The BANK RATE

An article on Current Economics which will interest every student of international affairs.

DURING the past few weeks the various financial papers have been discussing the action of the Bank of England in raising the Bank Rate to 4 per cent. in the first week of July. Some theorists, such as Prof. Cassel, have justified this ; others, such as Mr. Keynes, have severely condemned it. It is vitally important for working-class students to understand the issues in this controversy : what are the effects of movements of the Bank Rate and what its political significance ? For on our understanding of this issue depends our power of forecasting movements in the price level, in unemployment, and in the general productive activity of capitalism. Moreover, behind this controversy lurks one of the important conflicts of interests inside the capitalist class, which is of considerable political significance in the present crisis-period.

Now the Bank Rate is the rate which the Bank of England charges to borrowers who come to it for credit advances. These borrowers are usually merchants and manufacturers who wish to have credit in order to carry stocks of raw materials or of manufactured goods. Their demand for credit will depend in part on the profit they expect to get out of trade or production, in part on the cost of obtaining credit (*i.e.*, the Bank Rate). A credit advance as a rule takes the form either of an "overdraft," giving the right to draw cheques up to a certain amount, or of discounting a Bill of Exchange.* The effect of such an advance is to give to the borrowers more purchasing power, in the form of the right to draw cheques, than they would otherwise have. If they use this purchasing power, the demand for goods increases, and the general level of prices tends to rise.

It will be clear that a raising of the Bank Rate will make borrowers less willing to borrow, or at any rate to borrow as much as before. Hence merchants and manufacturers will get less credit advances from the banks : they will find money "dear" ; and they will have less purchasing power to spend on replenishing stocks, employing labour, etc. The result will be a tendency for the general level of prices to decline.

The three important effects of a raising of the Bank Rate will therefore be :—

1. To lessen trade and industrial activity.

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* See PLEBS *Outline of Economics*, p. 66.

2. To lessen the demand for labour and so increase unemployment.
3. To lower the general price-level.

But other effects also follow. In the first place, this decrease in the amount of credit advances will decrease the amount of cheques coming to the banks to be cashed. It will, therefore, decrease the demand for, and the amount of, pound Treasury notes in circulation. It will, therefore, raise a little the value of each pound Treasury note, or its purchasing power in terms of commodities in general.

In the second place, it will make it more profitable for foreigners who have money to lend, to send it to London and invest it there (either in bills or short-term bonds or securities), where the rate of interest is high. Hence there will be a demand for sterling (or for bills on London) in the international money market, which will raise the value of sterling relative to other currencies. In other words, the foreign exchange will move in favour of Britain. Another influence aiding this will be a slackening off of imports, owing to the lower price-level in Britain, and a consequent tendency for an export surplus, creating a demand for bills on London to pay for the exports.

Hence the other two important effects are :—

4. Improvement in the internal value of the currency.
5. Improvement in the external or foreign exchange value of the currency.

It will be noticed that 3 and 4 are identical things looked at from different sides. Price of Goods is Goods expressed in Money. Value of Money is Money expressed in Goods. One is the "reciprocal" of the other. Hence we can lump both together under the term *Deflation*. It will be noticed that, although these effects will be most obvious when the Bank Rate is *raised*, the same effects are likely to happen if the Bank Rate is merely kept too high.

But Deflation once started tends to go on in a vicious circle. When prices are falling, merchants and manufacturers who hold stocks of goods stand to lose. If the price level is falling 5 per cent. a month, and at the beginning of the month a capitalist has bought stocks at £100, at the end of the month the stuff will only sell for £95. Hence business men will be very cautious of replenishing stocks and starting production going, if they think prices are going to continue to fall. They will let their capital stay in the form of money at the bank, rather than put it into goods. In other words, money will circulate less quickly, because people wish to keep a larger proportion of their resources in the form of money (which is rising in value) and less in the form of goods (which are falling in price). Now this slowing down of the velocity of circulation of money has a deflationary effect on prices.* Further, business men are still less inclined to pay the heavy costs of borrowing from the banks, and the volume of credit advances made by the banks declines. The more prices fall, the greater becomes the burden of the Bank Rate, and the greater its deflationary effect.

