depression; but in any case it is difficult to understand why Treasury opinion should have been so firmly convinced that debt repayment increased the funds available for industry.<sup>1</sup> Government stock is generally regarded as the safest haven for money in the market; it is not immediately obvious that Hick's contention that those whose stock was being repaid would have to reinvest in similar securities, rather than in more risky enterprises, is either wrong or unrealistic.<sup>2</sup> Further, the very ease, and increasing ease, by which the Government was able to effect the Conversion operations of 1921-25 is an indication of the lack of demand in the market for funds. It is one of the unfortunate implications of cyclical policy that the easiest times for a Government to fund and repay debt are just those when, from the point of view of countering cyclical influences, it should not be doing so. But the Treasury officials continued to believe that the transfer to savers was a good thing in itself, rather than simply an incidental part of the debt management policy.

There can be no doubt that the large volume of floating debt which existed in the immediately post-war period was a serious problem for the officials; it is equally clear that although they were aware of the problems created in a situation in which deflation was taking place while the total size of the National Debt was being marginally increased, the administrative difficulties of dealing with the short-term and floating debt obscured their perception of the importance of these problems.

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1. See, for example, P.R.O., T.172/1208, memo. by Niemeyer on monetary policy, 5 Oct., 1921.
  2. Hicks, The Finance of British Government 1920-1938, p.341.

Their understanding of the deflationary mechanisms set off by their policy seems to have been highly rudimentary;<sup>1</sup> and both Blackett and Niemeyer, but particularly the latter, resisted strenuously any attempt to divert Treasury debt policy from the straight and narrow path of redemption and retrenchment. It is not, however, obvious that they would have been popular with the general public had they been less orthodox; the mood of the country was not such as to encourage experimentation.

#### Interest Rate Policy, 1920-5

Prior to the First World War, changes in Bank Rate had been entirely the province of the Bank of England, and there is no evidence to suggest that the Treasury was consulted about changes. During and after the war, however, while there were large numbers of Treasury Bills on tap and the banks held considerable balances at the Bank, Bank Rate was totally ineffective, and the ruling rates in the market were largely determined by the Treasury Bill rate. Thus until the tap issue was suspended in 1921, by which time the credit situation had in any case changed considerably, it was necessary for there to be co-operation between the two authorities on the course of interest rates, and the Treasury in effect had the casting vote.

Early in 1920 it became apparent that the rises in Bank and Treasury Bill rates of the previous autumn had had little effect on the market, and that inflation was still continuing apace. It was becoming obvious that if the Government's avowed policy of curbing inflation and inducing

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1. There was another deflationary aspect to the repayment of the floating debt; with the reduction in Ways and Means advances from the Bank it became necessary for the Public Deposits item to be increased, and this withdrawal of funds from the market implied a doubly deflationary effect. See Harris, Monetary Problems of the British Empire, pp.172-173.

deflation was to be carried out, further action would have to be taken. But there was considerable opposition among the bankers to any increase of rates.<sup>1</sup> So before the Chancellor made up his mind, he asked his chief advisers at the Treasury to submit memoranda on the desirability or otherwise of dearer money. He also requested one on the same subject from the Bank of England. All the memoranda were written within a few days of each other in the early part of February 1920. A conference with the bankers followed in March, and eventually in April the unanimous advice of the advisers at the Treasury and the Bank was taken, and Treasury Bill and Bank Rates were raised on successive days, the former from 5½% to 6½% and the latter also by 1% to 7%.<sup>2</sup>

The memoranda written by the officials to the Chancellor were collected into a single file during Keynes' time at the Treasury in the Second World War, and form a series of documents of absorbing interest for the study of the monetary policy of the period. There is also an interesting covering Note written by Keynes in 1942. In 1920 he had, in common with the other officials, advocated dearer money at once, although he favoured a swifter measure of deflation than had in fact been applied. Despite the changes in his ideas by the time he wrote the later note, Keynes says that his advice would still be the same.

"With all the methods of control, then so unorthodox, excluded, I feel myself that I should give today exactly the same advice that I gave then, namely, a swift and severe dose of dear money, sufficient to break the market, and quick enough to prevent at least some of the disastrous consequences which would otherwise ensue."<sup>3</sup>

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1. Economist, Vol. XC, 17 Apr., 1920.
  2. According to Clay, the Chancellor was in fact under pressure from Lloyd George to reduce rates, to cheapen Government borrowing, and by raising security prices to enable the banks to liquify their holdings of long-term stock. Clay, Lord Norman, pp.124-5. For a summary of Bank Rate Changes 1919-1925, See below, Appendix, Table 2.
  3. P.R.O., T.172/1384, covering note by Keynes, 7 Jan., 1942.

In the event, he says, this advice was taken, but too timidly; however, he doubted whether much of the consequences could have been averted even if the deflation had been faster. The moral of the tale, and the lesson for the future, is, he suggests, that controls should be continued for much longer than was politically feasible in the post-First World War period, particularly as the controls then in existence were more crude than those evolved during the course of the Second World War. The main lesson for the policy makers for the period following the current war is, he says, that

"all controls must be retained in principle for a period of at least two years...If the vast bulk of purchasing power, which must necessarily exist at the end of the war, is released in the psychological conditions necessarily surrounding the end of the war, the result cannot be different from what it was in 1919 to 1921."<sup>1</sup>

But in 1920 the paraphernalia of control had been largely disbanded, mainly in response to the unanimous clamour of opinion of all shades for a return to the laissez-faire conditions of 1914, and a removal of the restrictions imposed by Government control.<sup>2</sup> If inflation was to be controlled and deflation begun, there was little choice of policy; and the unanimity of the Chancellor's advisers is an indication of this.

The papers contain memoranda by two permanent officials, Blackett and Niemeyer; one by Hawtrey, the Director of Financial Inquiries, one by Keynes, although he had by this time resigned from the staff of the Treasury to have a free hand in writing his book on the Peace Conference, and one by a member of the Bank of England staff, sent by Cokayne with a covering letter. Niemeyer's paper is short and to the point. He laid particular emphasis on the importance of raising our rates so that they should not be so far out of line with those prevailing in the United States.

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1. P.R.O., T.172/1384, covering note by Keynes, 7 Jan., 1941.
  2. See above, pp. 133-144.

This is for two reasons: the encouragement to our own investors to take their money abroad, where it can earn better interest, would be reduced, as would be the incentive for foreign borrowers to draw on London for loans rather than try in the United States. A further reason was that if the holding of stocks became more expensive, traders would be forced to liquidate them, and this would force prices down and encourage exports, both of which would have an advantageous effect on the exchange. Niemeyer stressed that a reduction of rates, which apparently was being urged on Chamberlain by the Prime Minister, would lead to ruin.

"...a reversion to cheap money would undo all the educative effect of even 6%. People will say: scarcity is over; money is cheap; there is no need for economy: and rush down the steep place of inflation until the shilling goes the way of the franc and the mark."<sup>1</sup>

Blackett's memorandum was longer, more detailed and more closely argued. The basic substance of his argument was that during the war, credit inflation, brought about by the Government borrowing more than the true savings of the people, had resulted in a large increase in purchasing power. At the same time, production of goods and services had not only not risen to meet this increase, but had in many cases fallen, because of the necessity for diverting resources into the manufacture of instruments of war, and men to the waging of it. As a result, a considerable rise in prices had occurred. Although a big price rise had also taken place in the United States, the rise was not so great, and a depreciation of sterling in terms of the dollar had therefore taken place. The only remedy for this was a reduction in the British price level to parity with the American in terms of gold prices. Before the war a rise in Bank rate would normally have been sufficient to initiate an adjustment in price levels. But the situation in 1920 was rather different.

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1. P.R.O., T.172/1384, memo. by Niemeyer, 3 Feb., 1920.

"...though people still think and talk about Bank Rate its action though important is at present subsidiary to that of the Treasury Bill rates."<sup>1</sup>

In addition, the pre-war effect of a rise in Bank Rate on the flow of gold was not likely to be seen for a very long time, because the difference in the price levels and therefore the depreciation of the exchange was so great.

One of the objections to a policy of dear money was that the current profitability of trading was so great that even a large rise in interest rates would not be sufficient to liquidate stocks or reduce trade borrowings. Blackett suggested that in practice this assessment was not accurate in any but very short-term situations.

"It is true that the riotous activity of trade and the phenomenal profits which are the effects of continually rising prices make it difficult to check borrowings. But this is largely because there is an expectation that prices will still continue to rise; some borrowers and in particular foreign borrowers are checked by every rise in rates. And once it is clear that a definite policy of deflation is in process of being realised, the expectation of further rises in prices will be dispelled and moderately high rates will effectively restrict borrowing."<sup>2</sup>

However, Blackett emphasised that while a policy of dearer money such as to restrict credit and reduce prices was advisable, and indeed a restriction of credit was an essential preliminary to deflation - currency restriction alone being insufficient, since increases in the volume of currency were largely a reaction to high prices rather than the cause of them - it would be necessary to guard against proceeding too precipitately.

"A dear money policy has for its object a restriction of credit. Its power for good in this direction is limited by the proviso that it must not be carried to such lengths that it will cause a decrease in production. Falling prices are disliked by all traders, and however much the working man as consumer may dislike high prices, he dislikes still more reductions in wages and lack of employment. Any policy therefore which aims at reduction of prices must move slowly, and if the social benefits which the world hopes to win from the reconstruction period are to be attained, real wages must be kept above pre-war levels and unemployment must be avoided to the utmost extent possible."<sup>3</sup>

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1. P.R.O., T.172/1384, memo. by Blackett, 21 Feb., 1920.

2. Ibid.

3. Ibid.

Blackett emphasised the inflationary nature of Ways and Means advances; but he also stressed the similar effect of Treasury Bills, particularly as they approached maturity:

"...Treasury Bills with a very early maturity date are looked on by the banks and still more by many of their customers as the equivalent of purchasing power."<sup>1</sup>

It was important, therefore, that the Treasury should be able to renew all Bills without too much difficulty, and this implied higher rates. These rates would probably not have to be maintained for very long, as once the cycle of price and wage rises was broken, conditions would become easier again, and when rates could be brought down again it would be possible for the Government to begin funding the debt, to make sure that the problem could not arise so acutely again. Blackett concluded:

"It is certain that a further inflation of credit would inevitably lead to a further rise in prices. If a steady following of the policy of deflation can secure the country against a new rise in the cost of living or keep within small limits the further temporary rise which the general conditions in the world today threaten to cause, and can then lead on to a real fall in that cost, not only will the community reap an adequate reward for the expense incurred in paying high rates for Treasury Bills, but the Exchequer will benefit by a gradual restoration of normal exchanges and the earlier arrival of the moment when the national debt can be funded on reasonable terms."<sup>2</sup>

The advice which the Chancellor received from the professional economists and from the Bank was on much the same lines.<sup>3</sup> Keynes was in favour of more drastic action than Blackett was prepared to contemplate; he proposed a rise to 7% at once followed by a further rise to 8%, and opined that 10% bank rate might eventually be necessary. He felt that a quick clean cut would be better than a slow fall in the price level, and that although a crisis might result it would probably be a financial one only, not a commercial one.<sup>4</sup> The Bank of England was, as one might

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1. P.R.O., T.172/1384, memo. by Blackett, 21 Feb., 1920.

2. Ibid.

3. Ibid., memos by Hawtrey, 4 Feb., 1920, Keynes, 15 Feb., 1920, and one, unsigned, from the Bank of England, 10 Feb., 1920.

4. Ibid., memo. by Keynes.

have expected, even more concerned with the effects of inflation on the exchanges than were the Treasury advisers.

"The first and most urgent task before the Country is to get back to the gold standard by getting rid of this specific depreciation of the currency.

This end can only be achieved by a reversal of the process by which the specific depreciation was produced, the artificial creation of currency and credit, and for this the appropriate instrument is the rate of interest."<sup>1</sup>

The Bank's memorandum was accompanied by a letter from Cokayne urging an increase in rates, because of the amount of accommodation which the Bank was being asked for at the current Bank Rate of 6%.<sup>2</sup>

Following this flood of official advice, Chamberlain also received the opinions of the bankers upon the subject, at two meetings early in March.<sup>3</sup> They were almost unanimous in their opposition to a rise in interest rates, and suggested that it would in any case be ineffective since the profitability of trade was so great at the present time. In any case the only way of restricting credit was for the bankers to ration advances to their customers, and they therefore suggested to the Chancellor that he should allow them to do this voluntarily without a further rise in interest rates, and see what effect this had. Chamberlain was most unwilling to do this, but he could not extract any more definite undertaking from the bankers, as to the extent to which they would be prepared to reduce their advances.

Chamberlain decided to give the bankers a little time in which to try to improve the situation by their own efforts. But the situation was becoming steadily worse. Blackett, who in early February was of the opinion that a 6% bank rate was high enough for the time being, and was chiefly concerned that rates should not be reduced, was by early March

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1. P.R.O., T.172/1384, memo. from Bank of England, unsigned, but the author was almost certainly Montagu Norman.
  2. Ibid., Cokayne to Chancellor, 25 Feb., 1920.
  3. Ibid., reports of meetings with the bankers on 9 and 11 Mar., 1920.

convinced that Bank Rate should be raised to 7% as soon as possible.<sup>1</sup> Early in April the Treasury began to experience considerable difficulty in renewing Bills, and Bank Ways and Means rose by £55 million in the first ten days of the month.<sup>2</sup> This called forth a strong protest from Norman, who had by this time taken over from Cokayne at the Bank. He asked to see Chamberlain with a view to discussing an immediate rise in rates, since he was unwilling any longer to wait while Chamberlain assessed the results of the bankers' voluntary efforts.<sup>3</sup> The meeting took place the following day, the 13th,<sup>4</sup> and Treasury Bill and Bank Rates were each raised by 1% on 14th and 15th of April respectively.

The fears of the Treasury men were not fulfilled about the possibility of a need for 8% or even 10% later on. But the difficulties of the spring of 1920 continued to affect the atmosphere of decision-making for some time, as did the need to finance a large volume of Treasury Bill borrowing, and Bank Rate stayed at 7% for a year, when it was brought down by  $\frac{1}{2}$ % steps to 5% in November 1921. Treasury Bills had by then ceased to be available on tap in the fashion of the war and post-war period, so that there was no longer a rival to Bank Rate in the dictation of the level of money rates in the market. As the country was by this time in the grips of a severe trade depression, even 5% seemed high, and the rate came down to  $4\frac{1}{2}$ % in February 1922, 4% in April and 3% in July, where it stayed for a year.<sup>5</sup>

From this time on, Bank Rate policy seems to have been mainly in keeping with Cunliffe's recommendation that rates should be kept above those in countries with whose currency sterling was at a discount. The Federal Reserve rate was raised from 4 to  $4\frac{1}{2}$ % in February 1923, and this

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1. P.R.O., T.172/1384, note by Blackett, 4 Mar., 1920.

2. Economist, Vol.XC, 17 Apr., 1920.

3. Clay, Lord Norman, pp.127-128, Norman to Blackett, 12 Apr., 1920.

4. Ibid., p.128.

5. Economist.

and the Ruhr crisis in the summer resulted in an outflow of short-term funds which increased the sterling discount again. Bank Rate was raised to 4% in July 1923, and when the Federal Reserve rate fell to  $3\frac{1}{2}\%$  and then 3% in the summer of 1924 Bank Rate was maintained at the 4% level and the Bank took advantage of the situation to make its own rate effective and to discourage foreign loans, to aid the appreciation of sterling. The unofficial discouragement of foreign lending was intensified in the autumn, and there was a sharp fall in new issues. When the Federal Reserve rate was raised to  $3\frac{1}{2}\%$  in February, Bank Rate was immediately raised to 5%, to maintain the differential which Norman felt to be necessary to encourage the appreciation of sterling to par, before returning to the Gold Standard in April.<sup>1</sup>

While there seems to have been more co-operation between the Treasury and the Bank in this later period than pre-war, once the compulsion on mutual agreement and understanding had been removed with restoration of the tender issue to its previous position, it was not to be expected that Norman would welcome interference from the Treasury in what he regarded as the internal affairs of the Bank, and the regulation of Bank Rate became again a matter for the Bank alone. It is recorded that Churchill did once attempt to influence Norman in a Bank Rate decision, and was met with a decisive rebuff.<sup>2</sup> But although the Treasury officials may not have been quite so single-minded in their attitude to the Gold Standard as Norman, on the whole they shared the orthodox attitude to interest rates, as is well illustrated by their behaviour and advice in the crisis of spring 1920.

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1. Sir Albert Feavearyear, The Pound Sterling (2nd edn; Oxford: Clarendon Press 1963), p.358.
  2. P.J. Grigg, Prejudice and Judgement (London: Jonathan Cape, 1948), p.193.

CHAPTER SEVEN

THE TREASURY AND THE

GOLD STANDARD

During the whole of the period from 1918 to 1925, the aim of restoring the Gold Standard in Britain dominated the actions of the Treasury officials in the Finance Divisions, and the advice which they gave to the Chancellor, no less than it did the policy of the Governor of the Bank of England. The need to keep Bank Rate high in order to attract funds to London and support sterling, when the internal situation would have suggested quite different moves, bedevilled all efforts towards trade recovery, and increased the already huge burden of servicing the National Debt. The belief that the restoration of the Gold Standard would help Britain to regain her previous trade position acted to the detriment of other suggestions for reviving the stagnating export trades. The importance of avoiding the currency disasters experienced by countries on the Continent, and in particular by Germany, also pointed to the dangers of inconvertible currencies and the advantages of the "automatic" discipline of the Gold Standard.

