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DARLING, GOODENOUGH AND McKENNA: ECONOMIC THOUGHTS OF THE CITY TOWARDS BRITISH RETURN TO GOLD IN 1925

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I

According Theodore E. Gregory, there were three views of the representative British opinions on foreign investment after the First World War, that is, (1) the orthodox Free Trade view, (2) the Imperialist-Protectionist view, and (3) the Economic-Nationalist view. He explained, 'the first view is the view of the City; the second that of the Conservative party and its industrial affiliations; the third view is that of the economic and intellectual group who are engaged in reshaping the ideas of the Liberal party, the most brilliant single representative of this group being J.M. Keynes.'[1] This classification could not only be available for the understanding of various views about British foreign investment, but also depict some important aspects of the contemporary British economic policy. However, 'the view of the City' seems to have been more extensive, and, in fact, a few influential bankers of the City proclaimed a sort of 'Imperialist' policy as to the monetary reconstruction of the British Empire. Amongst others, John Ford Darling, a director of the Midland Bank, and Frederick C. Goodenough, Chairman of the Barclays Bank, made a proposal respectively for intensifying the financial tie of the Empire. On the other hand, Reginald McKenna, Chairman of the Midland Bank and an intimate friend of Keynes, emphasized the importance of domestic monetary management and advocated non-Imperial and, in a sense, nationalistic financial policy.

The aim of this paper is to explore what these joint stock bankers thought about a desirable monetary system of Britain or the British Empire towards the Return to Gold in 1925, and thus to provide some materials for tracing various influence of these economic ideologies of the City upon the direction of British monetary policy and the formation of joint stock banking strategies. There are many sophisticated arguments on the politico-economic causes and effects of the British Return to Gold,[2] but they will not be treated here as such, although several suggestions may be given as to an Imperial background for the Return, especially in relation to Darling's 'Empire Currency Bills' proposal mentioned next.

[1] T. E. Gregory, 'Foreign Investments and British Public Opinion,' in *Foreign Investment* (Lectures on the Harris Foundation), The University of Chicago Press, 1928, p. 97.

[2] See, for example, D. E. Moggridge, *The Return to Gold: The Formulation of Economic Policy and its Critics*, Cambridge, 1969.

II

In March 1920, when the external value of sterling sank to an extremely low level owing to the suspention of 'pegging' the sterling-dollar exchange in the previous year, L. Worthington Evans, Minister of Pensions, appealed to the Cabinet for considering how to deal with the serious effects upon the Imperial monetary and financial unity of 'the divergence in values between gold and sterling,' and said:

> It seems to me that the whole Empire should support the Pound sterling; it is to prevent breaks away in currency which are likely to change the trade channels. An Empire currency is needed.[3]

In response to his proposal Darling wrote a memorandum entitled 'Suggestions for an Empire Currency and an Empire Bank,'[4] in which he proposed the establishment of an 'Empire Bank' based upon 'self-liquidating bills of exchange,' that is, the bills drawn against 'a movement of commodities (a) from one part of the Empire to another, (b) from a part of the Empire to a foreign country, (c) from a foreign country to a part of the Empire.' His scheme can be shown as follows:

> With a currency system based on self-liquidating bills of exchange there would scarcely be room for inflation, for over so large an area as the British Empire the currency would automatically expand and contract with the movement of goods and of prices, for on that movement it would be based. The question however arises whether there would be produced sufficient bills of exchange of the character described to prove a wide enough basis for the credit and currency systems of the Empire. This leads us to consider the desirability of creating a Central Bank for the Empire, not to compete with other banks in ordinary banking business, but to the banker of Governments and of banks, with a central office in London and offices throughout the Empire.

In the memorandum of March 31, L.W. Evans and Lieutenant-Colonel L.S. Amery supported Darling's plan together with that of Major Ewart Grogan and recommended them to the Cabinet for consideration as a *temporary* measure in the coming Imperial Economic Conference, though they aimed at ultimately bringing sterling back to its 'old gold parity.'[5] But Darling transformed his idea into that of a more radical character than what Evans and Amery expected it to be.[6]

[3] Memorandum by the Minister of Pentions, entitled 'Currencies within the Empire,' March 20, 1920. Public Record Office (hereafter, PRO), T160/550/F7219/1.

[4] PRO, T160/550/F7219/1.

[5] Memorandum entitled 'Imperial Exchange and Currency,' March 31, 1920. PRO, T160/550/F7219/1.

