

The Problem of Monetary Control in Britain, 1948-51

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The monetary policy of the first majority Labour government in Britain is notorious for the attempt in 1945-47 of the first Chancellor of the Exchequer of that administration, Hugh Dalton, to drive down interest rates on long-term government bonds to 2½ per cent. The monetary policy of the following four years, until the Conservatives returned to power in October 1951, is equally well known for the apparent lack of any active or deliberate monetary policy — even when the UK was forced to devalue the pound from US \$ 4.03 to US \$ 2.80 in September 1949. In J.C.R. Dow's well known description,

"This period might be described as the St. Lucy's day of monetary policy: for a year or two in the middle of the period there is scarcely a sentence in any official statement which mentions credit or interest rates. It is probably correct to say that the aim was a 'neutral' monetary policy, which would not work against the general aim of disinflation."¹

Alec Cairncross in his *Years of Recovery* did not change this view, although he mentioned discussion of domestic monetary policy during the devaluation crisis and reported pressure to raise short-term interest rates from the Governor of the Bank of England, C.F. Cobbold, on Sir Stafford Cripps, Dalton's successor as Chancellor, and on Hugh Gaitskell, the third postwar

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¹ *The Management of the British Economy 1945-60* (Cambridge, 1964), pp. 227-8.

Labour Chancellor of the Exchequer (1950-51).² But it has since become clear from the records of the Treasury and the Bank of England that the official silence hid a prolonged debate between the monetary authorities about the problem of controlling monetary growth in those years. As a result of his study of the work of the Economic Section of the Cabinet Offices in the 1940s and 1950s Cairncross has described a part of that debate which involved Robert Hall, Director of the Section 1947-61, but he looked at it mainly from the point of view of the Economic Section.³ He did not analyze the magnitude of the problem facing the authorities, nor the impact of their tentative measures of monetary control.

Cripps' and Gaitskell's monetary policy can be briefly described. Bank rate stayed at 2 per cent where it had been almost continuously since 1932, the interest rates on Treasury bills and Treasury Deposit Receipts (TDRs) remained at the $\frac{1}{2}$ per cent and $\frac{5}{8}$ per cent to which Dalton lowered them in October 1945, while long-term interest rates crept upwards from Dalton's $2\frac{1}{2}$ per cent to nearly 4 per cent by October 1951. This upward drift of long-term rates accompanied a slow growth of the money supply, observed at the time in the deposits of the London Clearing Banks published each month. The only visible attempt to control monetary growth were the Chancellor's repeated "requests" to the London Clearing Banks to moderate their lending in particular directions. During the war the banks had been asked to limit their lending to projects helpful to the war effort; at the end of the European war they were asked not to

² *Years of Recovery: British Economic Policy 1945-51* (London, 1985), pp. 176-9, 182, 190, 441-3. Dow had also noted the pressure on Gaitskell which he attributed to the Clearing Banks (*Management*, p. 230n).

³ ALEC CAIRNCROSS, "Prelude to Radcliffe: Monetary Policy in the United Kingdom 1948-57", *Rivista di Storia Economica*, 4 (1987), pp. 2-10; ALEC CAIRNCROSS and NITA WATTS, *The Economic Section 1939-1961. A Study in Economic Advising* (London, 1989), pp. 213-15. An important source for Cairncross was ROBERT HALL's diary, now published: *The Robert Hall Diaries 1947-1953* (ed. Alec Cairncross, London, 1989).

make large personal loans or advances for speculation, and to concentrate on loans for reconstruction, especially exports. These requests were reemphasized and expanded in December 1947, April and October 1949 and April 1951, with increasing publicity.⁴

This monetary "regime" came to an end in the winter of 1951-2. The new Conservative Chancellor of the Exchequer, R.A. Butler, raised Bank rate, first to 2½ per cent on 7 November 1951 and then to 4 per cent in the budget of 11 March 1952. The authorities also converted £ 1000 m Treasury bills into short-term bonds, eliminated TDRs, and changed the relation between Bank rate and other short-term rates.⁵ Such a revival of monetary policy after wartime and immediate postwar neglect had already taken place in several other European countries and in the USA — which raises the question of why the "revival" in Britain came that late and why it took the (limited) form it did.⁶ On the face of it, the British measures can be seen as following the intellectual fashion or as accepting the monetary consequences of being an open economy with a fixed exchange rate. But as in the United States the intellectual fashion had begun to change earlier, in 1947 when it was reinforced by a balance of payments crisis which forced major changes in other aspects of UK macroeconomic policy. Further, the UK money stock was not linked to the UK balance of payments in the way required

⁴ Dow, *Management*, pp. 235-8, and below pp. 13, 16, 20.