But over and above the logical reasons for desiring a return to the Gold Standard, there was a longing for a return to the relatively stable conditions of the pre-war world, when Britain held an undisputed position of supremacy in international finance, and the dangers of Britain's trade position were not immediately obvious. It is this element of belief in the advantages of the Gold Standard as an article of faith that makes the problem of prime importance in Treasury thinking, and thus in any study of the Treasury during the inter-war period. But the direct involvement of the Treasury in this area of financial policy was a new development; until the effective prevention of gold exports during the war, the operation of the Gold Standard had been the responsibility of the Bank of England. Thus although the Gold Standard was a new problem for the Treasury, it had a considerable history, and it was also an area in which the Bank was deeply concerned.

## The Historical Background

In order to understand the supreme importance of the Gold Standard, and the sacrosanct nature of the pre-war pound, it is necessary to examine briefly the history of the problem. The establishment of the mint price of gold at £3.17.10½d a standard ounce had occurred in 1717, following a period of devaluation of gold against silver. From that point on, changes in the relative values of the two metals took place through a rise in the gold price of silver, rather than a fall in the price of gold in terms of silver, and Britain was thus established on a gold standard for domestic purposes.<sup>1</sup>

During the Napoleonic Wars, in 1797, the Bank of England was obliged to suspend payments, and for the rest of the wartime period trade was financed by means of an inflated paper currency. Following the end of the war, considerable controversy arose over the currency problem. Finally in 1819 Peel secured the passing of an Act, which is generally known by his name,<sup>2</sup> in which a timetable was set out for a restoration of the pre-war currency standard. During the course of the eighteenth century the ancient prohibitions on the exporting and melting of gold and silver had become increasingly ineffective. Peel extended the effects of the restoration to overseas trade by expressly permitting the export and melting of gold, and by repealing the relevant portions of the Statutes which prohibited these activities. Thus began the standardisation which lasted almost exactly a hundred years.

The apparent parallel between 1819 and 1919 is striking. The country had been forced off a fixed standard by war, and had ended the war with an inflated paper currency. A committee was set up - chaired by Peel in 1819, by Cunliffe in 1919 - to discuss the problem, which concluded that Britain should restore a fixed price for gold, equal to the pre-war parity, and convertibility, as

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1. Sir Albert Feavearyear, The Pound Sterling (2nd edn; Oxford: Clarendon Press, 1963), p. 154.
  2. 59GIII, c.49, 2 July, 1919.

soon as possible. The conclusions of the committee were also those of virtually all the witnesses in both cases. The principal difference was that Cunliffe's committee recommended that convertibility should be into bullion, and that the internal gold circulation should not be restored; this course of action had in fact been suggested to Peel's committee in 1819 by Ricardo, in order to mitigate the deflationary effects of the stabilisation policy, but the suggestion was rejected.<sup>1</sup> Finally, the restoration period, and the years immediately afterwards, were characterised by falling prices, trade depression and high unemployment.

### The War and Post-war Periods

The parallel between 1819 and 1919 did not fail to strike the officials of the Treasury, and indeed the Chancellors, for one of the papers written for Churchill at his request by Hawtrey in 1925 was on the subject of the restoration of the Gold Standard after the Napoleonic Wars.<sup>2</sup> But the influence of the previous century of Gold Standard operation was sufficient to encourage the officials to stress the speed and ease - from a financial point of view - with which the Standard was restored, rather than the rigours of deflation to which the economy was subjected, and the distress which resulted. Furthermore, because the officials were thinking at least partly in terms of 1819 as a historical precedent, they paid insufficient attention to the impact of fresh factors, such as the vast body of floating Debt which had been incurred during the war and which dramatically affected the ability of the Treasury and the Bank to control the supply of credit, the changes in gold supply and in the extent to which the available gold supply was channelled through London, and so on. The Gold Standard was not in fact officially abandoned until after the war; during the war there

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1. Feavearyear, The Pound Sterling, p. 220.

2. P.R.O., T.172/1499B, memo. by Hawtrey, undated.

was virtually no export of gold, partly due in the later stages to the submarine risk and insurance problems. But during most of the war, Britain was liquidating existing securities and borrowing heavily in New York to support the exchanges at the official rate; the object being to avoid paying vastly inflated prices for war supplies and food purchased in America. This policy ran into increasing difficulties in 1916 and early 1917, and in the view of Keynes, who was handling the problem in his capacity as a temporary Treasury official, only the entry of America into the war in April 1917 saved sterling and the currencies of the other belligerents from collapse.<sup>1</sup> After the end of the war, the need for exchange support for this purpose declined, and in March 1919 the export of gold was prohibited by administrative regulation.<sup>2</sup> This was later modified to permit export of new gold from South Africa, by arrangement with the Bank of England, and given statutory force by the Gold and Silver (Export Control) Act of 1920.<sup>3</sup> This Act had an expiry date of December, 1925, and this implied deadline was to have repercussions later.

The classical exposition of the working of the Gold Standard in the period before 1914, set out by the Cunliffe Committee in its First Interim Report, has already been discussed.<sup>4</sup> There is every reason to believe that this was the view which the principal Treasury officials took of the situation. Sir John Bradbury, then joint Permanent Secretary, took a major part in the discussions of the Committee, and signed its Interim Report. By the time the Committee came to consider its Final Report, Sir John had left for the Reparations Commission, and his place was taken by Sir Basil Blackett, then Financial Controller at the Treasury, who also concurred in the conclusions, and signed the Final Report. Because the Treasury had a member on the Committee, it was felt that the Treasury

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1. J.M. Keynes, Activities 1914-1919: The Treasury and Versailles, Collected Writings of J.M. Keynes, ed. E. Johnson (London: Macmillan and Co., for the Royal Economic Society, 1971), p. 224.
  2. Feavearyear, The Pound Sterling, p. 351.
  3. 10 and 11 Geo. V, c.70.
  4. See above, Ch. III passim.

view was adequately represented, and no Treasury witnesses were called. But there is little evidence to suggest that other members of the Finance Divisions would have expressed contrary opinions; Sir Otto Niemeyer, who became Blakett's deputy in 1921, tended to be rigidly orthodox on the subject, and younger officials who expressed opinions later were substantially in agreement with their superiors.<sup>1</sup> Keynes, who was later such a convinced opponent of a return at the pre-war parity, was apparently not consulted, but there is no evidence to suggest that at that stage he had evolved his ideas sufficiently to have been a determined critic, had he been called as a witness before the Cunliffe Committee. His involvement with post-war planning while at the Treasury seems to have been confined to the problems of peace terms and reparations.<sup>2</sup>

As we have seen, no record remains of the process by which the Cunliffe Committee's reports came to be accepted by the Government; the fact that no mention was made of any discussion in any of the official records of the period, nor in the private papers of the Prime Minister or either of the Chancellors concerned, nor in any of the fairly large number of biographies and autobiographies of the period, suggests that there may well have been none, that the necessity for the measures recommended by the Committee was accepted as automatically by the Government as by the Committee and most of its witnesses, and by the Treasury officials.<sup>3</sup> Be that as it may, the Reports of the Committee set the course for Britain's financial policy for a decade, and provided an exposition in uncompromising terms of both the logic and the faith of the proponents of the Gold Standard.

#### The Waiting Period. 1920-1924

The examples of the Treasury's obsession with the Gold Standard during the 'twenties are numerous. The first major occasion after the Committee reported

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1. See below, p. 328.

2. Keynes, The Treasury and Versailles, Part II.

3. See above, Ch. III, especially pp. 99-109.

in which the question of the Gold Standard was treated as a major element in a discussion of another problem was in the spring of 1920, when the officials were urging a rise in Bank and Treasury Bill Rates. The chief reason for advocating this policy was the need to control the internal inflation which was then at its height, during the post-war boom. But the exchanges were a major factor in the argument too, even though at the time there was no prospect of an immediate return to the Gold Standard, since the pound was then more than a dollar under the pre-war par rate.<sup>1</sup>

During the course of the discussions of the Bank Rate problem, Sir Ralph Hawtrey, Blackett and Niemeyer all wrote memoranda on the subject, as did Sir Brian Cokayne, then Governor of the Bank of England. All of them stressed the importance of higher money rates in achieving the goal at which they were all aiming, the return to the Gold Standard. Hawtrey urged as one reason for a higher Bank Rate the fact that

"...the gap that has to be crossed before sterling rises to its gold par is already enormous..."<sup>2</sup>

Blackett also stressed the importance of the exchange rate factor as one of his reasons for recommending a rise in the Bank Rate:

"In spite of a big rise in prices in the United States of America where the Gold Standard has remained effective the level of sterling prices has risen much higher than the level of dollar prices. The natural result is a depreciation of sterling in terms of dollars. The only effective remedy is to bring back sterling prices to a level approximately equal to their proportionate level as compared with dollar prices before the war..."<sup>3</sup>

Blackett was in no doubt that the restoration of the exchanges to par was the right objective in itself:

"If a steady policy of deflation can secure the country against a new rise in the cost of living...and then go on to a real fall in that cost,...the Exchequer will benefit by a gradual restoration of normal exchanges..."<sup>4</sup>

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1. W.A. Brown, The International Gold Standard Re-interpreted (2nd. edn; New York: N.B.E.R., 1940), p. 231, Table 18.
  2. P.R.O., T.172/1384, memo. by Hawtrey, 4 Apr., 1920.
  3. Ibid.
  4. Ibid.

Niemeyer was of the same opinion, but expressed himself in rather more forthright terms:

"It is notorious that American rates are even now much higher than London rates: if, as is not improbable, there is a financial crisis in America, American rates will go still higher. Our exchange will depreciate still further and the gap between gold and sterling, which we hope to bridge, will become wider and wider...the logic of the position seems to be that we should substantially increase it [British Bank Rate]."1

Cokayne put even greater stress on the needs of the exchange situation:

"The first and most urgent task before the country is to get back to the gold standard by getting rid of this specific depreciation of the currency."2

The importance of promoting a return to the Gold Standard continued to be a major feature in Treasury memoranda in this period. Niemeyer, asked by the Chancellor in November 1921 to prepare a statement on the principles governing British policy on inflation, credit and prices, said:

"The main principle of monetary policy followed since the Armistice flows from the Report of the Cunliffe Committee... To this day there has been no substantial change in the policy then adopted. It has been steadily pursued."3

It is interesting to note that Niemeyer was not thinking only of the benefits of stable exchanges and a return to the Gold Standard to the financial position of the country. As is frequently suggested in the Treasury files, the Gold Standard was thought of as an unemployment policy as well.

"...the object of our monetary policy has been throughout to produce such economic conditions as would enable British trade to compete in world markets and thus afford, as in the past, steady employment in this country."4

The importance of a restoration of the Gold Standard in the other major countries of the world was one of the major themes of the Genoa Conference, called by the British to discuss the problems of European economic reconstruction, and held in 1922. Indeed, as others have noted, the programme adopted by the

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1. P.R.O., T.172/1384, memo. by Niemeyer, 3 Feb., 1920.

2. Ibid., memo. by Cokayne, 25 Feb., 1920.

3. P.R.O., T.176/5, memo. by Niemeyer, 5 Oct., 1921, para. 1.

4. Ibid., para. 7.

Conference in the financial sphere closely followed the Cunliffe Committee's recommendations. Balanced budgets, an end to inflation and a return to the Gold Standard were prescribed as the remedies for Europe's ailments. But these traditional tenets were reinforced by some novel ideas about Central Bank co-operation which were largely the work of Hawtrey.<sup>1</sup> Unfortunately, the troubled conditions of the 'twenties rendered such desirable developments impossible, and the orthodox merits of the Gold Standard continued to be urged without there being any prospect of the international co-operation which the changed conditions of the post-war years rendered essential. But there seems little doubt that the Genoa Conference, at which Britain took a leading role in urging other countries to put their financial houses in order, had the effect of reinforcing the Treasury's determination to set an example to the world by returning to the Gold Standard ourselves.

Soon after the Conference, at the beginning of 1923, the exchange situation began to look more hopeful, and there was some possibility of returning to the Gold Standard at that stage. In January 1923, Niemeyer was asked by the Chancellor to comment on a suggestion by McKenna, Chairman of the Midland Bank, that Treasury Bonds be withdrawn from the market in favour of Treasury Bills, the effect being to encourage short-term lending at the expense of medium-term, and to induce a general fall in money rates since Treasury Bill rates were lower than Bond rates. Niemeyer rejected the suggestion for a number of reasons, among which not the least important was the effect on the exchanges of cheaper money and possible inflation.

"American prices are rising steadily...exchange is working towards par; with her enormous gold accretions America can hardly avoid further credit inflation and price increases. As soon as this process has gone a little further and we arrive at par, we shall get all the inflation we want here; possibly more than we want if America begins to send back gold. If in advance of this we start an inflation of our own, we shall lose all the advantage we have laboriously gained just when all the trumps are in our hand."<sup>2</sup>

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1. P.R.O., Cab. 31/1; H. Roseveare, The Treasury (London: Allen Lane The Penguin Press, 1969), pp. 262-3.
  2. P.R.O., T.176/5, memo. by Niemeyer, 24 Jan., 1923.

In the event, a return to the Gold Standard was not attempted at that stage, primarily because of the dislocation of the international financial system resulting from wartime debts and reparations. At that time, although the Anglo-American debt problem was near solution (the terms for funding arranged by Baldwin were formally agreed in February 1923) the European situation was still very unstable: France had invaded the Ruhr in January as a consequence of a technical German default on reparation payments. In a note on a question to be asked in the House of Lords on the problems of the currency situation and the need for a new Committee to review it, Niemeyer wrote:

"....[The Report of the Cunliffe Committee] speaks of 'a review...when the exchanges are working normally'. Obviously we have not reached this condition. Indeed, until there is a settlement of Reparations we cannot even begin to see what the normal exchange position will be."<sup>1</sup>

Despite these international difficulties, the Treasury advisers still kept the return as the central theme in their policy recommendations. R.G. Hawtrey, writing in March 1923, suggested that there were two main objectives to be kept in view:

"(1) We must avoid any further deflation, and with a view to the early absorption of our unemployed a moderate degree of inflation, such as has been experienced in the past twelve months in America, would be desirable;

(2) We must restore sterling to its gold par as soon as possible."<sup>2</sup>

Hawtrey accepted that these two objectives might be largely incompatible, but this did not lead him to reject either alternative. His remedy was that we should export large sums of gold to America in order to promote inflation there, rather than bring the exchanges to par by forcing further deflation in this country. This advice was repeated in another memorandum in October, 1923.<sup>3</sup>

The fact that there might be a conflict between different parts of their policies was not, however, obvious to all the Treasury officials, and there are some interesting examples of inherently contradictory statements on these problems

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1. P.R.O., T.176/5, note by Niemeyer, 24 Apr., 1923.

2. Ibid., memo. by Hawtrey, 5 Mar., 1923.

3. Ibid., memo. by Hawtrey, 31 Oct., 1923.

in the Treasury memoranda. Niemeyer, writing in March 1924 on the evils of inflation, said:

"This country has to sell her goods, if she is to live, abroad. The great difficulty of the last two years...has been that many of the natural purchasers of British exports have not been able to afford British sterling prices. Nothing effective can be done for trade or unemployment by increasing these prices."<sup>1</sup>

This statement is followed a few lines later by the inevitable:

"...the object to be kept steadily in view is to arrive at a parity between sterling and gold."<sup>2</sup>

Yet unless Britain's customers were able to keep their exchange rates in step, this process must have resulted in British goods becoming yet more expensive for them. But this contradiction never became apparent to Niemeyer and his colleagues, because they regarded the pre-war parity as a fixed and immutable law of the universe; it was all the other factors which were out of step, not the gold parity.

Another example of this attitude is to be found in a memorandum written on the best means of assisting in the relief of unemployment and distress:

"The root cause of unemployment at the present time...is that costs of production are so high that purchasers whether from abroad or in this country cannot afford to buy. The main item in the cost of production is the cost of wages. The only hope of ultimate full employment in this country is therefore a reduction in prices and correspondingly in wages."<sup>2</sup>

The writer apparently did not understand that the wage-earner is a consumer as well as a producer, and with his reduced wages would be able to buy still less; nor that the poverty of other countries relative to Britain would hardly be eased by pushing sterling up to parity with the dollar.