[6] R. S. Horne, President of the Board of Trade, also presented a more far-reaching question concerning the stabilisation of inter-Imperial exchanges (Memorandum of the President of the Board of Trade, dated July 3, 1920. PRO, T160/550/F7219/1.). He said as follows: 'As to the end of maintaining a stable inter-Imperial exchanges so long as there is no gold basis to give it, there can be no question that it would be desirable, assuming that it is attainable. Whether or not it is advisable to take steps to secure it, depends in the first place upon the duration of the period that may be expected to elapse before the gold basis is restored, which therefore seems to me to be the fundamental question raised. There remains, of course, the further question of whether anything can be done to stabilise inter-Imperial exchanges *even after the restoration of the gold basis*. This question is certainly worth exploring.' (my italics)

Two years later there had been an important development in the monetary problems of the British Empire. On December 4, 1922, Darling made an address to the Manchester Association of Importers and Exporters, the title of which was 'Currency Co-operation in the British Empire,' and proposed the issue of 'Empire Currency Bills.' His scheme not only became one of the main themes in the Imperial Economic Conference of the next year, but, though indirectly, affected the amendment of the Australian Commonwealth Bank Act in 1924.[7]

As a fundamental material which allows us to trace the outline of 'Darling scheme,' we can take into consideration the 'Memorandum prepared by Mr. J. F. Darling for submission by the Manchester Association of Importers and Exporters to the Imperial Economic Conference, October, 1923,' which was published in *The Bankers' Magazine*.[8] The 'Memorandum' begins with the following sentences:

> The Empire Currency Bill scheme seeks to establish for the Empire, apart from India, which has the silver rupee—1. A uniform basis for currency; 2. A secondary basis for credit (the primary basis being currency); 3. A balancing factor for the exchanges within the Empire. Before the war gold served (1) and (3); the first class commercial bill of exchange served (2).

The recognition of the absence of these three factors after the First World War was the starting point of Darling's argument. He said it must 'inevitably retard the trade and development of the Empire. Our problem, therefore, is to find an instrument which will assist and develop trade and improve the mechanism by which that trade is financed.' The condition for solving the problem was the creation of an instrument with the same 'negotiability and mobility' as gold had had, that is, 'Empire Currency Bills.' It would have 'behind it a percentage of gold and percentage—of the responsibility by agreement of the participating countries in the Empire.' In other words, 'Empire Currency Bills' would be issued partly upon gold and partly upon the ability of each participating countries to meet her own liabilities. They were supposed to perform several important functions. Firstly, they would become the reserve for currency issue of each countries within the Empire. Secondly, 'the bill should be drawn at three month's date, and thus the liability of the partners could be determined at practically any time, and on payment of their liabilities the partners should be free to retire.' Therefore, each 'partners' could restore "the sovereign right to inflate" at her disposal. Thirdly, the bills 'would be issued in sterling in London and the liability would be determined in sterling in London.' Fourthly, the issue of the bills was to be entrusted to the 'Empire Currency Bills Commissioners' in London. The proceeds of the bills alloted to each 'partners' could be used in 'paying off its own Treasury Bills or other short-dated debt,' and each country must 'pay to the Commissioners quarterly its share of interest and charges.' These characteristics of the bills will make clear, to some extent, the policy implications of the scheme. Though it accepted "the sovereign right to inflate" of participating countries, it asked the 'partners,' especially the Dominions, to take a step in alignment with British foreign monetary policy and, consequently, to belong to the sterling currency area, a miniature of the pre-War gold standard system. What would,

[7] See, L. F. Giblin, *The Growth of a Central Bank: The Development of the Commonwealth Bank of Australia 1924–1945*, Melbourne, 1951, Chapter I.
[8] Vol. 116 (1923), pp. 645–652.

then, be the relation between the 'Empire Currency Bills' and the 'three factors' cited above in developing an Imperial monetary and financial tie in which Great Britain or London was to occupy a core position? Darling divided his arguments about it into three parts.

I) 'Empire Currency Bills' as a basis for currency issue of the 'partners.' Though the 'total amount of the issue of Empire Currency Bills, the extent of each country's participation in the issue, and the percentage of the gold reserve, are subjects for agreement by the Governments of the participating countries in conference,' it was proposed that the 'Commissioners' should 'adjust the amount of bills to be offered to the public' and 'see that the total issued did not exceed the authorised amount.' The amount of the bills payable on maturity 'in currency in any one of the participating countries at the option of the holder' could be provided as follows: 'if a bill for £100,000 were presented for payment at Melbourne, the Commonwealth Bank, which is the issuer of currency in Australia, would cable the Commissioners, who would cause the bills offered to the public in London to be reduced by £100,000 and issue a fresh bill for that amount to the Commonwealth Bank against its increase in currency.' Thus the 'Commissioners' were to be supposed to play the same role in the British Empire as the Bank of England in the United Kingdom. In this respect there was a strong resemblance between the 'Empire Currency Bills' scheme and Darling's previous plan for an 'Empire Bank.'[9]

II) 'Empire Currency Bills' as a basis of credit. According to Darling, in Australia 'the banks hold in legal tender (gold and notes) 21 per cent of their deposits,' while in London 'the average cash reserves of the clearing banks in only about 11 per cent, considerably less than in pre-war days.' He considered this difference had resulted from the circumstance that the latter had been making use of the British Treasury bill as a 'secondary reserve.' One of his fundamental ideas was that the 'Empire Currency Bills' should function as a 'secondary reserve' within the Empire. Through 'this material,' he emphasized, London Money Market as 'a valuable for the Empire' should become the core of the credit system throughout the British Empire. The same view was expressed in his letter to the President of the Board of Trade and other Ministers on May 5, 1923.[10] He suggested in it that his scheme could be done 'in a comparatively simple way by an extention of the British Treasury Bill system.'