⁵ For the details see (Radcliffe) Committee on the Working of the Monetary System, *Report* (Cmnd. 827, 1959), paras. 406-407.

⁶ European experience was summarized for the Treasury in EC(D) (49)5, "Post-war Experience of Credit Restriction Abroad", 23 December 1949, T233/1400, Public Record Office. On the policy developments in the USA see J.S. FFORDE, *The Federal Reserve System 1945-1949* (Oxford, 1954), M. FRIEDMAN and A.J. SCHWARTZ, *A Monetary History of the United States 1867-1960* (Princeton, 1963), Chapters 10 and 11; and HERBERT STEIN, *The Fiscal Revolution in America* (Chicago, 1969), Chapter 10. The most widespread reason for the general postwar neglect of monetary policy was the desire to maintain low interest rates until after the expected postwar slump (which never came). For other reasons in Britain, see S. HOWSON, "Socialist' monetary policy: monetary thought in the Labour Party in the 1940s", *History of Political Economy*, 20 (Winter 1988), pp. 543-64.

by the monetary theory of the balance of payments, nor was capital highly internationally mobile. Exchange controls were in force around, though not between, the sterling area countries, and the pound sterling was freely convertible into US dollars only for a brief period in 1947.

The purpose of this paper is thus to answer that question in the light of new information, which comes from two sources. First, most of government records for the period are now available in the Public Record Office, and I have also used records in the Bank of England's archives, especially the Chief Cashier's files on debt management and monetary policy in the late 1940s.⁷ Second, the *Monetary History of the U.K. 1870-1982* has provided for the first time monthly estimates of the total U.K. money supply (including the deposits of the nonclearing banks).⁸ These sources are used, first, to describe the problem facing the UK monetary authorities in and after 1947; second to indicate the different views of the government and the Bank of England on the nature of the problems as they emerged in the authorities' prolonged debate over monetary control; and third to outline the consequences for monetary conditions in Britain in 1948-51. Dow suggested that the slow growth of bank deposits in 1947-51 was due to the "informal policy of restraint" on bank advances (at a time when the banks did not wish to expand their already large holdings of bonds), and that the rise in long-term interest rates could be largely explained by the "relative [to income] restraint imposed on the money supply".⁹ However, lack of control over the monetary base meant that the money supply was determined rather by changes in the *demand* for money.

⁷ These sources are identified in the notes by the abbreviations PRO and BOE.

⁸ F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume 1: Data, Sources, Methods* (London, 1985).

⁹ Dow, *Management*, pp. 230-1.

The problem: the legacy of war and of Hugh Dalton

During World War II Britain had maintained a fixed exchange rate for the pound sterling against the dollar, controlled imports, prohibited capital movements out of the sterling area group of countries by exchange controls, and covered her current account deficit by sales of assets, lend-lease or mutual aid from her North American allies and the accumulation of short-term debts to the rest of the sterling area. Exchange controls were continued after the war in the Exchange Control Act, 1947. The insulation of the capital market permitted the authorities to adopt a fixed interest rate policy for the duration, keeping Bank rate at 2 per cent, Treasury bill and TDR rates at 1 and $1\frac{1}{8}$ per cent respectively, and nominal long-term yields on government bonds around 3 per cent.¹⁰ The monetary consequences were, of course, a continuously rapid growth of all the monetary aggregates (currency, bank deposits, monetary base, narrow and broad money stock) averaging 15 per cent a year over six years.¹¹ The monetary base and M3 for the war and early post-war years are plotted in Chart 1.