The policy of subordinating all other considerations to a restoration of the Gold Standard was not entirely without its critics. Many industrialists, including some prominent in the Federation of British Industries, were unhappy at the apparent stagnation in production and employment; but none of any weight

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1. P.R.O., T.176/5, memo. by Niemeyer, 1 Mar., 1924.
  2. P.R.O., T.172/1208, memo. undated and unsigned, but context indicates mid-1921, and style suggests that the author was Niemeyer.

was prepared to cease at least paying lip-service to the importance of returning to the Gold Standard. Indeed the views of the FBI upon the subject became so schizophrenic that several different versions of the FBI's representations to the Bradbury Committee in 1924 have appeared, some in direct contradiction to one another.<sup>1</sup> Other doubters appeared on the left wing of the Labour Party, notably G.D.H. Cole, with his famous phrase, "the worship of par".<sup>2</sup> About the middle of 1923 Keynes began to protest about the way deflationary policies were working out, and started his long quest for a sound theoretical base for his unorthodox ideas about purchasing power and the prime importance of the stability of the price level.<sup>3</sup>

Nevertheless, the bulk of informed opinion was still strongly in favour of restoring the Gold Standard. The first Labour Government, which came to power in late 1923, continued the policy of its predecessors. By this time the American debt settlement negotiated by Baldwin had proved workable, and the situation in Europe was beginning to improve. During the course of 1924, the German mark was stabilised, and an interim reparations settlement was reached, and in October 1924 the Dawes Loan was successfully floated to aid German recovery. The pound, which had fallen from its peak of \$4.70 in March 1923 to \$4.29 in January 1924, had by May recovered to \$4.39.<sup>4</sup> The climate for a return was thus becoming more favourable as the need for a decision was becoming more pressing, due to the expiry of the gold export prohibition at the end of 1925. At the suggestion of Montagu Norman, Governor of the Bank of England, a fresh committee on the currency issue was set up by Snowden, Chancellor in the Labour Government.<sup>5</sup> This committee's report was the initial impetus for the discussions which took place within the Treasury early in 1925 on the return to gold, and it is therefore appropriate that we should now turn to an examination of its proceedings and findings.

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1. See below, pp. 321-322, 332-333.

2. Morning Post, 13 June, 1924, letter to the Editor from G.D.H. Cole.

3. See, for example, Times, 7 Aug., 1923, letter to the Editor from J.M. Keynes.

4. W.A. Brown Jr., The International Gold Standard Re-interpreted, p. 231, Table 18.

5. P.R.O., T.160/197/7528, Niemeyer to Chancellor, 5 May, 1924.

## The Bradbury Committee

This committee was, in effect a reconvening of the active members of the Cunliffe Committee who were still alive. The only members who had not also served under Cunliffe (who died in 1920) were Sir Austen Chamberlain, who was Chancellor of the Exchequer at the time, and Sir Otto Niemeyer, who became the Treasury representative. The other members were Sir John Bradbury, Professor Pigou and Gaspard Farrer.<sup>1</sup> Thus the Committee consisted of an ex-Chancellor, an ex-Permanent Secretary to the Treasury, a serving Treasury official, and two signatories to the Cunliffe Committee's Reports. It is therefore scarcely surprising that their report was in favour of returning to the Gold Standard in 1925. However, the process by which the Committee arrived at its decision was not quite so simple as it sounds, and the period of its discussions falls into two distinct parts, separated by the General Election of November 1924.

The Committee followed largely the same course as its predecessor, hearing witnesses, discussing the whole problem in the light of their comments, and producing a draft report. They heard fewer witnesses than the previous Committee however, perhaps largely because the Committee had been appointed without public announcement, and some need for discretion, if not for secrecy, was felt.

The Committee's first witness was, appropriately enough, Montagu Norman, Governor of the Bank of England. He was firmly in favour of returning to the Gold Standard as soon as was reasonably possible. He felt that the mere announcement of the intention to return would be enough to bring the exchanges to par. However, when asked whether he felt that the eighteen months which remained before the embargo expired was too short a time to achieve parity and return to the Gold Standard he replied that in essence there was enough time, but:

"I do not think it is a reasonable proposition to put before the man in the street."<sup>2</sup>

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1. P.R.O., T.160/197/7528, Niemeyer to Chancellor, 19 May, 1924.
  2. P.R.O., T.160/197/7528/02/1, evidence of Montagu Norman before the Bradbury Committee, 24 June, 1924.

This momentary concession to popular opinion did not outlast the summer, and there was no trace of hesitation in his second appearance before the Committee.

The general feeling of the majority of the witnesses, including Sir Felix Schuster, Professor Paish, Walter Goodenough and even Reginald McKenna was that with patience, parity with the dollar would be regained without direct action, either through a rise in American prices, or through the confidence engendered by an announcement of the intention to lift the gold export embargo. Goodenough expressed the 'middle-of-the-road' attitude well:

"I want to see a free gold market, but I do not want to force it. I want it to come as easily and naturally as possible."<sup>1</sup>

Both McKenna and Keynes, however, put the argument for price stability strongly, and it is apparent that they made a considerable impression at the time. In a letter to Farrer written during the course of these sessions in the summer of 1924, Bradbury wrote:

"I am so far impressed by the views of McKenna and Keynes as to think that it may be wise not to pursue a policy of restoring the dollar exchange to parity at the cost of depressing home prices."<sup>2</sup>

However, he felt that this should be no impediment to the restoration of the Gold Standard:

"The odds are that within the comparatively near future America will allow gold to depreciate to the value of sterling..."<sup>3</sup>

Apart from Keynes and McKenna, the only witnesses who were at all hesitant in their advocacy of a return to the Gold Standard were the representatives of the Federation of British Industries. Their principal feeling was that while Britain should aim at a restoration of the Gold Standard, she should not 'go it alone'. However, when asked if Germany, the Scandinavian and Commonwealth countries together represented a sufficiently large body for Britain to have in

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1. P.R.O., T.160/197/7528/02/3, evidence of Mr. Goodenough before the Bradbury Committee, 11 July, 1924.
  2. P.R.O., T.160/197/7528/01/1, Bradbury to Farrer, 24 July, 1924.
  3. Ibid.

company when returning, the representatives agreed that this would not be 'going it alone'. In addition, they made two comments which make it clear how far from the truth is the 'bankers' ramp' theory of the return to gold. At one point, they volunteered that:

"Considerations of high finance might make it [the return to gold] so important that we should have to take the risk".<sup>1</sup>

thus showing their acceptance of the possibility that the decision might have to be taken on purely financial grounds. Furthermore, they said,

"...those who speak for the Federation are just as well aware as anyone else that the ultimate banking interest is just the same as the ultimate trading interest."<sup>2</sup>

Having heard their witnesses, the Committee set about preparing a report. The first draft was produced by N.E. Young, the Treasury official acting as Secretary to the Committee, and then amended thoroughly by Professor Pigou. Pigou's draft effectively advocated a 'wait-and-see' policy for the immediate future, but his covering letter made it plain that this was not the whole truth of his feelings on the subject:

"On the main issue, which is one of practical politics and not of economics, whether the Government should take the plunge now or announce no renewal of the embargo, I am only just on balance in favour of a 'wait-and-see' policy. It would be very inappropriate for me as an academic person to press for heroism; but if the rest of the Committee had been in favour of it, I doubt if I should have opposed."<sup>3</sup>

Pigou's draft did, however, make a number of categorical assertions:

"During the last few years, two policies have been advocated as alternative to the restoration of the parity of the sovereign; one, the policy of devaluation, that is, of the re-establishment of a free gold market with a unit identical in name but of a lesser content than the pre-war standard unit: the second involving the abandonment of the gold standard. The former of these policies need only be mentioned to be dismissed; it could not be seriously considered as a policy for the United Kingdom. The second alternative policy, that of substituting the price level of commodities in general for gold as the regulating principle of the currency, has been fully and carefully explained in evidence before us...as a practical present day

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1. P.R.O., T.160/7528/02/3, evidence of the representatives of the Federation of British Industries before the Bradbury Committee, 29 July, 1924.
  2. Ibid., evidence of the F.B.I. representatives, 30 July, 1924.
  3. P.R.O., T.160/197/7528/01/2, Pigou's covering letter, quoted in Young to Bradbury, 12 Sept., 1924; Pigou's underlining.

policy for this country there is, in our opinion, no alternative comparable with return to the former gold parity of the sovereign. In this conclusion we are supported by the overwhelming majority of opinion, both financial and industrial, represented in evidence before us."<sup>1</sup>

Pigou then turned to the urgency of the problem, and here he felt that the best thing to do was to await the course of events in America, and to come to a decision in a year's time. The other members of the Committee thought this too cautious - Bradbury described it as "flabby"<sup>2</sup> - and Sir Austen Chamberlain summed up the position in a letter to Young:

"Was ever such a happy family? I wished to say more, Pigou would have liked to say more, Farrer regretted that more was not said - and Bradbury sat down and said (or rather wrote) it!"<sup>3</sup>

Chamberlain went on to suggest that the Secretary incorporate Bradbury's suggestions in Pigou's draft - "B in P" he called it - and this substantially represents the third draft report, which combined Pigou's assertions of the need for a return to the Gold Standard at the pre-war parity with greater optimism about the timetable.

Had the Labour Government not fallen in October 1924, this draft would probably have become the final report. But before the Committee could meet for final discussions, the political situation had changed. Soon after the election, Montagu Norman went to New York, apparently on his own initiative, to discuss with Benjamin Strong, Chairman of the Federal Reserve Board, the necessity for Anglo-American co-operation on the restoration of the Gold Standard in England. Soon after his return, in January 1925, the Committee was reconvened, this time with Sir John Bradbury as Chairman, since Chamberlain had taken office in the Cabinet of the new Conservative Government. Norman was recalled to give evidence again, with a Director of the Bank of England, Sir Charles Addis. While they were both in favour of returning to gold at the old parity, Norman alone was convinced

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1. P.R.O., T.160/197/7528/01/2, Pigou's draft report, Aug., 1924.
  2. Ibid., Bradbury to Young, 11 Sept., 1924.
  3. Ibid., Chamberlain to Young, 13 Sept., 1924.

of the desirability of an immediate return. In the period since the fall of the Labour Government, sterling had risen sharply against the dollar, from \$4.46 in October 1924 to \$4.78 in January 1925: and this rise proved crucial in all subsequent discussions. Referring to his attitude before this rise, Norman commented to the Committee:

"...while I was then greatly in favour of a return to gold at an early date, but a date which I could not be brave enough to define then, I am now greatly in favour of a return during this year."<sup>1</sup>

Norman was asked about the intermediate period between the announcement that the export embargo would not be renewed, and the actual removal; he felt that at the same time as the announcement was made it should be made clear that a general licence to export would be issued at once to cover the interim period. This seems to have been the origin of the form the announcement took, that is that the prohibition on export of gold would be lifted immediately without a transition period. He was not asked any questions about the relative price-levels in Britain and America, but volunteered a comment on:

"...the difficulty of the position of the two price levels in the two countries...that I think has so far adjusted itself and from what I understand is so close that even if it presented a difficulty six or seven months ago I do not think it presents a real difficulty now..."<sup>2</sup>

Thus Norman had no doubts. Sir Charles Addis, however, was not quite so sure. He felt that price-level calculations were dangerous as a basis for judgement and suggested another remedy. Price-level calculations were, he felt,

"...so diverse...as for myself at least to feel less and less confidence in relying upon them as a sign that the conditions necessary for a return to the gold standard have been reached...it is desirable that they should be put to some test before they are finally accepted as having reached the point of equilibrium. I know of no other test than an approximately steady rate of exchange round about parity for a continued period."<sup>3</sup>

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1. P.R.O., T.160/197/7528/02/3, second evidence of Norman before the Bradbury Committee, 28 Jan., 1925.
  2. Ibid.
  3. Ibid., evidence of Sir Charles Addis before the Bradbury Committee, 28 Jan., 1925.

Unfortunately Sir Charles rather spoilt this piece of advice by saying that the Government should announce its intentions, which as Pigou pointed out would tend to invalidate the test by encouraging speculative demands for sterling, and become a self-fulfilling prophecy.

The circumstances, discussion and evidence of the Chamberlain/Bradbury Committee have been examined in some detail because they represent the major contribution to Treasury thinking from outside the charmed circle of the Treasury and the Bank of England. During the period up to the fall of the Labour Government in October 1924, the recommendations of the Committee had been tempered with considerable caution, in view of the gap that still existed between sterling and the dollar. This view was largely in agreement with the opinions of the majority of witnesses, including the F.B.I. After the sharp rise in sterling during the winter of 1924/5, the Committee became much bolder. In its final Report it recommended that the Government should announce in the near future that the gold export embargo would not be renewed, and that until the end of the year a general licence would be issued, allowing the free outflow of gold. The Committee minimised the effects of the adjustments needed, and did not even consider the possibility that the recent improvement in the exchanges was due, not to a change in the underlying competitive positions of America and Britain, but to speculation that in the absence of any announcement to the contrary, with a Conservative Government, traditionally favourable to financial and commercial interests, in office, and with Montagu Norman in constant consultation with Strong, there was a strong presumption that prohibition would not be renewed.

Be that as it may, the Committee reported to the Chancellor on the 5th of February,<sup>1</sup> and from that point on the discussion largely concerned the Treasury

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1. P.R.O., T.160/197/7528/01/3; published as Cmd. 2393 (London: H.M.S.O., 1925). One writer has suggested that had the Conservatives not won the election, the Gold Standard would not have been restored: see W. Reddaway, "Was \$4.86 inevitable in 1925?", Lloyds Bank Review, 96(1970). Given Snowden's known views, it seems unlikely that the result of the election had any long-term effect, although return might have been delayed until the end of the year.

and the Bank of England alone. To this final phase of the discussions we shall now turn.

### The Period of Internal Discussion

Following the fall of the Labour Government in October 1924, a General Election was held, at which the Conservative Party was triumphant. The Chancellor of the Exchequer in the new administration was Winston Churchill who, although a politician of long experience, knew little about financial affairs. Partly, it seems, because of this, he asked more questions than was normal in a Chancellor, and the resulting memoranda present a full and clear picture of the situation in the first quarter of 1925.

According to Sir James Grigg, at that time the Chancellor's Private Secretary, Churchill was

"told soon after his arrival [at the Treasury in November 1924] that the Act under which gold payments were suspended would expire with the year 1925, and that he would, therefore, have to face before long the choice between going back to gold or legislating to stay off it for another period of years."<sup>1</sup>

Although serious discussions did not begin until the end of January 1925, the problem was undoubtedly in Churchill's mind from the time he took office.

In December 1924 he wrote to Baldwin, the Prime Minister:

"The Governor of the Bank will, I hope, have told you this weekend about the imminence of an attempt to re-establish the gold standard...It will be easy to attain it, and indeed almost impossible to avoid taking the decision..."<sup>2</sup>

and in January 1925 he asked Niemeyer to request Hawtrey to write a paper on the problem of gold and the United States, commenting:

"The United States has accumulated the greater part of the gold in the world and is suffering from a serious plethora. Are we sure that in trying to establish the gold standard we shall not be favouring American interests...shall we not be relieving them of the consequences of their selfish and extortionate policy?"<sup>3</sup>

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1. P.J. Grigg, Prejudice and Judgement (London: Jonathan Cape, 1948), p.180.
  2. Chartwell papers, Churchill to Baldwin, 12 Dec., 1924, quoted in D.J. Moggridge, The Return to Gold (Cambridge: C.U.P., 1969), p. 40.
  3. P.R.O., T.171/246, Churchill to Niemeyer, 2 Jan., 1925.

The real debate on the problem began at the end of January, initiated by a minute written by Churchill on the 29th, and referred to in the files as 'Mr. Churchill's exercise'. This questioned the whole basis of the Gold Standard, and argued in favour of a managed currency, aimed at a stable price level, and a continuation of the gold export embargo. The object of the exercise was to enable Churchill to marshal the arguments in favour of returning to the Gold Standard:

"...I do not wish it to be inferred that I have arrived at any conclusions adverse to the re-establishment of the Gold Standard. On the contrary I am ready and anxious to be convinced..."<sup>1</sup>

Niemeyer submitted two separate replies to this memorandum, one arguing the case Churchill had presented step by step, the other giving in more general terms the familiar summary of the arguments in favour of returning to the Gold Standard. A copy of the Report of the Bradbury Committee was attached. The commentary on Churchill's minute has one particularly revealing passage. On the subject of the advance in sterling, Niemeyer suggested that this was

"...primarily because everyone believes we are going to revert to gold. It would soon cease to do so if this belief were damped down."<sup>2</sup>

He thus recognised that the current improvement in the exchange was primarily due to speculative movements, without examining the possibility that speculation might act in a different sense once the Gold Standard had been restored. The remainder of the paper is concerned with combatting the points in a standard fashion.

Churchill's minute was also sent to Sir John Bradbury, Montagu Norman and Hawtrey. Norman had no doubts at all that

"in the opinion of educated and reasonable men..."<sup>3</sup>

there was no alternative to restoring the Gold Standard, and the only question to be decided was the date. Bradbury and Hawtrey, the former briefly<sup>4</sup> and the latter at great length,<sup>5</sup> concurred in the general belief that an early return to the

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1. P.R.O., T.172/1499B, Churchill to Norman, Niemeyer, Bradbury and Hawtrey, 29 Jan., 1925.

2. *Ibid.*, Niemeyer to Churchill, 2 Feb., 1925.

3. *Ibid.*, Norman to Chancellor, 2 Feb., 1925.

4. *Ibid.*, 'The Gold Standard', memo. by Bradbury, 5 Feb., 1925.

5. *Ibid.*, 'The Gold Standard', memo. by Hawtrey, 2 Feb., 1925.

Gold Standard was the only practicable policy for Great Britain to follow.