III) 'Empire Currency Bills' as an instrument for regulating exchanges within the Empire Over the relation between the intra-imperial exchanges and the bills he argued, 'Empire Currency Bills, being convertible at maturity into the currencies of any of the participating countries, would become the regulating factor in the exchanges between these countries,' and explained the mechanism of cable transfer at par, taking the case of Australia by way of example. He said, 'against a payment of sterling received by the London office of the Commonwealth Bank, it could cable to its Sydney office to issue currency, for with the sterling it could obtain Empire Currency Bills to hold against the currency.' As these cable transfers were to be issued 'only to the banks,' and 'the banks could at all times obtain cable transfers at par,' the problem of 'the very high exchange charges' resultant from the adjustment of overbought or oversold position of the banks could be solved. As a consequence of the above exchange transaction, Australian excess exports (imports) would bring

[9] See also, J. F. Darling, 'Stabilisation of Imperial Exchanges,' in *Journal of the Institute of Bankers*, Vol. 42 (1921), pp. 5–32.

[10] PRO, CAB 32/25.

about the increase (decrease) of the amount of the 'Empire Currency Bills' held in Australian banks, but, for example, the proceeds of excess exports might remain in London to be 'employed in bills or short investments' until they would be wanted in Australia. Moreover, generally 'if one lot of banks were in consequence reducing their holding of Empire Currency Bills, there would be another lot of banks ready to take them up,' and, therefore, the settlement of exchange transactions within the Empire could be taken place in London, 'the financial clearing house' of the British Empire.

As we have seen, some parts of Darling's proposal submitted in the 'Memorandum' seems to have been too much radical and, in a sense, unrealistic under the conditions in those days, but his scheme suggested a few important points to be considered. First of all, Darling thought that the creation of a new international reserve asset different from gold would be desirable to his scheme. As was shown in his later pamphlet,[11] the 'Empire Currency Bills' scheme was to be connected with his plan for 'The Bank for International Settlements,' a forerunner of the international monetary system after the Second World War. This aspect of his proposal, however, was ignored in the Imperial Economic Conference of 1923. In the second place, Darling aimed at the establishment of a *de fact* 'sterling exchange standard,'[12] although he emphasized the convertibility of 'Empire Currency Bills' into various kinds of currencies within the Empire. It was intended in his plan that the Imperial monetary and financial system should have been reconstructed through its absolute dependence upon the London money market where the 'Commissioners' were to perform basic financial functions, that is, the issue of the 'Bills,' the adjustment of the rate of public issues and so on. More generally, Darling expected the restoration of the pre-War gold standard system inside the British Empire by means of the attainment of an external equilibrium between the 'partners.' Therefore, his 'Imperialism' was accepted and supported by the economic interests in favour of external equilibrium of the Dominions, especially those of Australia and New Zealand. Noticeably, Darling often refered to the affairs of these countries in the 'Memorandom,' perhaps, for enhancing the feasibility of his concrete programmes.

III

As to the 'Darling scheme,' we must add some comments upon its influences on the Imperial Economic Conference of 1923, which was in session from October 1 to November 9. The Darling's proposal was open to arguments in the meeting of October 26 and the General Economic Conference of November 8. At the former meeting Sir James Allen, Minister of Finance of New Zealand, opened the discussion.[13] He pointed out two reasons why the Imperial currency and exchanges problem should be brought to debate: firstly, 'the serious detriment of trade caused by the difficulties in regard to remittances of money from London to New Zealand and vice versa, and the rates for exchanges,' and secondly, 'that Mr. J. F. Darling, a London Banker, had made a special study of this question, and he had put forward definite proposals for creating Empire currency bills.' But he him-

[11] *An International Currency: The Bank for International Settlements*, London, 1929.
[12] See, later discussions in the Imperial Economic Conference of 1923.
[13] Stenographic Notes of Meetings, PRO CAB 32/26.

self did not make any judgement about whether Darling's scheme would be practicable or not, and proposed the setting up of a committee on the currency and exchanges within the Empire to inquire into the following three ideas.

1) Darling's idea, that is, the above-mentioned 'Empire Currency Bills' scheme.