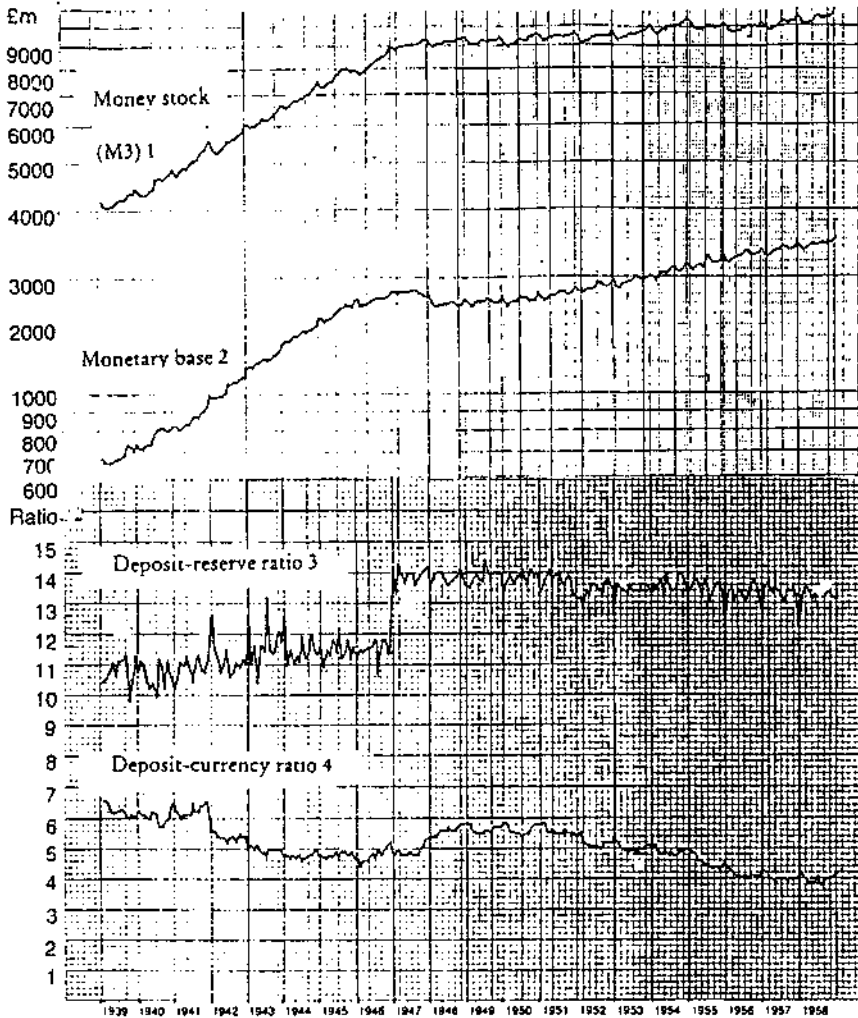
This did not, however, result in an equally rapid wartime price inflation, because of restrictions, including rationing and direct controls, on consumption and investment expenditure, price control and subsidies on items entering the official cost-of-living index. Retail prices rose by 43 per cent over the six years of war.¹² But the longer-term cost of monetary expansion and

¹⁰ R.S. SAYERS, *Financial Policy 1939-45* (London, 1956), especially chapters V and VIII. TDRs were direct short-term (6 months' maturity) loans by the major banks to the government which issued them to cover its residual borrowing needs. Introduced in June 1940, they amounted to £1859m at the end of the war compared with £3681m Treasury bills outstanding.

¹¹ Calculated from CAPIE and WEBBER, *Monetary History*, Tables I(1)-(3), II(1)-(2).

¹² Retail prices from C.H. FEINSTEIN, *National Income Expenditure and Output of the UK 1855-1965* (Cambridge, 1972), Table 65. The official cost-of-living index stood at 132 by August 1945 (September 1939 = 100). On the introduction of the stabilization policy, in 1941, see SAYERS, *Financial Policy*, chapter III. For some of the

Chart 1
 THE MONEY SUPPLY AND ITS PROXIMATE
 DETERMINANTS, MONTHLY, 1939-58



1. M3 = Currency in circulation plus net deposits of all UK banks. — 2. Monetary base = currency in circulation plus cash reserves of UK commercial banks. — 3. Deposit-reserve ratio = net deposits of UK commercial banks divided by cash reserves of UK commercial banks. — 4. Deposit-currency ratio = net deposits of UK commercial banks divided by currency in circulation.

Sources: M3: F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume I, Data, Sources, Methods, Table 1(3)*. — Monetary base: Calculated from data on currency circulation and on the Bank of England's balance sheet in *Bank of England Statistical Summary* (various issues) for 1939-45 and in *Monthly Digest of Statistics* (various issues) for 1945-58, and figures for banks' cash and till money in F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume I, Data, Sources, Methods, Table II(2)*. — Deposit-reserve and deposit-currency ratios: Calculated from figures for UK banks' net deposits in F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume I, Data, Sources, Methods, Table II(1)*, plus the sources used for the monetary base.

repressed inflation was to leave the private sector in a highly liquid state, with historically excessive money-to-income ratios. The *real* money stock (measured as the ratio of M3 to the GDP deflator) had been increasing at an average rate of six per cent in each war year while the growth of real output was only 1-2 per cent in 1942-3, after the adjustment to a full war economy, and negative in 1944-5. In the 1930s the ratio of private sector money balances (M1 and M3) to money income (GNP) had been declining to about one third and one half by the outbreak of war. In 1945 the money-to-income ratio for M1 had risen to 50 per cent, while M3 was now 70 per cent of income.¹³

This was the immediate postwar legacy of wartime finance. The problem three years later was worse, however, because of Dalton's "cheaper money policy". The attempt to fix long-term gilt-edged interest rates *below* the wartime 3 per cent in 1946 necessitated a further burst of monetary expansion, at a rate comparable to wartime experience.¹⁴

This pushed the money-to-income ratio of the nonbank private sector to 57 per cent for M1 and nearly 80 per cent for M3 (see Table 1). Although the continued existence of wartime direct and price controls make it difficult to see the immediate impact of the 12 per cent increase in real balances in 1946, this monetary expansion increased the pressure on the controls¹⁵ and on the balance of payments. The current account deficit, which had been reduced from £ 870m for 1945 to £ 230m for 1946, widened in 1947 to £ 381m. At the same time exchange controls

reasons for its effectiveness see GEOFFREY MILLS and HUGH ROCKOFF, "Compliance with Price Controls in the United States and the United Kingdom During World War II", *Journal of Economic History*, 47 (March 1987), pp. 197-213.