Further light on Bradbury's opinion on the vexed question of parity is shed by a comment by a more junior member of the Treasury staff, Frederick (later Sir Frederick) Leith-Ross:

"Bradbury told me that they [the Bradbury Committee] were going to recommend the return to gold at the old parity. This surprised me, as it seemed to me to be putting a strain on the balance of payments at the then price level. But Bradbury said the evidence, both from the City and from economists, was overwhelmingly in favour of the pre-war parity, now that sterling had risen so near to that level (about 10 per cent below). It must be remembered that in those days devaluation was a novelty and there was something sacrosanct about the old parity..."<sup>1</sup>

This incidentally is the only critical comment by a Treasury official that has come to light, and the only comment of a more junior official on the problem. In the Treasury files, apart from brief notes on purely technical aspects of the problem, the minutes and papers are exclusively written by the senior official, Niemeyer, Hawtrey in his position as a theoretician, Bradbury, an ex-Permanent Secretary to the Treasury, and Norman, Governor of the Bank. But if Grigg's reactions are representative, the juniors were not in any disagreement over policy. Of the famous dinner party at which Bradbury and Niemeyer supported the Gold Standard, opposed by Keynes and McKenna, Grigg says,

"I thought at the time that the ayes had it."<sup>2</sup>

and later comments that he considered that, by returning to the Gold Standard, we in Britain were "shackling ourselves to reality."<sup>3</sup>

The response of the officials to Churchill's 'exercise' seemed to satisfy him for the time being; he wrote to Niemeyer that:

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1. Sir Frederick Leith-Ross, Money Talks (London: Hutchison and Co., 1968), pp. 91-92. It is perhaps worth observing that present-day attitudes in political and official circles to the current dollar/sterling parity are hardly less deferential.
  2. Grigg, Prejudice and Judgement, p. 180.
  3. Ibid., p. 183.

"Your papers and the Report of the [Bradbury] Committee marshalled for the first time, so far as I am concerned, the arguments for the policy you advocate. The Report of the Committee certainly provides a broad foundation both of argument and authority justifying the action proposed."<sup>1</sup>

He requested some more factual information, including a note on the return to the Gold Standard after the Napoleonic Wars. At the same time, he wrote to Sir Austen Chamberlain, who had resigned as Chairman of the Chamberlain/Bradbury Committee on taking office in the new Conservative Government, sending him a copy of the Committee's final Report, and asking his opinion of it.<sup>2</sup>

Chamberlain replied:

"I have read with profound interest and complete agreement the report of the Currency Committee...I feel sure that, if you make your announcement with decisive confidence on your own part, the operation will now be found, all things considered, a very easy one...I strongly support what I believe is your own view that you should make an early announcement of your power and determination not to renew the restrictions on the export of gold."<sup>3</sup>

The Treasury discussions continued during February, and at one point there seems to have been a real possibility that Churchill would reject the advice of the officials, and postpone or reject outright a return to the Gold Standard. The cause was an article by Keynes in the Nation, entitled "The Return Towards Gold".<sup>4</sup> Keynes stressed the dangers of linking the price level in Britain with that in America, particularly when the American price level was inflated by a boom in which Britain had not fully shared, and advocated a managed currency. Churchill read the article and Niemeyer's comments upon it, and wrote to Niemeyer asking for further amplification and explanation in trenchant and almost bitter tones.

"The Treasury have never, it seems to me, faced the profound significance of what Mr. Keynes calls 'the paradox of unemployment amidst dearth'. The Governor shows himself perfectly happy in the spectacle of Britain possessing the finest credit in the world simultaneously with a million

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1. P.R.O., T.172/1499B, Churchill to Niemeyer, 6 Feb., 1925.
  2. P.R.O., T.171/246, Churchill to Sir Austen Chamberlain, 6 Feb., 1925.
  3. *Ibid.*, Chamberlain to Churchill, 8 Feb., 1925; present author's underlining.
  4. J.M. Keynes, "The Return Towards Gold", *Nation* (London: 1925), Vol. XXXV, 21 Feb., 1925.

and a quarter unemployed....The Treasury and the Bank of England policy is the only policy consistently pursued. It is a terrible responsibility for those who have shaped it, unless they can be sure that there is no connection between the unique British phenomenon of unemployment and the long, resolute consistency of a particular financial policy...At any rate while that unemployment exists, no one is entitled to plume himself on the financial or credit policy which we have pursued...You and the Governor have managed this affair. Taken together I expect you know more about it than anyone else in the world. At any rate alone in the world you have had an opportunity over a definite period of years of seeing your policy carried out. That it is a great policy, greatly pursued, I have no doubt. But the fact that this island with its enormous resources is unable to maintain its population is surely a cause for the deepest heart-searching."<sup>1</sup>

Niemeyer's reply to this letter was in two parts. One part took the form of a detailed series of comments annotating Churchill's own letter, while the other consisted of a short paper restating the Treasury case. This episode provides an example of the problems caused by the vagaries of the Treasury filing system. For the Treasury's 'Gold Standard file', T.172/1499B, contains in this instance only a carbon copy of Churchill's letter to Niemeyer, and thus on the basis of that file, upon which so much previous comment has been based, it would appear that Niemeyer's only reply was the short memorandum. The top copy of Churchill's letter, with Niemeyer's hand-written comments, is in one of the files of papers on the 1925 Budget, T.171/246, and has thus escaped general notice.

In his main reply to Churchill's letter, Niemeyer suggested that the Chancellor was overestimating the importance of credit policy.

"Does 'the paradox of unemployment amidst dearth' arise wholly or mainly from credit policy? Clearly not wholly....I doubt whether credit policy is even a chief cause, and I at any rate would not advocate, still less be 'happy' with a credit policy which I thought would produce unemployment....You can by inflation (a most vicious form of subsidy) enable, temporarily, spending power to cope with large quantities of products. But unless you increase the dose continually, there comes a time when having destroyed the credit of the country you can inflate no more, money having ceased to be acceptable as value....I assume it to be admitted that with Russia and Germany before us we do not think plenty can be found on this path.

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1. P.R.O., T.172/1499B, Churchill to Niemeyer, 22 Feb., 1925. Elsewhere in the letter, Churchill refers to his thoughts as "these Sunday morning reflections".

If that be admitted, economic employment can only be given to the extent to which commodities can be produced at a price which existing uninflated wealth can pay for them. As the result of war there has been a great decrease in wealth, and there is consequently less effective demand. The only permanent remedy is to recreate the losses of war - really, not merely by manufacturing paper - and what we have to do for this purpose is (1) to stabilise our currency in relation to the main trading currencies of the world, (2) to reconstruct the broken parts of Europe and (3) to encourage thrift and the accumulation of capital for industry. These methods and not doles and palliatives are going to remedy unemployment (at least to the extent to which it was remedied in pre war days). We are now trying to put the finishing touches to (1). We have done what we can for (2) League Loans, Dawes, etc. We do all we can for (3) especially by repaying debt and by encouraging a belief that currency will not lose its value. Other methods may give for a year or so a hectic prosperity...but they won't give a permanent cure.

The above is necessarily put in a doctrinaire way. In practice we have to go now slow, now fast. But the root idea I am convinced is right, and the only way to enable this small island bound to buy and sell largely abroad...ultimately to support its population."<sup>1</sup>

There is unfortunately little evidence to show what Churchill's reaction was to this classic exposition of the traditional Treasury view. But <sup>in</sup> his attitude to the Governor, whom, in the letter just quoted, he blamed equally with Niemeyer for the problems of the economy, there seems at this time to have been a strong element of ambivalence. In the passage just quoted, Churchill's animosity towards the Governor is evident; yet we have Randolph Churchill's evidence that Norman visited his father once or twice a week during this period, and the younger Churchill remembers Norman telling Winston "I will make you the golden Chancellor."<sup>2</sup> The two men had a serious brush over the rise in Bank Rate from 4 to 5 percent in March 1925. At this time Niemeyer was away in Geneva on reparations business, and we have the story from Leith-Ross. Norman called at the Treasury to tell the Chancellor of his intention, and finding him away, asked Leith-Ross to inform Churchill.

"When Winston heard it he was indignant and complained bitterly that he ought to have been consulted."<sup>3</sup>

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1. P.R.O., T.172/1499B, Niemeyer to Churchill, 24 Feb., 1925.
  2. A. Boyle, Montagu Norman (London: Cassell and Co., 1967), p. 189.
  3. Leith-Ross, Money Talks, p. 95.

Apparently Leith-Ross suffered somewhat in the backwash of this indignation, and told Niemeyer of it in his next letter. Niemeyer replied,

"Winston will never realise that he is not Governor of the Bank..."<sup>1</sup>

Despite this altercation, relations between the Governor and the Chancellor continued to be mainly friendly; there is for instance a note in Norman's diary of lunching with Churchill in Downing Street in mid-March.<sup>2</sup>

In addition to the internal discussions, the Treasury had plenty of advice from outside. The files contain numerous press-cuttings, letters from interested parties, and so on. The bulk of the material is in support of the decision to return to the Gold Standard. Of particular interest is an article by Snowden, the former Labour Chancellor, published in the Observer in February 1925, on the advantages of the policy.

"To restore stability we must bind the currency to gold. All the dangers and uncertainties of an unstable currency will remain if the pound reaches par unless it is stabilised by being placed on a gold basis."<sup>3</sup>

Snowden did, however, stress the need for co-operation with other countries, particularly America, and this was a point echoed by the Federation of British Industries, who wrote to Churchill in the middle of March. The Federation was of the opinion that a return to the Gold Standard should be delayed until American prices had risen sufficiently to enable British prices to remain stable, but it appreciated that

"...while a waiting policy might be to the more immediate interests of those engaged in industry, it may be urged that other considerations make it inexpedient that we should wait indefinitely for the necessary upward movement in American prices."<sup>4</sup>

Furthermore, the Federation

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1. Leith-Ross, Money Talks, p. 95.
  2. Boyle, Montagu Norman, p. 189.
  3. Observer, article by Snowden, 8 Feb., 1925.
  4. P.R.O., T.172/1499B, F.B.I. to Churchill, 17 Mar., 1925.

"...desired to state clearly that in their opinion, since Great Britain is the principal international clearing house both for money and for goods, any step which would lead to a general return to a gold standard by the principal industrial countries in the world would be greatly to the benefit of British industry..."<sup>1</sup>

This point about a general return was, as we saw, raised before the Cunliffe Committee, and the Federation's representatives then agreed that the Scandinavian countries, the major Commonwealth countries, and Germany together constituted a sufficiently large block of countries to accompany the British return. The Federation's letter of March 1925 was less explicit on the subject, which is unfortunate, since it was principally on the attitude of the Federation that one commentator has based his assertion that Churchill was 'railroaded' into returning to the Gold Standard by bad Treasury advice.<sup>2</sup>

#### The Return to Gold

The Treasury thus approached the point of decision through a period of exhaustive discussion. This discussion, and the collection of papers which have survived, are unique in Treasury documentation, although the process was in general typical of that normally followed. But when all the arguments had been put and discussed, a firm decision had to be taken. Unfortunately, there is very little information about the final discussion at which the decision was formally taken. This took place at a meeting on March 20th, 1925, between the Prime Minister, the Chancellor, the Foreign Secretary, Norman, Bradbury and Niemeyer.<sup>3</sup> There is no record of the discussion at this meeting, nor of the Cabinet discussion of the proposal, since the decision formed part of the 1925 Budget, and, in accordance with convention, no minutes were kept of the meeting at which the Budget proposals were discussed. There is no record of the Cabinet having discussed the problem at any other time. The restoration of the Gold Standard

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1. P.R.O., T.172/1499B, F.B.I. to Churchill, 17 Mar., 1925.

2. See below, p.335.

3. P.R.O., T.172/1499B, note by Niemeyer, 20 Mar., 1925.

was announced in the House of Commons during the Budget speech, on April 28th, 1925.<sup>1</sup>

### The Treasury and the Return to Gold

The decision to return to the Gold Standard was, as we have seen, subject to doubt and criticism in some quarters at the time, and to increasing criticism since. The main burden of this criticism has been that Churchill was persuaded, against his better judgement and by the bad advice of his Treasury officials, to take the wrong decision, and that other courses of action were open to him. There seems little doubt that in later years Churchill himself came to believe that the 'doctrine of bad advice' was relevant in this case.<sup>2</sup> But at the time, there is much evidence to suggest that the Chancellor was at least a willing victim. It is true that he went on questioning the policy right up to the last moment: for instance, as late as April 23rd, only five days before the Budget, he wrote to Niemeyer asking him for an argued case in favour of returning to the Gold Standard immediately, rather than waiting for the gold export embargo to expire at the end of the year. But the tone of his request makes his attitude obvious:

"I am, as you know, in favour of this course on general grounds, but I should like to see the case for it set out quite clearly."<sup>3</sup>

The suggestion that Churchill was urged into the decision by bad advice has been given added force in recent years by the publication of Churchill's minute of February 22nd, in which he raises the problem of 'the paradox of unemployment amidst dearth'.<sup>4</sup> Skidelsky has asserted solely on the basis of this memorandum that Churchill was virtually forced into the decision by the Treasury, and suggested that only the memory of his father's fate prevented him from resigning rather than

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1. H. of C. Debates, 1925, CLXXXVIII, cols. 52-57.

2. See, for example, Grigg, Prejudice and Judgement, p. 185.

3. P.R.O., T.171/246, Churchill to Niemeyer, 23 Apr., 1925.

4. P.R.O., T.172/1499B, Churchill to Niemeyer, 22 Feb., 1925.

carry out the policy of returning to the Gold Standard.<sup>1</sup> Another writer, Rhodes James, has commented,

"The 'doctrine of bad advice' may be invoked on this occasion, but it should be emphasised that the urgings of the Federation of British Industries were in a contrary direction. By acting against this advice, and taking that of the bankers, Churchill had made a decision which was fully in line with his attitude on economic matters."<sup>2</sup>

In other words, Churchill took the decision willingly, but in doing so ignored the advice of the industrialists and took that of the bankers. This point about the attitude of the Federation of British Industries is something of a vexed question. Baldwin's biographers, for instance, state that the Federation was in favour of returning to the Gold Standard in the spring of 1925.<sup>3</sup> It is clear both from their evidence to the Bradbury Committee, and from the letter written in March 1925, that they certainly were not opposed to a return, but that they were anxious lest the return be forced, and credit restriction, falling prices and depression result. Their advice was quite clearly not sufficiently categorical to stand against so many opponents in financial circles, and in commercial fields too - the London Chamber of Commerce, for instance, was strongly in favour of a return to the Gold Standard.<sup>4</sup> Finally, the Federation themselves admitted that there might be circumstances in which from a financial point of view it might be 'inexpedient' to wait, and that in the long run the interests of the industrial and banking communities were the same.

On the personal level, there seems little doubt that the Treasury found Churchill somewhat trying at times. Thomas Jones noted:

"Grigg has not found Winston so malleable as Horne or Snowden."<sup>5</sup>

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1. The Times, article by R. Skidelsky, 17 Mar., 1969.
  2. R. Rhodes James, Churchill: a Study in Failure, 1900-1939 (London: Weidenfeld and Nicolson, 1970), p. 161.
  3. K. Middlemass and J. Barnes, Baldwin (London: Weidenfeld and Nicolson, 1969), p. 304.
  4. P.R.O., T.172/1499B, London Chamber of Commerce to Chancellor, 16 Mar., 1925.
  5. Thomas Jones, Whitehall Diary, Volume I, 1916-1925 ed. K. Middlemass (London: O.U.P., 1969), p. 315, entry for 17 May, 1925.

Leith-Ross, who was away during February 1925, wrote afterwards:

"The situation was still fluid during February and Niemeyer wrote me [sic]: 'Gold is excessively active and very troublesome. None of the witch-doctors see eye-to-eye and Winston cannot make up his mind whether he is a gold bug or a pure inflationist.' The Chancellor finally decided in favour of the return to gold - partly, as he himself said, because he knew that if he adopted this course Niemeyer would give him irrefutable arguments to support it, whereas if he refused to adopt it he would be faced with criticisms from the Treasury to which he would have no effective answer."<sup>1</sup>

However, it was not until some time after the decision that Churchill began to have serious misgivings. At the time, the single highly critical minute stands out as being atypical of his personal opinions; his speeches afterwards, and his letters to Baldwin, showed him to be happy with the results.<sup>2</sup>

As to the wisdom of the decision itself, opinion since has been almost unanimous in declaring that Keynes was right and that the pound was overvalued by approximately 10%. Since this work is primarily concerned with the way in which the decision was taken, it is not appropriate here to examine this question in any detail, particularly as many of the participants felt the calculations of relative price-levels to be so crude at that time as not to be very helpful. It is certainly arguable that the Treasury's statistical expertise was sadly lacking, and that had they been better equipped they might have realised that the rise in sterling in the winter of 1924/5 was a purely speculative one. The purchasing power question, and the economic implications of the decision, have been ably dealt with by Moggridge, and I see no cause to dispute his analysis.<sup>3</sup> However, to maintain that the decision was wrong from the point of view of hindsight without taking the matter any further, begs the question of what would have been the correct decision, and whether this was a practical and a political possibility. It is arguable that in fact, given the administrative, financial and political

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1. Leith-Ross, Money Talks, p. 92.