2) The opinion expressed in two memoranda prepared by the British Treasury.[14] The main object of the first memorandum dated May 2, 1923, was to criticise the Darling's plan without any concrete proposals for adjustment of exchange disturbances within the Empire owing to 'the vagaries of sterling' after the War. Assuming the 'vagaries' would have ceased soon, the Treasury put an active plan in the second memorandum dated July as follows:

> The best method is to rely on a central bank of issue. A central bank of issue can effect the exchange in either or both of two ways. It may undertake to issue its notes against sterling and convert them back into sterling at a fixed rate, and it may itself take measures for expanding and contracting credit as the state of the exchanges may require. The former method, which is that of the exchange standard, is the more directly effective. So long as it is operative, the sterling resources in the Dominion, being convertible into one another, form a single whole. A shortage of sterling and a shortage of cash are, from their point of view, the same thing, and equally compel a contraction of credit. But if the central bank, besides buying and selling sterling for notes, makes a practice of rediscounting for the other banks, these latter can replenish their cash by this means. If they are enabled to do so on easy terms, the contraction of credit will be avoided.[15]

It should be noteworthy that the idea of the Treasury was very similar to that of Darling's 'Empire Bank' proposal and that it was to become an essence of the Resolution mentioned later.

3) The proposal of Sir James Cooper, Deputy-chairman of the British-Australian Wool Realisation Association. He approved of the Darling's plan,[16] but proposed an alternative one, 'assuming the possibility of Mr. Darling's scheme not being accepted,' to the following effect:

> (a) Let the Commonwealth Government definitely arrange that the Commonwealth Bank of Australia shall fulfill its proper and original function and allow perfect freedom for exchange operations in any part of Australia to any customer who likes to open an account with it. (b) Let the New Zealand Government regardless of its holding in the Bank of New Zealand, insist on the Bank of New Zealand allowing perfect freedom likewise throughout New Zealand. (c) Let both, through these banks in London, give proper facilities for the purchase and sale of Australian exchange in London.[17]

[14] PRO, CAB 32/25.

[15] 'Empire Currency,' Memorandum prepared in the Treasury, July 1923, p. 2, PRO, CAB 32/25.

[16] In his letter to R. G. Hawtrey dated September 18, 1923, he made clear that the New Zealand Banking community had also approved of Darling's plan; 'according to the N. Z. Herald of July 27th which I saw, a Mr. P. H. Cox, Chairman of the Associated Banks of New Zealand, expressed "hearty approval of the proposal for Empire Currency Bills founded on statute," which he also stated "would form an Empire bond of great strength," I confess I had hardly expected that he, in his opinion, would have given the idea such hearty approval, but it shows I think that the idea is making progress in New Zealand Banking circles.' (PRO, T160/550/F7219/2.)

[17] Stenographic Notes of Meetings, PRO, CAB 32/26.

Toward Allen's proposal, Bruce, Prime Minister of Australia, was favourably disposed, and yet he was serious about the Darling's scheme, for it put forward a request for 'a complete reversal of the whole banking system of Australia.' But he argued that 'there was an absolute necessity for doing something.' Moreover, he referred to the fact that while Australia 'had ample funds in Great Britain it was almost impossible to transfer them to Australia' from 1922 to 1923, and pointed out there was no method by which the British-Australian Wool Realisation Association could get facilities to transfer its sterling holdings in London to Australia. Then, Mackenzie King, a representative of Canada, said 'the subject did not affect Canada particularly,' for exchange transactions in Canada 'were made primarily in relation to New York.' On the other hand, H. Burton, Minister of Finance of the Union of South Africa, did not object 'the committee going to the matter,' though he criticized the Darling's proposal because 'it provided machinery for creating currency without at the same time creating any machinery for controlling credit.' Finally, Allen's proposal was accepted, and the Committee on Inter-Imperial Exchanges was to be set up.

Meetings of the Committee were held five times. At the second meeting of November 1 Darling was asked to attend to make some complementary explanations to his Memorandum, in which he referred to the possibilities of control of credit under the system of 'Empire Currency Bills' through making clear the difference between the Bills and other Government securities such as the British Treasury bills.[18] However, he was not able to develop his argument into more persuasive one, for he confused the functions of Gold with those of 'Empire Currency Bills.' Although Gold and the Bills are both to be regarded as a standard measure of value or a basis of currency and credit, the former has been a historically and naturally accepted basis of value and credit, while the latter could be created upon a voluntary and manageable agreement between countries. Therefore the issue of 'Empire Currency Bills' should have provided a more chance of credit control. He failed, regrettably enough, to grasp the serious meaning of what his plan could have brought about. After hearing Darling's evidence, the Committee could not find out in the 'Darling scheme' any special reasons to adopt an alternative Empire currency system, and became in favour with the orthodox pro-Gold Standard opinions expressed in the Treasury Memorandum, for which R.G. Hawtrey was mainly responsible.

At the beginning of the General Economic Conference of November 8, Charles Addis, Chairman of the Committee, presented the resolution agreed to by it as follows:

1. That arising as they do from the suspention of an effective gold standard, the difficulties of inter-Imperial exchange will disappear when the currencies of Great Britain and the Dominions affected are again made convertible into gold.
2. That it is neither necessary nor desirable to adopt complicated plans for a new instrument of credit, such as Empire currency bills, which involve difficult and disputable constitutional and financial questions.
3. That where difficulties have arisen in regard to exchange between certain parts of the Empire and between such parts and the United Kingdom:
    (a) The position could be ameliorated if the note-issuing authorities were to accumulate sterling assets and to undertake to exchange their local currencies for sterling and vice versa.