Now, ever since the spring of 1920, when the Bank of England raised its rate to 7 per cent. with the object of stopping Inflation, this process of Deflation has continued. As was shown in The PLEBS Unemployment Number, and as I showed in the January *Communist Review*, there were during the summer of last year distinct signs of a revival of trade and production. An actual trade boom was in progress in U.S.A. last winter. In this country costs had been "cut" enormously, stocks of commodities were very much depleted. Demand for coal and pig iron had recovered considerably. Dr. Varga in his excellent report to the Comintern, published in English as *The Process of Capitalist Decline* (which everyone should read), gives evidence of this revival in several capitalist countries. There was, however, in this country (and also in some others) one thing that stopped that revival from taking place—the deflationary influence of a high bank-rate.

What was the object of the Bank of England in keeping its rate so high? Its object was to achieve 4 and 5. The restoration of the pound sterling to its pre-war parity—with gold and with the dollar, and so to restore the gold standard. But in trying to achieve 4 and 5, the deflationists also produced 1, 2 and 3. Now, 1 and 3 are severely detrimental to industrial and commercial capital—they mean less business and no profits. On the other hand, 4 and 5 are beneficial to the financial interests—restore the "prestige" of the City of London, and make all debts calculated in sterling of a greater *real* value.

Here, then, is the germ of that important clash of interests between industrial capital and the financial interests, to which Mr. Philipe Price drew attention about a year ago in *The Labour Monthly*. The industrialist desires Inflation; the financier and banker desire Deflation. To some extent, of course, the industrialist and the financier are linked together in the form of Finance Capital. But there is still sufficient difference between them to produce a conflict.

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* See *Economics Textbook*, p. 58. A modern statement of the formula of the price-level, which better fits post-war conditions, is $P=\frac{KR}{N}$, where P=value of money, R=total resources of commodities, N=quantity of money in circulation, and K=proportion of resources which people keep in the form of money. If K (which is a fraction) gets larger, P (value of money) gets larger. See *M.G. Reconstruction* No. 11, p. 660.

Until the spring of this year all was going well with the deflationists. For, while deflation was in progress in this country, in U.S.A. there was inflation. In 1922 in U.S.A. the price-level rose about 12 per cent. This was depreciating the value of the dollar and hence of gold, since the greatest demand for gold comes at present from the U.S.A., which alone among the leading nations is on a gold standard.* Hence sterling and gold were coming nearer to one another. In February, however, the Federal Reserve Board of U.S.A. (largely representing J. P. Morgan interests) put up its rate by ½ per cent.; and this had the effect of checking the rise in prices and of producing a small fall and a slackening off of industrial activity. Sterling and gold moved apart again.

This, of course, did not please Threadneedle Street and Lombard Street at all. The first week in July the British Bank Rate was raised, in order to raise the prestige of Queen Sterling and her paramour, the City of London. This action, combined with the psychological effects of the reparations deadlock are the two factors intensifying the crisis of capitalism as it affects this country at the present time. This conflict between industrial and financial interests is an important cause of instability in world capitalism at the present time. It renders schemes for stabilisation, like those of Prof. Cassel and Mr. Hawtrey, unpractical; since it will not be scientific but economic interests which will predominate in the regulation of the bank-rate and the currency. Moreover, before the war speculative "manipulation" was confined mostly to the Stock Exchange and Produce Markets. To-day a powerful combine, with political and financial influence, can extend its "manipulation" to the value of the very currency itself, as Stinnes is said to have done in Germany. The immense centralisation of modern capitalism, both economically and politically, gives to one powerful group of interests the power to wreck the whole economic life of the nation, perhaps of the whole capitalist world.

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* See "Students' Notes."