2. Middlemass and Barnes, Baldwin, p. 303.

3. Moggridge, The Return to Gold, particularly pp. 71-90.

structure of the day, there was no feasible alternative but to take what proved to be the 'wrong' decision.

It is easy, so many years afterwards, to forget how 'way-out' Keynes' ideas were at the time, particularly since he then had no theoretical backing for them. The financiers, many of the commercial and industrial interests, the financial press, the majority of politicians in the major parties, were all in favour of the return. Even the Federation of British Industries only differed to an extent which must have made it seem to the convinced that they were 'dithering'. Keynes' prime supporter in the banking sphere, McKenna, said in January 1925, in a private conversation at the Treasury:

"Even if the gold standard were not preferable for other reasons, its universality would be decisive in its favour....So long as nine people out of every ten in every country think the gold standard is the best, it is the best."<sup>1</sup>

Further, when asked for his opinion by Churchill at the famous dinner party reported by Grigg, McKenna again deserted his friend and agreed that we would have to go back to the Gold Standard. Beaverbrook's championship seems likely to have cost the opposition more enemies than it won friends in influential circles. In these circumstances, it is hardly surprising that the officials were misled by the rise in sterling, which they had been long expecting, into believing that the underlying movement in American prices was in the desired direction, and that the exchanges were a more accurate indicator of relative price levels than the 'price indices.

Given that the great mass of informed opinion was in favour of a return to the Gold Standard, the Treasury would have had to be a singularly independent-minded, imaginative and authoritative body to combat it. But the whole organisation of the Treasury, including its method of doing business and the way in which its staff were trained, militated against its being in any sense a place for original

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1. P.R.O., T.171/246, McKenna's conversation with the Chancellor, 17 Jan., 1925.

ideas and fresh policy initiatives. The whole ethos of the Treasury was based on following historical precedent, on doing things the way they had always been done, and from this arose the desire to get back to the conditions of pre-war days, the 'back to normalcy' desire that was echoed in the population as a whole. This is what makes the Gold Standard so important for the purpose of this work. It occupied a pre-eminent place of importance among the problems of the period. But it also, and in large part because of this, typified the whole official dilemma. The structure of the Treasury, and its pattern of policy-making, meant that the strongest possible emphasis was placed on following previous decisions and practice, where this had proved successful. This meant that where conditions had changed, the Treasury was likely to take insufficient account of the changes: this was particularly true of the Gold Standard question. Thus the Treasury became, in a sense, the prisoner of past success; it advised the Chancellor to take what proved to be the wrong decision, because the decision-making processes allowed insufficient weight to be given to changed conditions.

CONCLUSION:

THE ROLE OF THE TREASURY IN THE

FORMATION OF BRITISH ECONOMIC POLICY, 1918-1925

The aim of this study has been to identify the role of the Treasury in the formation of British economic policy in the years from 1918 to 1925. During this period, radical changes were taking place, both within the traditional spheres of responsibility of the Treasury, and in the scope of its commitments and involvement outside those areas. For a number of reasons, the years of the First World War and the period immediately afterwards saw changes of considerable magnitude in the work of the British Treasury. Partly it was due to the great upheaval in all areas of economic life caused by the war, and partly to long-term trends which had begun before 1914. As a result of alterations in external conditions, in both the domestic and the international economy, the Treasury's traditional areas of responsibility - budgetary control and debt management - changed both in substance and in magnitude. At the same time, the Treasury's responsibilities extended into new areas which either did not exist before the war, or else were not regarded as being the concern of the central government. Many of the great problems of the 'twenties, such as reparations, inter-allied debt, and high long-term unemployment, had no pre-war parallel. There was thus no previous experience to act as guide. Moreover, another important area of difficulty in the 'twenties, that of international monetary policy and the Gold Standard, had been primarily the responsibility of the Bank of England before the war.

The role of the Treasury in policy-making can be divided into three main elements. The first concerns the way in which opinion was formed within the Treasury, and the factors influencing the advice which the officials tendered to their Ministers. Secondly, there is the nature of the advice which they gave, its appropriateness and effectiveness in the problem concerned, and the competence of the Department in implementing decisions on policy matters. Thirdly, we should consider the effect of this advice and the manner in which it was given upon the decision-making process, and the extent of official influence on Ministerial opinions and decisions.

## Treasury Structure and the Formation of Opinion

The Treasury which had to deal with these problems of change was, at the same time, going through a period of internal upheaval. The structure which had been appropriate to a small, homogeneous Department became inappropriate to one more than twice its pre-war size, and with greatly enlarged and highly disparate responsibilities. The Department was accordingly reorganized, but it was still a relatively small body at the administrative level, and retained much of its friendliness, and its traditional methods of working and approach to its duties.

This was particularly true in those sections of the Treasury most closely concerned with policy-making. This was largely a function of the way in which the Treasury staff was organised. The parts of the work of the Treasury most closely concerned with policy-making were heavily concentrated in the Finance Divisions of the Treasury, 1D and 2D, which after the reorganisation of 1919 were grouped together, with Financial Enquiries, to form the Finance Department, under the Controller of Finance. The remainder of the Administrative Class staff in the Treasury worked in the Supply and Establishments Divisions, where the responsibilities were of a more routine kind, and which, since these Divisions tended to work through and with other Government Departments, rarely took policy initiatives of their own. Within the Finance Department, the numbers of staff, although double the pre-war figure, were still very small. In 1920, there were seven Principals and four Assistant Principals, divided between the Finance Divisions, with a Principal Assistant Secretary in charge of 1D and of 2D, and a Controller of Finance with overall responsibility to the Chancellor, and the rank of a Permanent Secretary. So that in the Department most closely concerned with policy-making, there was during the inter-war period a staff of thirteen civil servants of the administrative class. It is perhaps not surprising, then, that at least this part of the Treasury retained much of its pre-war atmosphere, and tended to remain a closely-integrated Department.

The small size of the Department mainly concerned with decision-making would probably have tended to encourage homogeneity and continuity in opinions and actions. But other factors contributed to enhance this tendency. Each Principal had an Assistant Principal responsible to him; since Assistant Principal was a training grade, and a man in this position was not able to commit the Treasury to a course of action on his own authority, the two tended to work closely together. One contemporary, it will be remembered, was, as an Assistant Principal, responsible to two Principals; he was given a room between the two occupied by his seniors, with interconnecting doors to both rooms, and there was considerable and close contact between the junior and his seniors. It is, however, interesting that as far as one can tell, this close contact was confined to the professional situation. Certain clubs had several Treasury members, but <sup>there was</sup> no strong tendency for nearly all, or large sections, to belong to one particular club, nor for them to belong to the same clubs as their Ministers. Nor is there any suggestion from contemporaries that there was much social contact between officials; their homes tended to be in many different areas, and what contact there was, was with the few officials who lived relatively close. Organised Service activities only really tended to get under way in the later part of the inter-war period, although there was by the late 'twenties a rambling club in existence, which used occasionally to meet Baldwin and Norman after their tramp and go to Baldwin's home to sing madrigals. But apparently no 'shop' was talked even on those occasions.

Within the Department, as we have seen, action tended to be taken at the lowest level consistent with the importance of the problem. Each Principal had his own area of responsibility; it was the job of his Assistant to draft written material on matters within this area, and for the Principal wherever possible to take the necessary steps himself in the light of the evidence presented to him. This would of course include precedents for the question. Where a problem was a particularly difficult one, it would be taken up with the appropriate Under Secretary, or if really serious it might eventually reach the Controller, whose

responsibility it was to see that matters of Ministerial concern did in fact reach the Minister. Matters for decision might also be raised independently at any level; problems were also presented to the officials from Ministers for advice and information. Where matters of major policy importance were concerned, only the most senior officials tended to be involved; this seems to have been partly because the Treasury was very 'security-conscious' even at this period. The one exception to this seems to have been where the staff of the Chancellor's Private Office were concerned: the Minister's Private Secretaries played a pivotal role in the network of official relationships.

The conservative bias in the official environment tended to be reinforced during the period from 1918 to 1925 by continuity of tenure of office among the small number of officials concerned with advising Ministers on matters of policy. All three men who held the post of Controller of Finance had been Treasury civil servants for most of their working lives, and one man, Sir Otto Niemeyer, was successively Deputy Controller and Controller for six of the seven years of our study. For the same six years, another man, Sir Warren Fisher, held the post of Permanent Secretary, with ultimate responsibility for the work of the Treasury as a whole. In addition, a single Private Secretary, Sir James Grigg, served five of the seven Chancellors of our period, that is all except Bonar Law and Sir Austen Chamberlain.

#### Treasury Opinion and Competence

As might be expected from what has been said about the training and experience of Treasury officials, the main strand of thought identifiable in our period is their great concern with orthodox values, and the importance of historical precedent. This tradition also found some support in the population as a whole, which was anxious to return to the apparent stability and certainty of the pre-1914 period, a desire echoed in the popular American cry, 'back to normalcy'.

Nowhere is the desire to return to pre-war stability more evident than in the Reports of the Cunliffe Committee. Sir John Bradbury, then joint Permanent Secretary to the Treasury, made a major contribution to the form and content of the Reports. At the heart of the Committee's recommendations was the belief that the pre-war Gold Standard represented the only tenable way of regulating Britain's financial relations with other countries. The analysis presented by the Committee of the way in which the Gold Standard worked before the war failed to recognise the fact that an essential part of its smooth working was the position of London as the financial centre of the world. The extent to which the European Allies were indebted to the United States contributed to the rise in importance of New York, as did the effects of the sale of British overseas assets during the war. Because they did not realise that the pre-war Gold Standard was essentially a sterling standard, they did not make sufficient allowance for the increasing importance of New York as a financial centre, nor did they fully appreciate the way in which the changes brought about by the war would affect the working of the Gold Standard.

In the country as a whole, the desire to return to pre-war conditions found expression primarily in the demand for a 'bonfire of controls'. Initially, there had been much anxiety about the possibility of high unemployment, when the Forces were demobilised, but as these fears were apparently seen to be groundless, the situation changed, and more and more people became anxious to be rid as soon as possible of irksome Government interference in their everyday lives. The structure of control had grown up in such a way that the line of least resistance at the end of the war was simply to let them lapse, and this was a major factor in the speed with which the Government jettisoned its hold over the economy. This was a serious setback for those who, like Addison, saw the period of reconstruction as an opportunity for using some of the control which the Government had amassed during the war period as a means of improving the lot of the people in peace-time.

The death-blow to these schemes was, however, dealt by the 'Economy' campaign of 1919, with whose aims the Treasury, anxious to re-establish its control over Government expenditure, completely concurred. In the early part of 1919, the Treasury had found itself opposed by many men in public life, who felt that large sums of money were necessary to rebuild the economy, and to provide jobs and homes 'fit for heroes'. As time went on, however, public opinion became increasingly anxious about the levels of Government expenditure, led by an anti-waste campaign directed by the popular newspapers. In the spring of 1919, Lloyd George had advocated reconstruction with as much vigour as Addison; by the late summer of that year, when the unemployment bogey had for the time being receded, he was being assisted by the Permanent Secretary to the Treasury in carrying out a stringent economy campaign, in which many treasured schemes of reconstruction, such as the creation of a Ministry of Supply, were quietly shelved. Despite this setback, Government involvement in the economy continued to be at a higher level than before the war, and Government expenditure took about double the proportion of GNP which it had expended before the war. In the Treasury's anxiety to reduce public expenditure, and in particular its antipathy to the big new Departments set up during the war which were felt to be particularly spendthrift, it may be that another attitude was involved besides that of the desire to re-establish Treasury control. It may be that their resistance to movements in the direction of a mixed economy was partly due to a reluctance to allow their traditional role in the economy to change. This would go some way to explaining the lack of any sense of direction in Treasury activities in our period, or of any recognition of the impact upon the economy of Treasury actions.

The speed and readiness with which controls were removed served to increase the problems which the Treasury experienced in the field of debt redemption and monetary policy. In this field, the Treasury's task was made immeasurably more difficult by the improvident way in which the war had been financed, whereby

taxation had been expected to provide only sufficient revenue to cover normal peace-time expenditure, leaving the whole cost of the war to be financed from loans. This area is another in which the Treasury's predilection for following pre-war precedent is evident, even when this involved pursuing conflicting strategies. The two main aims of Treasury policy here, pursued both for their own sake, and because if carried out successfully would assist the return to the Gold Standard, were the funding and repayment of the vast volume of Government debt as quickly as possible, and the maintenance of interest rates which would be competitive with those in other centres, especially New York. This latter aim often led during the 'twenties to a higher level of interest rates than would have seemed wise if judged purely in the light of the needs of the domestic economy. A further aim, which was largely in conflict with the other two, was to keep the cost of Government borrowing as low as possible; throughout the early 'twenties, the volume of Treasury Bills which had regularly to be renewed was such that this consideration had to take second place to the others. Thus during this period, once the potential for imposed controls over the money market had been gladly relinquished by the Treasury in 1919, the authorities were to a large extent at the mercy of the market. But the payment and funding of the short-term debt was an essential prerequisite for regaining official control over money rates, a desirable thing in any case, and essential before a return to the Gold Standard was attempted.

Throughout the post-war period, the importance of a return to the Gold Standard bulked large in the minds of the Treasury officials. There was something almost moral about the fervour with which they pursued their goal; there was certainly an element of 'setting an example' to the rest of the world in much of their writing on the subject, as if Britain had only to behave as though the world had remained unchanged since 1914 for this to be so. The question of the Gold Standard was one with which the Treasury had not previously had to deal,

but it was a situation in which the desire to get back to pre-war stability was significant. This desire, coupled with and enhanced by the Treasury's preoccupation with historical precedent, tended to blind the officials to the changes which had taken place during the war. The lack of factual knowledge about the nature of these changes enabled the officials to take less cognizance of the new situation than was appropriate. They were inclined to pursue their aim single-mindedly, even when the requirements of this policy conflicted with the immediate needs of the domestic economy. This is another example of the unwillingness of the Treasury to think in terms of the impact of its actions upon the economy as a whole. But it may also have some significance in terms of the desire of the Treasury to return to its pre-war role, as well as to previous policies. For the Gold Standard was traditionally the responsibility of the Bank of England. One might have expected that, having gained control over so important an instrument in the regulation of economic life as the exchange rate, the Treasury would have made some effort to retain it; but there is no evidence of tension of this kind between the Treasury and the Bank. This may at first seem surprising, but there appears to have been a well-understood separation of roles and identities between the two institutions. Treasury officials with pre-war experience seemed to regard the pre-war functions of the Bank which had been abrogated to the Treasury during the war as very temporary responsibilities, to be restored to the Bank as soon as was feasible, so that the Treasury could return to its normal peace-time role.

Among the aspects of Treasury policy which we have examined, the only point at which a Treasury official suggested a major change in policy, in conflict with many other influential people, was the Blakett initiative over inter-Allied debts. This is a good example of an occasion when a Treasury official, unencumbered by the weight of historical precedent or the overwhelming weight of informed opinion, put forward a policy which could have formed a basis for a viable solution for one of the most serious and intractable problems of the inter-war period. It

was, however, as far as can be seen, unique. Whether this was because this combination of circumstances, involving a lack of close historical precedents, combined with a dearth of strongly-held influential opinion, occurred only in this field, is difficult to say. But it may well be thought significant that the only discoverable major contribution to a new policy initiative by a member of the Treasury was in an area where he had, so to speak, a clear field. It is interesting to note, too, that the area concerned was that of international policy. For if there was evidence of the Treasury breaking new ground in the inter-war period, it is in their increasing involvement, particularly at the personal level, in international affairs; the careers of many of those mentioned in this study bear witness to this.

Thus a most striking aspect of Treasury policy in our period is the extent to which it was dominated throughout by the overwhelming desire and need to return to the Gold Standard as soon as possible, at the pre-war rate of exchange. Wherever any major policy matter was discussed, the probable effect on Gold Standard policy was a major factor. The conclusions of the Cunliffe Committee laid down in uncompromising terms what every Treasury official of note felt to be the principles on which post-war monetary policy should be based. Every attempt during the early 'twenties to expand the economy and improve the employment situation by a measure of what would nowadays be called reflation, was met with the same objection, that it might damage our prospects of returning to the Gold Standard.

But although this aspect of policy is vitally important, it was in fact part of an all-pervading attitude in the Treasury, that after the war it would be possible and desirable to continue to behave, in the economic sphere, in the same way as before the war, despite the extent to which conditions had changed. This can be seen in many of the policies advocated by the Treasury. The approach which it took during the economy campaign is one example. The opportunity to take

advantage of some of the beneficial aspects of war-time control was lost in the hectic rush to rid the economy of all controls as soon as the war was over. But this attitude was simply a continuation of the previous peace-time laissez-faire approach to economic problems, and an intrinsic part of the efforts to reintroduce Treasury control. Similarly, the approach to the problem of the National Debt was a continuation of the pre-war attitude that funding and repayment were the only correct methods of dealing with the problem, despite the fact that the National Debt had reached such proportions by the end of the war that to fund and repay at the rate that most Treasury officials would have liked would have resulted in severe deflation. Awareness of this problem was demonstrated by Blackett, but the evidence is that he was alone among senior Treasury officials in having some awareness of the macro-economic implications of Treasury activity in this field.