[18] Committee on Inter-Imperial Exchanges, PRO, CAB 32/37.

(b) This measure might be further developed and assisted by the creation of central banks and by mutual cooperation as recommended by the Genoa Conference.
(c) In some cases the bank charges for buying and selling sterling appear to be unduly high, and should be capable of reduction.[19]

Addis gave notes in detail on it, but especially it is necessary for us to take notice of his talk on the Darling's proposal. He asserted Darling 'agrees that his scheme would be subject to revision and alteration, if the gold standard restored. There is a further similarity between his scheme and those measures which we have suggested for your adoption, in sofar as he also contemplates the creation of a central bank, one of whose functions would be the sterling exchange standard.'[20] In these remarks we can find out what revisions the Committee tried to make of the 'Darling scheme.' It seems that the aim of the resolution was reestablish the system of 'sterling exchange standard' within the British Empire and to reconstruct the London money market as the Imperial financial centre. It is nothing less than the economic policy adequate to the interests of Great Britain and a part of the Dominions, amongst others, Australia and New Zealand. Ultimately the above resolution was accepted in the Conference. And in such a way the Darling's proposal 'took effect,' though a important factor of his fundamental ideas was ignored.

IV

As was outlined above, Darling advocated an idea for the monetary reconstruction of the British Empire after the War, which I might term 'Monetary Imperialism,' with the creation of an international reserve asset and a sort of 'managed' currency through the 'Empire Currency Bills.' However, the City, to which he belonged, did not necessarily support his scheme. The response of the City bankers as a whole to it was reported by *The Times*[21] as follows:

> The banking community will be much interested in the resolutions unanimously passed by the Representative and Expert Committee on inter-Imperial Exchanges appointed by the Imperial Economic Conference. As was expected, the Committee definitely rejected Mr. Darling's plan of Empire Currency Bills, which, they say, would involve difficult and disputable constitutional and financial questions. Put plainly, this means that the Empire cannot have a common fiduciary legal tender without fiscal and political unity. A common currency in inconvertible paper would involve the surrender of certain sovereign rights on the various political entities which make up the British Empire, and their excercise by a single Imperial authority. As the latter is politically impossible, the Empire must forgo the advantages which fiscal unity and a common legal tender would give.

These passages seem to suggest the interests of the City might face towards another type of 'Monetary Imperialism,' which was clearly expressed and advocated by Frederick C. Goodenough, Chairman of the Barclays Bank.

[19] *Ibid.*
[20] Stenographic Notes of Meetings, PRO, CAB 32/26.
[21] November 9, 1923.

The framework of his discussions on monetary matters consisted of three factors: a strong belief in well-behaved character of the pre-War Gold Standard system, the case for monetary unity of the British Empire, and the rejection of all kinds of 'managed currency.' These fundamental ideas remained unchanged until his death in 1934. In order to clarify their logical connections each of his arguments has to be examined more in detail.

I) Gold Standard System

According to Goodenough, 'the system upon which the Currency of a country is based should be sound, that is to say, should afford stability of value.'[22] The Gold Standard could become the most desirable one which was defined by him as a 'system for measuring the value of credit and commodities in terms of a currency based upon Gold.'[23] It could reduce 'the uncertainties and risks' included in various economic activities, and minimize the difference between the internal and external values of a currency based upon Gold. He also accepted the validity of the quantitative theory of money and defined it by such terms as these:

> the level of prices will depend on the quantity of money (including Credit) multiplied by the number of times such money is used on the one side, and on the volume of commodities to be exchanged on the other.[24]

Assuming the quantitative theory thus defined, he described the well-known principle of 'the automatic process of the Gold Standard' as follows:

> When the exchanges and the trade balance were favourable, gold flowed into this country and formed a basis for the credit required to finance increasing trade. On the other hand, when the balance of trade and the exchanges were unfavourable, it became profitable to export Gold and the withdrawal of Gold reduced the ratio of the Bank of England Reserve to its liabilities, until a point might be reached when this ratio might be regarded as dangerous, and then the Bank Rate would be raised. The increase in the Bank Rate would then help to retain in this country money which would have been remitted abroad, and also would attract remittances from abroad, and the outflow of Gold would thus checked.[25]

Goodenough thought, besides its automatic working, the Gold Standard could have other two merits; firstly, that 'the World is a firm believer in Gold as the most suitable standard for the measurement of value of currency, credit and commodities,' and secondly, that the British return to Gold 'has led, and will lead still further, to the same step being taken by other countries.'[26] However, he proposed the adoption of a gold exchange standard as the more favourable 'Empire Currency' system.