#### The Treasury Officials and their Ministers

The traditional view of the decision-making process in Government lays down that it is the civil servant's duty to advise his Minister on matters which are the latter's concern, on which the Minister makes up his own mind, and then goes to the Cabinet for discussion, and acceptance or rejection of his decision. What we have to consider is the extent to which this view represents the realities, rather than the form of the formulation of policy during our period. To some extent this must be a function of the personalities involved, both at the official and Ministerial levels; but it is also related to the general character of the Treasury as a Department, and to outside influences, both general and personal, such as the weight carried by the Chancellor in the Cabinet, the influence of public opinion, and so on.

The importance of the influence of personality upon the relationship between Ministers and their officials, and the extent to which particular Ministers tended to go against official advice or accept it without demur, is somewhat difficult

to establish. Several contemporaries have emphasised the importance of the personality of the Chancellor in establishing the quality of the relationship between himself and the officials. Where a Chancellor was a man of strong personality, senior in his party and experienced in holding political office, there seems little doubt that he was able without great difficulty to establish his own ideas, and be in that sense 'master in his own house', and all the contemporaries consulted agree that this is the situation which officials prefer. However, in the period from 1918 to 1925, a rather special set of circumstances presented themselves. There was considerable continuity among the officials; against this, there was great discontinuity among the Chancellors. During the period there were seven Chancellors, many of them with little or no experience of senior Cabinet responsibilities. The first two, Bonar Law and Austen Chamberlain, were considerably more senior and more experienced than their successors, but both had other responsibilities for a great part of their period of office, which tended to take them away from their Treasury duties a good deal.

Thus during the years immediately after the war, policy-making within the Treasury tended still to be concentrated in the hands of a few senior officials, whose training and method of working tended to reinforce the conservative traditions inherent in the atmosphere of the Treasury. The Ministers whom they advised tended to be in office for a short time, and to be inexperienced in Cabinet office and in financial affairs. Thus, while it seems clear from the evidence of contemporaries that both the normal situation, and that preferred by the officials, was for the Chancellor to be 'the boss', in our period the Chancellors were in the main either distracted by outside duties or lacking in experience, and the advice of Treasury officials tended to be accepted without much opposition from Ministers, nor did those Ministers show much initiative in policy-making themselves. However, it would be wrong to suggest that in their advocacy of traditional policies the Treasury officials were encouraging their Ministers to take a

contentious view. On the whole, the attitudes of the Treasury reflected the orthodoxies of the period, and were in agreement with the opinions of most of the leading figures in industrial life, in the City of London, in the 'serious' press, and among academic economists. There was some public opposition to deflationary policies during the 'twenties, but it did not become more than a 'respectable heresy', and none of those involved, except Keynes, was prepared to push their view to its logical conclusion and criticise the policy of returning to the Gold Standard, which was a main reason for continuing deflationary policies long after the needs of the domestic economy were for quite different measures.

The final link in the official decision-making process, that between Ministerial recommendations and the adoption of such proposals as Government policy by the Cabinet, is not easy to establish. One might have expected that an inexperienced Chancellor might have undergone pressure both from his officials to adhere to traditional policies, and from his Cabinet Colleagues, perhaps of a different nature. But one of the remarkable things about the period under review is the extent to which vital financial decisions were taken without the Cabinet being consulted at all. For instance, the decision to accept the Reports of the Cunliffe Committee was taken without consulting the Cabinet, and there is no evidence of the Chancellor having any informal consultations about the decision outside his own Department. Similarly, the decision to return to the Gold Standard was taken at a meeting at which the only politicians present were the Chancellor and the Prime Minister; the Cabinet was only told formally as part of the discussion of the Budget proposals, on the day on which the Budget was to be presented in the House.

However, there is little evidence to suggest that, had the Cabinet been consulted more frequently, the policy-making machinery would have been more capable of adapting to the changes which had taken place. The inter-Allied debt problem provides us with an interesting example of the inability of the Cabinet

to react appropriately to changed conditions, even when the officials and the Minister concerned were attempting to do so. In this situation, unshackled by the chains of conventional ideas and historical precedent, the Controller of Finance was able to produce an original and helpful solution to the problem, only to be thwarted by the less imaginative and more vote-conscious members of the Cabinet. This policy may not have been the right one for this particular problem, but it at least had the appeal of an attempt to 'cut the gordian knot'. Its rejection, and the manner in which it was rejected, provide further evidence of the extent to which the vast majority of people in public life, not just Treasury officials, were unable to widen their thinking sufficiently to make any real contribution to solving the economic problems of the period, and continued to be bound by traditional attitudes.

#### The Role of the Treasury

It seems clear that within the Treasury during the post-war period, there was a strong tendency to accept and put forward solutions which had been successful in the past in the same or similar situations in the past. This tendency was reinforced by the fact that these solutions were consistent with the traditions of the Department, and that the training and environment of the officials encouraged them to seek such consistency. In addition, the correctness of these orthodox solutions was apparently further endorsed by the way in which they conformed to the views of outside opinion close to the Treasury, and in particular to the recommendations of the Cunliffe Committee. The fact that this Committee had examined the problems of post-war financial policy in detail, and had, after considering and rejecting other possible courses of action, put forward just those solutions which the Treasury believed from past experience would be the most successful, was a powerful reinforcement for traditional attitudes. On the whole, it is not unfair to say that, after the Cunliffe Reports had been accepted, British

financial policy did not have any identifiable source; it simply consisted of a series of reactions to particular events and problems. Conscious decisions were taken about particular actions, but general discussion about central ideas in policy-making simply did not take place, except on rare occasions, such as Churchill's 'exercise' in the spring of 1925. Unfortunately, while the problems to which the Treasury officials were attempting to apply pre-war solutions appeared similar to situations which they had encountered before, conditions had in fact changed to a remarkable degree. Not only did the Treasury's predilection for previously successful remedies blind it to the changes within its traditional areas of responsibility. In addition, the training and experience of the officials concerned helped to hide from them the extent to which the role of the State as a whole had changed, and encouraged them to continue to view particular problems and their solution in isolation from the rest of the economy. In the field of international relations, as distinct from the specific position of Britain in the international economy, the Treasury recognised that conditions had changed to such an extent that greater international co-operation was essential. But it persisted in believing that it was possible for Britain to continue to behave as though her position in the world, and the position of the State in the British economy, were unaltered.

Thus the advice which officials gave to the Chancellor often tended to emphasise the appropriateness of one solution to a problem to the exclusion, or at least the denigration, of other possible courses. However, as we have seen, most of the Chancellors of the period were inexperienced in public finance and in office for a very short time. They do not seem to have resented, or even noticed, the lack of room for manoeuvre given to them by the way in which Treasury advice was presented during this period. Even Churchill did not persist with his criticisms once the Treasury view on the Gold Standard had been explained to him in detail, although he gradually grew bolder as his term of office progressed.

For as far as we can determine, the Chancellors were largely in agreement with their officials over the fundamental principles of economic policy, as were the majority of their contemporaries in politics, in industry and in the City.

There are therefore three major criticisms which can be made of Treasury attitudes during our period. Firstly there was a lack of consideration of the extent to which conditions had changed within the areas of financial and economic policy with which they had traditionally been concerned. Secondly, there was little recognition either of the changes in the role of the State in general, and the Treasury in particular, or of the effect of Treasury actions on the economy as a whole. Thirdly, and related to this last point, there was little in the way of long-term planning as a preliminary to action; apart from an almost blind faith in the Gold Standard, the restoration of which became an end in itself, there was very little sense of direction in the Treasury's actions during the post-war years.

Thus the role of the Treasury officials in the formation of economic policy during the period from 1918 to 1925 was to promulgate their considered views to the Chancellors whom they served. The measure of success which they achieved in putting forward their ideas, of which the central theme was the restoration of the Gold Standard, was due ultimately to the conjunction of events and the general climate of opinion. Despite the fact that pre-war experience was proving to be increasingly irrelevant, the traditional policies were endorsed because no-one in a position of responsibility had any idea what else to do. 'Back to normalcy' was not an attitude confined to Treasury civil servants; nor were they alone in viewing the world of the 'twenties through the blinkers of the past. They were simply typical of the public men of their time. However, for the Treasury, the urge to return to the stability of the pre-war world had a special significance: it was due not only to a desire to continue to carry out traditional policies, but also to an anxiety to resume an earlier role in the economy.

BIOGRAPHICAL APPENDIX

ON

TREASURY OFFICIALS

These biographical notes are intended to supplement the information given about Treasury officials mentioned in the text. The information is readily available in the standard works of reference.

Blackett, Sir Basil Phillott:

Born in 1882, the son of missionaries; his father was a clergyman. He went to Marlborough as a Foundation Scholar, after his father died. He gained a First in Classics at University College, Oxford in 1904, and entered the Treasury after coming top of the list in the Civil Service examinations. He was Secretary to the Royal Commission on Indian Currency during 1913-14; J.M. Keynes was a member of this Commission. He went to the United States twice on Treasury missions early in the war, and was Treasury Representative in Washington from 1917 to 1919. On his return to London, he was appointed Controller of Finance in the Treasury. In 1922, he went to India as Finance Member of the Viceroy's Council, and during his time in India he made major reforms and gained great personal prestige. On his return in 1928, he left the Treasury for international work on the Reparations Committee which drew up the Young plan in 1929, and for work in the City. He became a Director of the Bank of England in 1929. The events of 1931 converted him to Keynesian ideas, and he wrote a book on planned money. He stood as an unofficial Conservative candidate for Parliament in 1932, but failed to become elected. He died in a car accident in Germany in 1937.

Clubs: Oxford and Cambridge.

Bradbury, John Swanwick, First Baron Bradbury:

Born in 1872, he was the only son of an oil merchant. He was educated at Manchester Grammar School and Brasenose College, Oxford, where he gained a double First in Classics and Modern History. He entered the Colonial Office in 1896, from where he was transferred to the Treasury. He was Asquith's

Private Secretary in 1905, and became head of 1D in 1908. He was a member of the National Insurance Commission in 1911, and on returning to the Treasury was made joint Permanent Secretary in 1913. One of his major achievements in the early part of the war was the evolving of a system for issuing notes of small denominations, which became known as 'Bradburys', thus making his name a household word. In 1919 he left the Treasury to become British Delegate to the Reparations Commission, where he remained until he retired in 1925. He undertook a number of Directorships in the city, and served on the MacMillan Committee on Finance and Industry from 1929 to 1931; unable to agree with his colleagues on the Committee, he wrote a Minority Report, dissenting from their views.

Club: United University.

Chalmers, Robert, First Baron Chalmers of Northiam:

Born in Scotland in 1858, he was educated at the City of London School. He gained degrees in Classics and in Biology while at Oriel College, Oxford, and entered the Treasury in 1882. During his early years in the Treasury he lived in the East End of London, working at St. Jude's, Whitechapel, and giving up all his spare time to social work. He was promoted to Assistant Secretary in 1903, and in 1907 moved to the Inland Revenue, where he was Chairman until 1911. He then returned to the Treasury to be Permanent Secretary until 1913, when he went to Ceylon to be the Governor there. He was not happy in his new post, and returned to the Treasury in 1916, to be joint Permanent Secretary with Bradbury and Sir Thomas Heath until the end of the war. After his retirement he returned to academic life, and became Master of Peterhouse in 1924, where he remained until his death in 1931.

Club: United University.

Fisher, Sir Norman Fenwick Warren:

Born in 1879, the son of a gentleman of independent means, he was educated at Winchester and Hertford College, Oxford, where he gained a Second in Classics. He entered the Inland Revenue in 1903, and was Private Secretary to Chalmers, the Chairman, from 1907-1909. In 1912 he was seconded to the National Insurance Commission, where he remained for two years. He returned to the Inland Revenue, and became Deputy Chairman in 1914 and Chairman in 1918. In the autumn of the following year, he moved to the Treasury to become Permanent Secretary, a post which he retained until his retirement in 1939. His Treasury interests were confined in the main to Establishment problems. After leaving the Treasury, he spent the war as a Civil Defence Commissioner.

Clubs: Athenaeum, Brooke's.

Grigg, Rt. Hon. Sir Percy James:

Born in 1890, he was the son of a boat-builder, who set up in business on his own so that his eldest son could have the education his talents merited. He was educated at Bournemouth School and St. John's College, Cambridge, where he gained a First in Mathematics in 1913. He entered the Treasury, but in 1915, he joined the armed forces and served throughout the war. He returned to the Treasury in 1918, and in 1921 became Private Secretary to Sir Robert Horne on his becoming Chancellor. For the next nine years he was Private Secretary to five successive Chancellors. In 1930 he left the Treasury to become Chairman of the Board of Customs and Excise, from which post he moved after a few months to be Chairman of the Inland Revenue. In 1934 he went to India as Finance Member of the Indian Government, returning in 1939 to become Under Secretary of State for War; in 1942, he was made Secretary of State for War. After the war he left politics for business.

Club: Athenaeum.

Hawtrey, Sir Ralph:

Born in 1879, he was educated at Eton and Trinity College, Cambridge. He entered the Admiralty in 1903, and transferred to the Treasury the following year. In 1919 he became Director of the Financial Enquiries Division, which was part of the Finance Department. He retained this post until his retirement in 1945. His many publications, the first of which appeared in 1913 and the latest in 1967, included Currency and Credit (1919), Trade and Credit (1929), A Century of Bank Rate (1938), and many others.

Club: United University.

Leith-Ross, Sir Frederick:

Born in 1887, he was educated at the Merchant Taylors' School and Balliol College, Oxford, where he gained a First in Classics in 1909, and entered the Treasury in the same year. He was Private Secretary to Asquith from 1911 to 1913, and returned to normal Treasury duties in the Finance Division until 1920. He was British Representative on the Finance Board of the Reparations Commission from 1920 until 1925, when he returned to England to become Deputy Controller of Finance. In 1932 he became Chief Economic Adviser to His Majesty's Government, where he remained until his retirement in 1946. During this time he represented Great Britain at numerous international conferences and similar gatherings.

Club: Athenaeum.

~~Mac~~Fadyean, Sir Andrew:

Born in 1887, he went to University College School and then to University College, Oxford. He gained a First in Classics in 1909, and joined the Treasury the following year. He was Private Secretary to several Chancellors and Financial Secretaries, including Baldwin. In 1919 he went to Paris as Treasury Representative, and thereafter his Treasury career was spent almost

entirely overseas. From 1920 until 1922 he was Secretary to the British Delegation to the Reparations Commission, where he came into constant contact with Bradbury. He then became General Secretary to the Reparations Commission, on secondment, until 1924, and was Commissioner for Controlled Revenues in Berlin from 1924 until 1930. On his return to England in 1930, he decided against returning to the Treasury, and devoted his time to business and politics, where he was for many years the mainstay of Liberal Party organisation.

Club: Travellers'.

Niemeyer, Sir Otto Ernst:

Born in 1883, he was educated at St. Paul's School and Balliol College, Oxford. He entered the Treasury in 1906, and was made Controller of Finance in 1922, having been Blackett's Deputy Controller since the reorganisation of 1919. He remained in his new post until 1927, when he left the Treasury for work in international finance. He was a member of the Financial Committee of the League of Nations from 1922 to 1937. After he left the Treasury, he undertook a series of financial missions: to Australia and New Zealand in 1930, to Brazil in 1931, to Argentine in 1933, to India in 1935, and to China in 1941. He was a Director of the Bank of England from 1938 until 1952, and of the Bank for International Settlements from 1931 to 1965.

Club: Reform.

Phillips, Sir Frederick:

Born in 1884, he was educated at Haberdasher's Aske's and Emmanuel College, Cambridge. He gained a double First in Mathematics and Natural Sciences, and entered the Treasury in 1908. He spent all his working life in the Whitehall Treasury, being promoted to Assistant Secretary in 1919 and to

Principal Assistant Secretary in 1927. In 1940 he was Chairman of the Financial Committee of the League of Nations.

Clubs: United University, Reform.

Rowe-Dutton, Sir Ernest:

Born in 1891, he entered the Treasury in 1919, after transferring from the Inland Revenue, where he spent the war years. He accompanied Baldwin and Norman on the Funding Mission to Washington in 1923, and spent much of his career abroad; from 1928 to 1932 he was Treasury representative in Berlin, and from 1934 to 1939 he was Financial Adviser to the British Embassy in Paris.

Club: Union.

It is interesting to note, for purposes of comparison, that of the seven Chancellors of the period 1918 to 1925, only one, Snowden, did not attend a Public School, and four went to Harrow or Rugby. As to Clubs, of those mentioned for the Treasury Civil Servants, the Athenæum also counted among its members Baldwin, Churchill and Neville Chamberlain; Austen Chamberlain and Baldwin belonged to the United University, and Baldwin also to the Travellers'.

STATISTICAL APPENDIX

TABLE 1

Total government income and expenditure

United Kingdom, 1921-38

Figures in £ million

	Total Gross Income	Total Gross Expenditure
1921	1,426.0	1,188.1
1922	1,124.9	1,070.1
1923	914.0	812.5
1924	837.2	748.8
1925	799.4	750.8
1926	812.1	776.1
1927	805.7	782.4
1928	842.4	773.6
1929	836.4	760.5
1930	815.0	781.7
1931	857.8	814.2
1932	851.5	818.6
1933	827.0	833.0
1934	809.4	770.5
1935	804.6	784.7
1936	844.8	829.4
1937	896.6	889.1
1938	948.7	909.3

Source: Mitchell & Deane, Abstract of British Historical Statistics, pp. 395, 398, 400.