II) Sterling Exchange Standard

In order to promote trade within the British Empire, he supported the adoption of various

[22] *Address delivered by Mr. Frederick C. Goodenough (Chairman of Barclays Bank Ltd.) to the Liverpool and District Bankers' Institute* on Monday, December 6, 1920, p. 3.

[23] 'The Gold Standard,' *An Address delivered by Mr. Frederick C. Goodenough to the Oxford Luncheon Club*, Oxford, November 13, 1925, p. 3.

[24] *Address*, December 6, 1920, pp. 8–9.

[25] 'The Gold Standard,' p. 7.

[26] *Ibid.*, pp. 7–8.

measures already recommended, such as uniformity of the metric system and currency, or the codification of the mercantile law. But, amongst others, he emphasized the necessity of reconstruction of monetary unity of the Empire:

> Just as in the past there were questions of exchange between London and the various cities of the Kingdom which, by the expansion of our banking organization, were swept away, to the greater advantage of trade within the Kingdom—thus removing from the shoulders of the individual, or of the few, the burden of conditions created by the many —so should we now recognize that the extention of banking organization and the maintenance of fixed rates of exchange within the British Empire will give to our Dominions and Colonies a substantial preference, and would serve to consolidate and promote trade within the Empire, to economy in the use of gold, and so enable our gold resources to be utilized elsewhere. Drafts on London at fixed rates would be obtainable at all points, and similarly London would sell in the same manner, and the balance of trade within the Empire would be adjusted by a closer administration of inter-Imperial finance.[27]

His arguments consisted of two different proposals, namely, 'the extention of banking organization' and 'the maintenance of fixed rates of exchange' within the Empire. The former was partially realized through the establishment of Barclays Bank (Dominion, Colonial and Overseas), which led the 'Integration Movement' in 1920s.[28] As to the latter, Goodenough asserted the restoration of the pre-War Gold Standard so that the 'fixed rates of exchange' could be secured, though, before the British return to Gold, he suggested 'the adoption of a Gold Exchange Standard, or preferably and more easily a Sterling Exchange Standard' as a monetary system fitted for 'the intermediate stage.'[29]

III) Critique of Managed Currency

While he credited the system of gold standard with excellent workability, he fundamentally rejected the effectiveness of currency management. Goodenough pointed out some difficulties of 'system of managed currency' to secure price stability. Firstly, it would 'depend upon the manner in which the particular index number to be maintained would be calculated and what would be the proportionate weight given to each of the various commodities of which it would be composed.' Secondly, 'our prices would not necessarily conform to movements in world prices and that in circumstances, it would not be possible to maintain stability of exchange, whereas the Gold Standard—should bring about uniformity of world prices and also stability of exchange.' Thirdly, fluctuations in prices 'are in fact the natural and effective corrective for adjusting supply and demand. A substantial fall in the price of one important commodity might, therefore, if a given index number is to be preserved necessitate increases, large or small, in the price of other commodities, by way of compensation.'[30] Although he suggested that a managed currency was 'not an absolute impossibility if other countries were prepared to do the same,'[31] his rigid preference for

[27] *An Address to the Annual General Meeting of the Barclays Bank* held on January 14, 1918.
[28] See, A. S. J. Baster, *The Imperial Banks*, London, 1929, Chapter VI.
[29] *Address*, December 6, 1920, p. 16.
[30] 'The Gold Standard,' pp. 5–6.
[31] *Ibid.*, p. 6.

the system of Gold Standard over that of currency management remained unchanged until his death.[32]

Goodenough's arguments for 'Monetary Imperialism,' through which did he prove himself to be a 'confirmed Imperialist,'[33] could have some policy implications, their main points being a critique of managed currency, and a belief in the Gold Standard and 'Empire Currency' based upon it. For him the pre-War Gold Standard was the most desirable system for credit organization of the British Empire. Therefore, he thought, the British return to Gold would result in the reorganization of 'Empire Currency' system.

V

By comparison with Darling and Goodenough, Reginald McKenna seemed to be a non-Imperialist, rather as an economic nationalist with more progressive economic ideas. His economic and monetary views before 1925,[34] though, perhaps, a minority opinion in the City, contributed to the later development of economic policy principles in Great Britain. With regard to economic insight into real world he was outstanding among joint stock bankers. His economic reasoning was systematic, that is, based upon a sort of model-building, while, as to each economic problems which must be solved from various viewpoints he did not rely on purely economic thinking too far, and showed a more flexible stance; thus we should examine, firstly, the structure of his economic model, and secondly, his attitude to individual economic matters—for example, the post-War inflation and the British return to Gold—in relation to his theoretical framework.

I) Economic model of McKenna

According to McKenna, the general level of prices (P) is determined by four factors; demand=purchasing power of the public (Y), supply=national power of production (N), the velocity of expenditure (E) and the cost of production (C), where E is defined as the ratio of $Y-S$ (savings) to Y.[35] The increase (decrease) of Y, E and C, or the decrease (increase) of N can cause the increase (decrease) of P. Among these factors he emphasized Y and N. The increase of Y means the increase in currency (M) and bank deposits (D).