TABLE 2

Bank Rate, 1919-25

<u>Month and Year of Change</u>	<u>New Rate</u>
November 1919	6% (from 5%)
April 1920	7%
April 1921	6½%
June 1921	6%
July 1921	5½%
November 1921	5%
February 1922	4½%
April 1922	4%
July 1922	3%
July 1923	4%
February 1925	5%

Source: The Economist (London: 1919-1925)

TABLE 3

## Floating Debt of the U.K. Government

1919-1925

(Monthly Averages of Weekly Figures)

(£ m.)

	Bank Ways and Means	Depart- mental Ways and Means	Treasury Bills	Total		Bank Ways and Means	Depart- mental Ways and Means	Treasury Bills	Total
1919					1922				
Jan.			1095.8	1508	Mar.	-	130.3	907.5	1038
Feb.			1006.2	1388	Apr.	7.9	180.1	787.8	976
Mar.			958.9	1406	May	6.5	169.1	772.1	948
Apr.	231.9	238.7	982.7	1453	June	15.0	168.0	792.6	976
May	226.3	238.5	1018.6	1483	July	1.2	166.2	768.4	934
June	433.6	244.6	874.9	1531	Aug.	-	159.0	726.1	885
July	513.8	223.3	670.9	1408	Sept.	2.3	153.9	716.2	872
Aug.	191.2	209.2	787.3	1187	Oct.	6.7	180.6	734.9	922
Sept.	174.4	189.8	863.9	1228	Nov.	-	177.8	738.3	916
Oct.	121.3	189.6	983.8	1295	Dec.	8.8	206.3	731.2	946
Nov.	32.0	183.0	1085.1	1300	1923				
Dec.	45.8	190.2	1109.8	1345	Jan.	9.6	206.9	713.5	930
1920					Feb.	-	173.9	709.2	883
Jan.	28.8	180.5	1201.5	1411	Mar.	0.3	178.3	642.9	821
Feb.	28.3	168.8	1095.1	1292	Apr.	-	199.9	602.4	802
Mar.	8.9	175.5	1068.0	1252	May	-	194.3	588.7	783
Apr.	45.0	206.7	1049.4	1301	June	3.5	202.4	608.8	815
May	27.2	199.7	1060.1	1287	July	0.8	207.9	600.1	809
June	54.3	174.6	1069.1	1298	Aug.	1.3	196.8	598.6	797
July	41.1	167.5	1067.4	1270	Sept.	1.8	184.6	620.6	817
Aug.	41.2	158.4	1055.7	1155	Oct.	1.6	179.2	633.6	814
Sept.	30.1	148.2	1089.2	1267	Nov.	0.6	168.6	640.7	810
Oct.	59.8	175.9	1078.0	1314	Dec.	6.8	197.0	648.4	847
Nov.	49.4	189.3	1091.2	1330	1924				
Dec.	63.1	211.3	1124.5	1399	Jan.	2.0	190.7	649.2	842
1921					Feb.	1.2	176.9	641.3	819
Jan.	33.8	206.9	1152.0	1393	Mar.	-	186.4	594.3	781
Feb.	20.7	199.7	1121.5	1342	Apr.	-	208.8	554.2	763
Mar.	4.8	169.5	1098.3	1273	May	1.0	191.0	556.9	749
Apr.	11.9	175.4	1102.6	1290	June	11.8	195.6	584.3	792
May	15.5	164.3	1128.9	1309	July	1.3	194.2	594.7	790
June	38.5	132.0	1198.9	1369	Aug.	-	181.8	594.7	777
July	28.7	122.6	1208.5	1360	Sept.	0.9	174.1	601.1	775
Aug.	27.6	141.4	1183.9	1353	Oct.	3.4	176.1	612.3	792
Sept.	35.3	152.5	1156.4	1344	Nov.	0.4	172.1	618.8	791
Oct.	52.2	159.0	1138.7	1350	Dec.	9.8	189.6	635.0	834
Nov.	10.8	186.7	1116.7	1314	1925				
Dec.	16.1	189.6	1084.8	1291	Jan.	3.2	168.8	642.1	813
1922					Feb.	-	167.0	609.7	777
Jan.	6.5	146.1	1057.9	1211	Mar.	-	177.7	571.5	749
Feb.	6.4	126.1	983.7	1116					

Source: Morgan, Studies in British Financial Policy 1914-1925, p.147.

TABLE 4

## Composition of the National Debt, 1914 and 1919

Type of Security	£m.		Net addns. during financial yr. 1919/20
	Outstanding on 31.3.14	Outstanding on 31.3.19	
Funded debt	586.7	317.6	-2.7
Cap. val. of terminable annuities	29.6	20.6	-1.3
3½% War Loan 1925-8	-	62.7	-
4½% War Loan 1925-45	-	14.3	-1.5
5% War Loan 1929-47	-	2011.5	-34.7
4% War Loan 1929-42	-	56.3	-7.8
4% Funding Loan 1960-90	-	-	408.9
3½% Conversion Loan	-	-	-
4½% Conversion Loan 1940-4	-	-	-
4% Victory Bonds	-	-	359.5
Exchequer Bonds	20.5	383.7	-65.1
National War Bonds	-	1636.2	-160.4
Treasury Bonds	-	-	-
War Savings Certificates	-	227.0	46.6
Treasury Bills	13.0	957.2	150.1
Ways and Means Advances	-	455.0	-250.1
Total Internal Debt	649.8	6142.1	457.1

Source: E.V. Morgan, Studies in British Financial Policy 1914-1925  
(London: Macmillan & Co., 1952) p.107.

TABLE 5

Summary of Total Sums of Internal Debt Maturing

1921-2 to 1929-30

Financial Year	Total in £ million
1921-2	104.1
1922-3	233.7
1923-4	379.0
1924-5	160.9
1925-6	29.9
1926-7	----
1927-8	298.7
1928-9	554.5
1929-30	15.6
	-----
Total 1921-30	1776.4
	-----

Source: P.R.O., T.171/196, Blakett's memo. on funding,  
14 Feb., 1921.

National Debt of the U.K. Government

End of Financial Years 1913-14, 1918-19 and 1924-25 (£ m.)

Under 1 Year	1 to 4 Years	5 to 9 Years	10 to 19 Years	20 Years and Over	Unclassified
1913-14 Treasury Bills 13.0	Exchequer Bonds 20.5	-	-	2½% Consols 539.4 2½ per cents 3.8 2½ per cents 29.8	Banks of England and Ireland 13.6 Annuities 29.6
13.0	20.5	-	-	573.1	43.2
Total Internal Debt, 649.8					
1918-19	Exchequer Bonds 188.5 National War Bonds 632.8	3½% War Loan 62.7 National War Bonds 1003.3	Exchequer Bonds 15.6	2½% Consols 279.8 2½ per cents 2.7 2½ per cents 21.5 4½% War Loan 14.3 5% " " 2011.5 4% " " 56.3	Banks of England and Ireland 13.6 Annuities 20.6 War Savings Certs. 227.0
1591.8	821.3	1066.0	15.6	2386.1	261.2
Total Internal Debt, 6142.0					
1924-25	Ways and Means 166.6 National War Bonds 12.4 Treasury Bonds 23.6 Treasury bills 575.6	Treasury Bonds 334.7	4% War Loan 65.9 4½% Conversion Loan 210.6	2½% Consols 276.5 2½ per cents 2.4 2½ per cents 21.3 3½% Conversion Loan 708.9 4½% War Loan 12.8 5% " " 1987.0 4% Funding Loan 394.9	Banks of England and Ireland 13.6 Annuities 13.1 Savings Certificates 368.8 Victory Bonds 349.8
778.2	984.5	334.7	276.5	3403.8	745.3
Total Internal Debt, 6524.8					

Source: Morgan, Studies in British Financial Policy 1914-1925, p.139.

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Cab.27: Minutes of evidence of the Committees of the Cabinet, including the Finance Committee, the Home Affairs Committee and the Economic Defence and Development Committee.

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T.170: The Bradbury Papers.

T.171: Papers relating to the office of the Chancellor of the Exchequer.

T.175: The Hopkins Papers.

T.176: The Niemeyer Papers.

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## INDEX

- Addis, Sir Charles - 323-325.  
Addison, C. - 32, 53-54, 84-85, 89, 133, 162, 166-169, 172-177, 181.  
Admiralty, The - 56, 125, 146, 148, 152, 185-186, 191, 196.  
Agriculture - 165, 167.  
Aircraft Industry - 149-150, 154.  
Air Force - 149, 153, 185-186.  
Air Ministry - 149-150.  
Allied Armies of Occupation - 212, 214, 257.  
Armed Services - 131, 145, 154, 161, 175, 185-186.  
Armed Services Departments - 126, 147-148, 154-155, 185, 190, 192-197, 202.  
Army - 125-126, 148, 153, 185-186, 190.  
Asquith, H.H. - 42, 128, 160.  
Australia - 210.  
Austria - 125, 259.
- Baldwin, Stanley - 13, 31, 41, 54-55, 60, 62, 66-70, 73, 264-269, 275, 289, 317, 319, 326, 335-336.  
Balfour Committee on Commercial and Industrial Policy after the War - 84, 157.  
Balfour, Lord - 84, 157, 243, 253, 256, 259, 263.  
Balfour Note - 13, 66, 213, 225, 243, 245, 253-259, 261-264.  
Bank Charter Act of 1844 - 95-96, 100, 103, 105, 107.  
Bank of England - 5, 11, 12, 14, 15, 36-40, 49, 61, 62, 66, 77, 83, 85-88, 90, 95-102, 104, 106, 108, 111, 113, 117-119, 137, 210, 271, 282, 284, 288, 290, 292, 297, 299-301, 304-305, 307, 309-311, 312, 314, 319-320, 323, 325-326, 330.  
Bank of France - 114.  
Bank Rate - 14, 37-38, 43, 57, 58, 59, 60, 96, 103, 111-113, 117-118, 271, 276, 299-300, 302-304, 305-307, 309, 314, 331.  
Beaverbrook, Lord - 337.  
Belgium - 212-213.  
Birkenhead, Lord - 65.  
Blackett Plan for Inter-Allied Debt - 13-14, 216-222, 224-228, 235-236, 238-239, 244-245, 254, 263, 347-348.  
Blackett, Sir Basil - 13-14, 26, 30, 34, 35, 38-39, 41, 46-49, 53, 54, 59, 64, 88, 90-91, 207, 215-222, 224-225, 229-233, 243, 254-258, 263, 272-273, 280, 289, 292-296, 299, 301-305, 312-314.  
Board of Education - 174.  
Board of Trade - 64, 137, 139, 145, 157-161, 227, 245.  
Bonar Law, A. - 30, 41, 62-63, 64, 66, 68, 75, 79, 85-87, 185-186, 192, 264-268.  
Bottomley, H. - 35.  
Boyle, A. - 87.  
Bradbury Committee on the Currency Note Issue - 319-329, 335.  
Bradbury, Sir John - 12, 20, 26, 30, 32, 37, 40, 41, 42-46, 48, 49, 67, 78, 83, 85, 88-90, 95-98, 103, 109, 110, 169-171, 195, 215, 243, 312, 320-328, 333.  
British Empire and Commonwealth - 4, 49, 157, 231-232, 254, 321, 333.  
Brussels Conference, 1920 - 278, 282.  
Budget, The - 27, 28, 42, 47, 50, 51, 52, 55, 67, 186-197, 199, 202, 245, 273, 275-276, 278, 285-287, 297, 316, 330, 333-334.  
Building Industry - 161.
- Cabinet Office - 34-36.

Cabinet, The - 7, 11, 12, 14, 44, 63, 64, 69, 70, 79, 137-138, 142-143, 146-150,  
 154-155, 172-173, 178-181, 184-186, 188-193, 199, 211, 216, 221, 224, 226, 231,  
 232-239, 243, 245, 248, 250-254, 256, 258-260, 262-269, 290-291, 293, 333.  
 Economic Defence and Development, Committee of - 156-157.  
 Finance, Committee of - 153, 193-195.  
 Home Affairs, Committee of - 147, 150, 193.  
 Canada - 2, 86, 207.  
 Canal Control Committee - 132.  
 Capital - see Investment.  
 Capital, export of - 116-117, 130, 272.  
 Capital Goods Industries - 102, 112.  
 Capital Issues - see Investment.  
 Capital Issues Committee - 131, 136-137.  
 Carmichael, Sir James - 176.  
 Cave, Lord - 267.  
 Cave Committee on relations between Government and Industry - 181.  
 Chalmers, Sir Robert - 20, 40, 44, 85-86.  
 Chamberlain, N. - 41-42, 52, 71.  
 Chamberlain, Sir Austen - 13, 31, 41, 46, 62, 63-64, 75, 79, 85, 142-143, 147,  
 150, 154, 157, 159, 181-184, 186-189, 191-192, 194, 201, 214, 216, 223-225, 231,  
 233, 253, 259-260, 262, 263, 276-278, 289-290, 302, 305-306, 320, 323, 329.  
 China - 49.  
 Churchill, R. - 331.  
 Churchill, W.S. - 14-15, 31, 38, 41, 44, 52-53, 55, 58-60, 62, 72-75, 79-80,  
 140, 145-147, 149-151, 154, 158, 177, 185-186, 191, 228, 231-233, 235, 253,  
 255, 260-262, 307, 311, 326-337.  
 City of London - see London, City of.  
 Civil Industries Committee - 137.  
 Coal Industry - 129, 135, 138-139, 184, 186-187, 190, 192, 198.  
 Cockayne, Sir Brian - 106, 301, 305, 314-315.  
 Cole, G.D.H. - 319.  
 Commercial Banks - 83, 87, 93, 96-97, 99, 101-102, 107, 118, 167, 170, 276-277,  
 286, 289, 291, 299-300, 304-306.  
 Communications Industries - 198.  
 Consumer Goods - 89, 127, 130.  
 Controls, Government Economic - 12, 124-144, 156.  
 Coolidge, President, of the U.S.A. - 69.  
 Cost of Living Index - 127.  
 Credit - see Monetary Policy.  
 Crowe, Sir Eyre - 34.  
 Cunliffe Committee on Currency and Foreign Exchange - 11-12, 16, 46, 83-122,  
 208, 275-277, 282, 312-313, 315-317, 320, 333.  
 "Cunliffe Limit" - 106, 120.  
 Cunliffe, Lord - 11, 12, 62, 83, 85-88, 94-97, 98-103, 105-108, 136, 210-211,  
 306, 310-311, 320.  
 Currency and the Note Issue - 84-85, 99, 110, 118, 120, 166, 170, 207, 242, 261,  
 272-273, 275-276, 280, 303, 305-306.  
 Fiduciary Issue - 100-101, 103, 117.  
 Currency and Foreign Exchange after the War, Committee on - see Cunliffe  
 Committee.  
 Currency and Bank Notes Act 1914 - 118.  
 Curzon, Lord - 13, 179, 226-227, 253, 263.  
 Customs and Excise, Board of - 27, 31, 33, 77.

Davidson, J.C.T. - 267.  
 Davies, J.T. - 195.  
 Dawes Loan - 319.  
 Debt, Inter-Allied - 4-5, 33-34, 46, 48, 54, 108, 114, 130, 187, 205-210,  
 212-215, 219, 222, 237, 239-245, 247, 249, 251-253, 255-263, 317, 344, 347-348.  
 British Debt to U.S. - 4-6, 13, 33-34, 38-39, 48, 61-62, 64, 66, 214-233,  
 237-241, 244-269, 317, 319, 344, 347-348.  
 Cancellation of - 209-210, 216-236, 238, 240-241, 244, 247, 254, 261, 263,  
 268-269.  
 Funding Mission to U.S. - 60, 242-250, 252, 255, 263-269.  
 Debt, Internal - see National Debt.  
 Defence of the Realm Act 1914 - 128, 132, 135.  
 Deflation - 6, 14, 46, 52, 57-58, 90, 97, 105-107, 222, 275-286, 295-297,  
 301-304, 306-307, 311, 317, 319.  
 Dyestuffs Industry - 141.  
Economist - 135, 183-184, 210, 225, 241-242, 263, 273, 275, 283, 286.  
 'Economy' Campaign, 1919 - 6, 32-33, 55, 182-203, 345.  
 Electricity Industry - 161, 181.  
 European Reconstruction - 58, 214, 217-218, 226, 229, 248, 258, 263, 315.  
 Exchanges and Exchange Rates - 84, 95, 99-100, 102-103, 105-106, 115-116,  
 120-121, 166, 213, 221, 252, 258-259, 314-318, 337.  
 Exchange Control - 85, 120.  
 Sterling-Dollar Exchange - 217, 220-221, 224, 229, 274, 277, 279, 281, 296,  
 302-303.  
 Extravagance, Criticism of Government - 13, 65, 92-94, 144, 182-183, 187-188,  
 194-197, 199, 275, 299.  
 See also 'Economy' Campaign.  
 Farrer, Gaspard - 77, 93, 320-321, 323.  
 Federal Reserve Board - 5, 102, 104, 206, 306-307, 323.  
 Federation of British Industries - 106, 318-319, 321-322, 325, 332-333, 335, 337.  
 Financial Facilities, Committee on - 84, 167.  
 Fisher, Sir Warren - 9, 13, 30, 32-33, 35-36, 40-42, 53-56, 67, 73, 78, 145, 195,  
 197-199, 202, 222.  
 Food Control - 125, 128, 132, 136, 139-140, 142, 167, 187, 249.  
 Food, Ministry of - 129, 139-140, 145, 187, 196.  
 Foreign Office - 32, 33, 34, 226, 228, 253.  
 Forestry - 165, 167.  
 France - 4, 5, 115, 125, 173, 179, 205-208, 212-213, 217, 220, 226, 228-235,  
 237, 243-244, 247-249, 257-259, 261-262, 268-269, 317.  
 Geddes Committee on National Expenditure - 92, 139, 181.  
 Geddes Axe, 1922 - 6, 92, 133, 203.  
 Geddes, Sir Auckland - 34, 139, 158-159, 175-176, 179-181, 192, 228, 238, 246,  
 253-254, 264-265.  
 Geddes, Sir Eric - 92, 147.  
 General Election, 1918 - 64, 175, 180.  
 General Election, 1924 - 71, 320, 326.  
 General Strike, 1926 - 269.  
 Geneva - 331.  
 Genoa Economic Conference, 1922 - 58, 315-316.  
 Germany - 2-3, 10, 45-46, 107, 125-126, 156, 181, 198, 205-206, 210-214, 217,  
 226, 229, 232-233, 237, 240-241, 243-244, 247-248, 254, 257-258, 261, 268-269,  
 283, 307, 309, 317, 319, 321, 330.  
Globe - 210.