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[32] Cf. *Address to the Institute of Actuaries in London* held on November 23, 1933, reproduced in *The Bankers' Magazine*, Vol. 133 (1934), pp. 17–26.

[33] Baster, *op. cit.*, p. 235.

[34] His addresses and speeches etc. cited below are as follows; ⟨1⟩ 'Bank Deposits, Prices and Currency,' *Address to the General Meeting*, January 29, 1920. ⟨2⟩ 'International Exchange: Foreign Exchanges and the League of Nations,' *Speech before the University of Manchester*, November 17, 1920. ⟨3⟩ 'Monetary Deflation—Treasury Policy Impracticable,' *Address to the General Meeting*, January 28, 1921. ⟨4⟩ 'The Problem of Unemployment,' *Address to the General Meeting*, January 27, 1922. ⟨5⟩ 'Trade Prospects,' *Address delivered by McKenna at the Dinner of the Worsted Spinners' Federation at the Midland Hotel*, Bradford, on Thursday evening, May, 1922. ⟨6⟩ 'Trade and Employment—The Restrictive Influence of Deflation,' *Address to the General Meeting*, January 24, 1923. ⟨7⟩ 'Trade Recovery,' *Address before teh Belfast Chamber of Commerce*, October 24, 1923. ⟨8⟩ 'Currency, Credit and Trade—Importance of Monetary Policy,' *Address to the General Meeting*, January 25, 1924. ⟨9⟩ *McKenna's Evidence to the Treasury Committee on Currency and Bank of England Notes Issues*, July 10, 1924. ⟨10⟩ 'Commodity Prices and the Gold Standard,' *Address to the General Meeting*, January 27, 1925. ⟨11⟩ 'The Restoration of the Gold Standard,' *Speech before the Commercial Committee of the House of Commons*, March 4, 1925. For the use of these materials I am much indebted to the Archive of the Midland Bank plc.

[35] Cf. ⟨1⟩, ⟨2⟩, ⟨3⟩ and ⟨6⟩.

As D is created by credit, that is, 'loans by banks' and M is 'only a function of credit,' the increase of Y can be controled by credit.[36] The regulation of credit is possible through the banking system, ultimately with various operations of the Bank of England, but Government economic activities such as taxation and unproductive expenditure can cause some disturbances.[37]

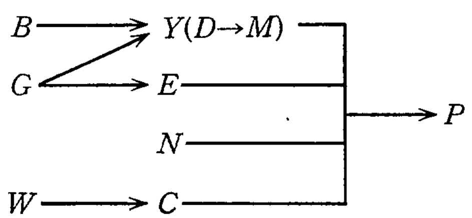
On the other hand, from an economic-nationalist point of view, he advocated for the development of the British 'national economy,' expecting the attainment of 'the highest level of our industrial capacity' which is to lower the level of P by increasing N. He argued as follows:

> The public have a wider recognition of the necessity for national economy, of the crushing effect of excessive taxation on industry, and of the need for greater production. In these circumstances it is not merely possible for us to get back to the pre-War level but we may perhaps look for a further development of our domestic trade so as to make up for part of the foreign decline. It is in this sphere that our best hope lies and it is here that we may find a wise direction of financial policy of the greatest avail.[38]

For this purpose he recommended 'a rational optimism' which 'encourages confidence, stimulates the spirit of enterprise, and sustains our energy,'[39] but criticized workmen's combination 'to restrict output,'[40] though 'the wealth of a nation and its power to pay' could be found 'in the mine, the factory, and the workshop, and its national power of production.'[41] Moreover, McKenna formulated a desirable 'financial policy' when national output is 'below productive capacity.' In that case 'the policy should be to let money out; when production is at a maximum, the outflow of money should be checked and, if inflationary symptoms have appeared, money should be withdrawn.'[42]

To sum up, his economic model can be shown like that of Figure 1 with the assumption that the Bank of England operations and the Government economic behavior could be measured by certain indicators denoted B and G each. It seems to be a kind of 'sequential transmission' model[43] assuming the endogeneous nature of money in circulation and the