Gold and Silver (Export Control) Act, 1920 - 312.  
 Gold Reserves - 44, 86, 94, 97-100, 102, 104-106, 108-109, 111-113, 115, 117, 119, 206-207, 213-214, 302-303.  
 Gold Standard - 6, 10, 10-12, 15-16, 25, 38, 43-44, 52, 54, 56-58, 60, 62, 75, 83, 88-89, 91, 94, 98, 103, 106, 108-117, 120-122, 207, 248, 273-276, 278, 281-284, 305, 307, 344, 346-347.  
 Restoration of - 56-58, 60, 61-62, 72, 75, 309-338.  
 Goodenough, W. - 321.  
 Government Finance - 5, 37, 50-52, 56-58, 70, 91-92, 182-203, 276, 278, 285-287, 345-346.  
 See also Budget, National Debt, Taxation.  
 Grey, Lord - 209.  
 Grigg, P.J. - 35, 44, 52, 59-60, 65, 68-69, 71, 73-75, 264, 335, 337.  
 Grigg, Sir Edward - 243, 254-256, 326, 328.  
 Gross National Product - 287.  
  
 Haldane Committee on the Machinery of Government - 8, 20, 146.  
 Hankey, Sir Maurice - 143, 178-179, 201, 233-235.  
 Harvey, U.S. Ambassador - 267.  
 Hawtrey, R.G. - 25-26, 48, 52, 56-60, 301, 311, 314, 316-317, 326-328.  
 Hayes Fisher, W. - 175.  
 Health, Ministry of - 32, 165, 167, 172, 174-175, 181, 191, 203.  
 Heath, Sir Thomas - 18, 20, 40, 196.  
 Hicks, U. - 281, 298.  
 Hilton Young, E. - 178-179.  
 Hitler, A. - 268.  
 Holden, Sir William - 99-100.  
 Home Office - 139.  
 Hope Simpson, Sir James - 208.  
 Horne, Sir Robert - 41, 62, 64-66, 72, 228, 242, 245-250, 253-254, 259, 262-263, 335.  
 House of Commons - 27-28, 63-65, 77, 79, 93-94, 135-138, 144, 153-155, 159, 174, 182-183, 194, 196-197, 245, 275-276, 278, 289-300, 334.  
 Housing - 142, 165, 167, 174-177, 179, 182, 190, 192, 203.  
 Housing, Ministry of - 32, 161.  
 Hughes, W.M. - 210-211.  
  
 Imperial Defence, Committee of - 92.  
 Inchcape, Lord - 88, 92-93, 146, 148.  
 Independent Parliamentary Group - 35, 36.  
 India - 3, 46, 49, 69, 149, 215, 263.  
 Industrial Production - 131, 133, 137, 168-169, 171, 177, 190, 280, 284, 302.  
 Industrial Relations - 130-132, 139, 164-165, 172, 178-179, 189.  
 Inflation - 43, 50-51, 57, 60, 85, 90-91, 100, 104, 107, 118, 127-128, 241, 272-273, 275-279, 282, 285-286, 289-302, 304-305, 314-318.  
 Inland Revenue, Board of - 27, 31, 33, 53, 55, 77, 138.  
 Interest Rates - see Monetary Policy.  
 International Chamber of Commerce, British Committee - 240.  
 Inverforth, Lord - 146, 151-152, 155, 177.  
 Investment and the Supply of Capital - 47-48, 89, 100-101, 104, 130-131, 136-137, 168-170, 180, 248-250, 263, 269, 274, 331.  
 Ireland - 69, 110, 120, 191.  
 Iron and Steel Industry - 135.  
 Italy - 205-208, 220, 226, 229-230, 232, 234, 247, 261-262.

James, R. - 335.  
 Jones, T. - 67-68, 72, 178-180, 185, 200, 335.

Keynes, J.M. - 8, 13, 15, 19, 44-45, 49, 68, 85-86, 109-110, 208-209, 211, 214-215, 242, 249, 279, 298, 300-301, 304, 312-313, 319, 321, 328-329, 336-337.

Labour, Ministry of - 127, 184, 196.  
 Labour Party - 38.  
 Labour Supply - 125, 131.  
 Demobilisation - 94, 106, 140-141, 164, 167, 171, 174, 178, 180, 191, 276.  
 Leaf, Dr. W. - 103-104.  
 League of Nations - 49, 65, 227.  
 Leith-Ross, F. - 30, 34, 38, 60, 328, 331-332, 336.  
 Liquor Industry - 129, 138-139.  
 Lloyd George, David - 13-14, 32, 36-37, 42, 44, 54, 64, 66, 69, 79, 86-87, 125, 128, 135, 139, 142-145, 151-152, 155, 158-159, 162, 173-183, 185-186, 188-189, 192-195, 197, 199-202, 208-210, 212, 214, 233-237, 243-245, 253-256, 258-259, 261-263, 279, 282.  
 Local Authorities - 161, 175, 179, 181.  
 Local Government Board - 32, 162, 174-176.  
 London Chamber of Commerce - 104, 335.  
 London, City of - 4, 43, 47, 59, 61, 86, 92, 95, 99-100, 102-103, 107-109, 112, 114, 215, 240, 245, 254-255, 268, 286, 302, 315, 328.  
 Long, W. - 148, 179, 185-186, 191.

MacFadyean, A. - 45, 68.  
 Macmillan Committee of Finance and Industry - 88-89, 101.  
 McKenna, R. - 44, 86, 278-279, 284-286, 316, 321, 328, 337.  
 Midland Bank - 278, 284, 316.  
 Milner, Lord - 192.  
 Moggridge, D.J. - 336.  
 Mond, Sir Alfred - 47, 147, 157.  
 Monetary Policy - 315.  
 Credit creation and control - 84, 91, 97-98, 106, 114-116, 118-119, 121, 170, 223-224, 272, 275-276, 278, 284, 299, 302-305, 311, 315.  
 Interest Rates - 299-307.  
 Special Deposits - 286.  
 Monetary Theory of the Trade Cycle

Montagu, E. - 149, 152, 180.  
 Munitions, Ministry of - 19-20, 125, 129, 132-133, 137, 138, 141, 144-150, 152, 154-155, 161, 177, 183, 193-194, 196, 199, 302.

Napoleonic Wars - 310-311, 329.  
Nation - 278, 329.  
 National Debt - 10, 14, 38, 47, 70, 89, 92, 98, 100, 102, 104-108, 119-121, 167-171, 184, 187, 198, 215, 220, 249-250, 271-276, 278-282, 286-298, 302, 309.  
 Conversion Loan  $3\frac{1}{2}\%$  1921 - 295-297.  
 Exchequer Bonds - 295-297.  
 Funding - 208, 287-294, 298.  
 Floating Debt - 84, 89-91, 108, 271-272, 274-278, 286-298, 311.  
 National War Bonds - 295-297.  
 Sinking Fund - 90, 98, 105, 118, 170, 231, 296.  
 Treasury Bills - 104, 119, 271, 276-277, 286, 288-289, 314, 316.  
 Treasury Bonds - 295-297.  
 Victory Bonds - 183-184, 187, 286, 287-288, 291.  
 War Loan 5% - 297.  
 Ways and Means Advances - 90-91, 106, 118, 120, 271, 277, 286, 288-289, 297, 304, 306.

National Income - 6, 124, 127.  
 National Service, Ministry of - 176, 196.  
 National Union of Railwaymen - 139.  
 Navy - 185.  
 Niemeyer, Sir Otto - 14, 25, 26, 30, 34-35, 37-38, 41, 44, 49-53, 55-56, 59,  
 73, 244, 256, 279, 294, 299, 301-302, 313-318, 320, 326-328, 330, 332-334, 336.  
 Norman, Montagu - 36-40, 46, 49, 59, 60, 61-62, 66, 67, 87, 106, 108-109,  
 264-265, 282-283, 291, 306-307, 319-321, 323-325, 327-328, 331-333.  
Observer - 332.  
 Office of Works - 147-148, 155.  
 Overseas Investments - see Capital, export of.  
 Overseas Lending - see Capital, export of.  
  
 Paish, Professor - 321.  
 Peace Conference of Paris, 1919 - 79, 88, 114, 142-143, 150, 178, 201, 206,  
 208, 211-212, 301.  
 Pearce Committee on the Increase in Wealth (War) - 90, 289, 292-294.  
 Peel, Sir Robert - 310.  
 Pensions, Ministry of - 145.  
 Percy, Lord Eustace - 69.  
 Phillips, F. - 48, 60-61.  
 Pigeon, Professor A.C. - 83, 86, 91-92, 95-97, 101-102, 320, 322-325.  
 Prices - 43, 50-51, 57, 60, 94, 103, 105, 107, 109, 112, 127-128, 130, 132-133,  
 136, 138-140, 142, 144, 146, 159-160, 184, 206, 272, 274, 276-283, 290, 293-294,  
 302-304, 315, 318-319, 321-322, 324, 326, 328, 332, 337.  
 Production, post-war boom in - 94, 107, 120, 155, 161, 182, 277-280, 289.  
 Profiteering - 190, 192, 289.  
 Profits - 131, 134, 274.  
 Public Opinion - 93, 131, 133, 144, 163, 183-184, 187, 193, 200-202, 209-210,  
 225, 236, 240, 251, 263, 278, 282, 289, 299, 301, 320-321, 337.  
 Public Record Office - 25, 31.  
  
 Railways - 125, 129, 132, 139, 179, 198.  
 Rathbone, Secretary to U.S. Treasury - see U.S. Treasury.  
 Rationing - 130, 140, 187.  
 Raw Material Supply - 107, 128-130, 136-137, 140, 143, 146, 164, 171, 249, 280,  
 285.  
 Reconstruction - 85, 88, 93, 101, 119, 121, 133, 142, 144-182, 187, 202, 212,  
 303, 331, 344-345.  
 Reconstruction, Ministry of - 32, 84-85, 145, 160-182.  
 Reparations - 46, 94-95, 107, 121, 205, 215, 217, 226, 228-229, 231-232, 234,  
 237-239, 240-242, 243-252, 254, 258-259, 263, 283, 317, 319, 331.  
 German Reparation (Recovery) Act - 213.  
 Hythe Conversations - 231, 233, 235.  
 Reparations Commission - 42, 45, 88, 211-213, 215, 312.  
 Spa Conference - 237.  
 Road Transport - 161, 164, 179.  
 Rowe-Dutton, E. - 36, 60, 264.  
 Russia - 4, 204, 330.  
  
 Samuel, A.M. - 101-102.  
 Samuel Committee on National Expenditure - 196.  
 Savings, Government action and - 51, 127, 197, 199, 295, 298, 302.

Schuster, Sir Felix - 100-101, 321.  
 Scotland - 110, 120.  
 Scott, Sir Robert - 35.  
 Second World War - 130, 138, 300-301.  
 Shield Nicholson, Professor J. - 101-102.  
 Shipping - 125-128, 135, 145, 156, 163-164.  
 Shipping, Ministry of - 19, 125, 132, 145, 196.  
 Skidelsky, R. - 334-335.  
 Smuts, General - 174-212.  
 Snowden, P. - 30-31, 41-42, 45, 71-72, 319, 332, 335.  
 South Africa - 312.  
 Special Deposits - see Monetary Policy.  
 State Guarantees and Subsidies - 135, 157, 167, 198.  
 Stationery Office - 155.  
Statist - 184.  
 Sterling - 58, 110, 215, 220-221, 248, 306-307, 309, 312, 317-319, 325, 328, 337, 344.  
     Convertibility of - 105, 109, 119, 276.  
     Devaluation of - 107, 207.  
     Parity with Dollar - 84, 89, 91, 207, 242, 248, 279, 281, 284, 302, 314-316, 318-319, 321, 323-324, 328.  
     Sterling-Dollar Exchange - see Exchanges.  
 Stevenson, Sir James - 149-150.  
 Strong, B. - 323, 325.  
 Supply, Ministry of - 133, 143-155, 199.  
 Sylvester, A.J. - 35.  
  
 Taxation - 47, 50, 52, 65, 89, 104, 169-170, 180, 189, 197-198, 228, 237, 249-251, 261, 285-286, 290-306.  
 Trade, Overseas - 2-4, 156-160, 192, 310, 318.  
     Balance of Trade - 112-113, 119.  
     Balance of Payments - 105, 111, 116-117, 127, 190, 223, 269.  
     Exports and Re-exports - 3, 100, 103, 106-107, 109, 112, 125, 130, 135, 137-138, 217, 221, 223, 249, 280, 282-283, 294, 302, 309, 324-325.  
     Imports - 106, 109-110, 126, 129-130, 132, 136, 140, 156-160, 280, 294.  
     Tarriffs and Protection - 135-136, 141, 156-160.  
 Trade, World - 113, 122.  
 Transport Industry - 132, 139, 164, 167, 181, 188.  
 Treasury  
     and the Cunliffe Committee - 11-12, 84-85, 89-91, 96, 98, 344.  
     and Debt, Inter-Allied - 13-14, 208-210, 215-224, 229-233, 239, 244-250, 264, 269.  
     and the Economy Campaign - 12-13, 144-145, 151, 184-189, 191-202.  
 Treasury  
     and the Gold Standard - 15-16, 98, 283-284, 309-338.  
     and Interest Rate Policy - 299-307.  
     and Monetary Policy - 271-275, 299-307.  
     and National Debt - 14-15, 286-299.  
     Organisation - 18-40, 341-343.  
 Treasury  
     Personnel - 7-11, 40-81, 341-343, 349-352.  
     and Reconstruction - 169, 174, 176-177, 181.  
     Record-keeping - 28-31.  
     and Reparations - 210-211, 214-215.  
     and Supply, Ministry of - 147, 150.

Unemployment - 3, 6, 50-51, 56-57, 60-61, 70, 108-109, 134, 140, 144, 161, 167, 171, 177-182, 200-202, 244, 247-248, 272, 274, 279, 281-283, 303, 311, 315, 318, 329-331, 334, 344-345.  
Conferences on Unemployment - 180, 279.  
Public Works - 56.  
Unemployment Relief and Insurance - 134, 167, 173-174, 178, 182, 198.  
United States of America - 2-6, 33-34, 38-39, 44, 46-47, 50, 58, 64, 102, 108, 115, 127, 164, 185, 205-210, 212, 214-269, 274, 276-277, 301-302, 312, 314-317, 323-324, 326, 332, 337, 344.  
British Funding Mission to - see Debt, Inter-Allied.  
Congress - 209, 216, 219, 225, 238-239, 245, 248.  
Public Opinion - 209, 216, 225, 238-239, 245, 248.  
U.S. Debt - see Debt, Inter-Allied.  
U.S. Treasury - 64, 213-216, 218-219, 223-225, 229-231, 233, 235, 237-239, 266.  
Upcott, G. - 35-36.  
  
Vehicle Manufacturing Industry - 129, 133.  
Versailles, Treaty of - 189, 211-212, 214-215, 242.  
  
Wages and The Standard of Living - 43, 50-51, 128, 178, 185, 196, 274, 282-284, 293-294, 303-304, 318.  
War Office - 126, 137, 140, 148, 149, 188, 191, 196.  
War Priorities Committee - 137.  
Westminster Bank - 93, 103, 240.  
Wilson, President of U.S.A. - 214, 235-238.  
Wilson Smith, Sir Henry - 39, 60.  
Withers, H. - 26.  
Worthington Evans, Sir Lancing - 227.  
  
Young, N.E. - 322.