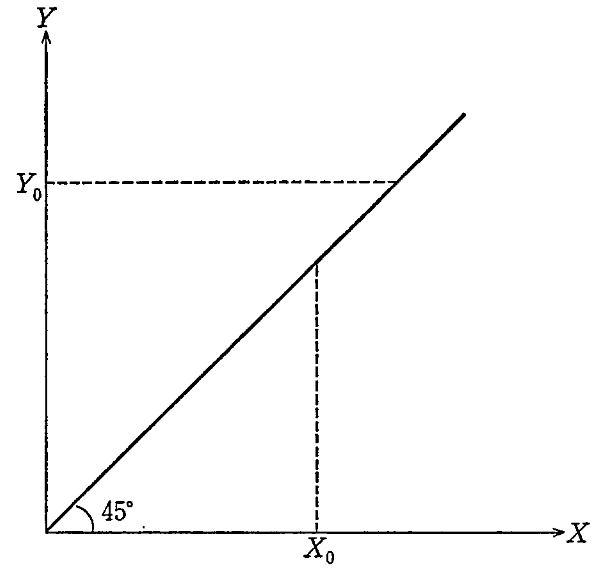
FIGURE 1. ECONOMIC MODEL OF MCKENNA



W: workmen's nominal wages
$\rightarrow$: causal relation

[36] ⟨9⟩, pp. 1–4.
[37] Cf. ⟨1⟩.
[38] ⟨6⟩, pp. 8–9.
[39] ⟨5⟩, pp. 1–2.
[40] ⟨4⟩, pp. 18–19.
[41] ⟨2⟩, p. 2.
[42] ⟨8⟩, p. 15.
[43] Amit Bhaduri, *Macroeconomics: The Dynamics of Commodity Production*, Macmillan, 1986, p. 131.

FIGURE 2.



X: amount of goods available for purchase
X_0: maximum amount of goods available for purchase at a given time
Y: purchasing power
Y_0: purchasing power at a given time

exogenously determined wage rates.

II) McKenna's view on inflation and deflation

His view on the fluctuations of prices can be shown in Figure 2, where X_0 and Y_0 respectively denote the maximum amount of goods available for purchase and the purchasing power at a given time. He devided inflation and deflation into two types; inflation occurs when $Y>X_0$ (Type I) or $Y_0>X$ (Type II), and deflation occurs when $Y_0<X$ (Type I) or $Y<X_0$ (Type II).[44] He recommended the inflation and deflation of Type I as desirable, especially against the post-War inflation this type of deflation could have countervailing power, for, he considered, it would bring about 'a larger supply of the commodities we all need, a greater surplus for foreign export, and a larger total of real wealth.'[45] However he did not forget to call attention to the excess of deflation or deflationary policy which might be 'a cause of unemployment.'[46]

McKenna's argument as to inflation and deflation seems to have been a simple application of his theoretical framework. It was quite different from what he told about the British return to Gold in 1925.

[44] Cf. ⟨4⟩.
[45] ⟨4⟩, pp. 26–27.
[46] Cf. ⟨7⟩.

III) McKenna's attitude toward the return to Gold in 1925

In his evidence to the *Treasury Committee on Currency and Bank of England Notes Issues*, he referred to the arguments for and against Gold. According to him, the arguments in favour of the resumption of gold payments could be given in three ways. Firstly, gold is the basis of 'securing confidence.' Secondly, Great Britain and the British Empire 'are closely concerned in maintaining the value of gold.' And thirdly, 'a slow process of rising prices' could be expected after the return to Gold. He thought it to be 'the easiest way to get rid of an excessive burden' of the immense national debt. On the other hand, the return to Gold could be refused because 'gold is very costly.' Thus, on balance, he should be 'in favour of resuming the gold standard, notwithstanding the risk of cost.'[47] But, he added, 'if gold is going to fluctuate I do not want to fluctuate with gold: I want stability.'[48] He also said in his speech before the Commercial Committee of the House of Commons, 'I am in favour of a stable currency which alone can secure justice to all classes.'[49] His stance to this problem seemed to be based upon a temporary judgement of changing world economic situations, not upon some theoretical considerations. Rather, consciously or not, he had already prepared an analytical framework for dealing with more catastrophic economic problems such as inflation and unemployment.[50]

VI

Even after 1925 Darling, Goodenough and McKenna expressed in various speeches and pamphlets their own beliefs in British economic policy. Darling, while proposing another type of 'Empire Currency,'[51] devised an institution for managing international reserve assets such as the Bank for International Settlements.[52] Goodenough practised his 'Imperialism' in ordinary banking business. Through the establishment of the DCO and the Barclays Bank (Canada) he tried to develop an international or, more exactly, inter-Imperial branch banking strategy which was to determine the character of his bank after the Second World War.[53] Although the economic thoughts of these two 'Imperialists' bore little relation with contemporary British economic policy, McKenna's economic ideas were deeply connected with it. He played an active role in the Macmillan Committee and the Economic Advisory Council, in which he put a more sophisticated argument with some theoretical improvements of his economic images and their policy implications.

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[47] ⟨9⟩, pp. 11–12. See also, ⟨10⟩, pp. 24–25.
[48] *Ibid.*, p. 20.
[49] ⟨11⟩, p. 8.
[50] See, 'Obituary: Mr. Reginald McKenna,' *The Times*, September 7, 1943.
[51] See, for example, *The "Rex": A New Money to Unify the Empire*, 1930.
[52] See, the pamphlet cited in note 11.
[53] Cf. Derek F. Channon, *British Banking Strategy and the International Challenge*, Macmillan, 1977, pp. 126–129.