¹³ Calculated from CAPIE and WEBBER, *Monetary History*, and FEINSTEIN, *National Income*.

¹⁴ For the reasons for a policy so inappropriate to an inflationary situation see S. HOWSON, "The Origins of Cheaper Money, 1945-7", *Economic History Review*, 40 (August 1987), pp. 432-52, and "Cheap Money Versus Cheaper Money", *Economic History Review*, 42 (August 1989), pp. 401-5.

¹⁵ This shows up in MILLS and ROCKOFF, "Compliance with Price Controls", Tables 2 and 3.

Table 1
MONEY-TO-INCOME RATIOS, ANNUAL 1932-58

	M1/Y	M3/Y
1932	0.33	0.63
1933	0.34	0.63
1934	0.34	0.61
1935	0.35	0.61
1936	0.37	0.63
1937	0.35	0.60
1938	0.33	0.54
1939	0.34	0.55
1940	0.33	0.49
1941	0.35	0.51
1942	0.37	0.52
1943	0.39	0.55
1944	0.44	0.62
1945	0.50	0.70
1946	0.57	0.79
1947	0.53	0.76
1948	0.49	0.70
1949	0.47	0.67
1950	0.46	0.65
1951	0.41	0.58
1952	0.38	0.55
1953	0.36	0.54
1954	0.36	0.53
1955	0.33	0.48
1956	0.31	0.45
1957	0.29	0.44
1958	0.28	0.43

Sources: M1 and M3: F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume I, Data, Sources, Methods, Tables 1(2) and 1(3)*.
Y (GNP at market prices): C.H. FEINSTEIN, *National Income, Expenditure and Output of the U.K. 1855-1965*, Table 3.

were being relaxed in preparation for the restoration of current account convertibility of the pound on 15 July 1947 as required by the Anglo-American Financial Agreement of December 1945. One outcome was the so called "convertibility crisis" when the pound was promptly made inconvertible again on 20 August (1947).¹⁶ Another was the belated recognition by the

¹⁶ Balance of payments figures from FEINSTEIN, *National Income*, Table 15. For details of the development of the crisis, and for the role of capital flows in it, see CAIRNCROSS, *Years of Recovery*, Chapter 6.

Labour government that the prevention of open inflation and improvement of the balance of payments required deflationary domestic macroeconomic policy, not an overoptimistic faith in the continuation of wartime controls. Some essential measures were taken, most notably in the area of budgetary policy. Dalton aimed for a surplus in his April 1947 budget, and after the convertibility crisis produced another budget, increasing the estimated surplus for the 1947/48 financial year from £ 270m to £306m. There were also cuts in the import programme and in planned investment. As Dow remarked, "[this] autumn budget of 1947 set the pattern for the next three years", even though Dalton ceased to be Chancellor the day after the budget.¹⁷

Although active intervention to force down interest rates had ceased at the beginning of the year, well before the balance of payments crisis¹⁸ and long-term government bond yields had gradually returned to 3 per cent, Dalton had continued to affirm the government's commitment to "cheaper money". On taking over from Dalton, Cripps reaffirmed the commitment, in the hope of financing the government's nationalization programme as cheaply as possible: the first major issue of government guaranteed stock as compensation was £ 1000m for the railways on 1 January 1948. This reason became less pressing after 1948. Active monetary measures were in fact stalled by disagreement on the nature of the monetary problem and over the appropriate role of monetary policy — as the next section demonstrates.

The perceived problem: the authorities' debate

Official concern about the growth of the money supply dates from late 1947. The possibility of a change in monetary

¹⁷ On DALTON's views see his *Principles of Public Finance* (4th edition, 1954), Chapter XXVIII; for the details of the budgetary measures see DOW, *Management*, pp. 27-28, 198-200 (quotation from p. 28), and CAIRNCROSS, *Years of Recovery*, pp. 418-423. Dalton resigned because of a budget leak.

¹⁸ HOWSON, "Origins of Cheaper Money", p. 450.

stance had been raised in Treasury-Bank discussions during the convertibility crisis, but only as something to consider if there were no American aid to Britain under the Marshall Plan. After several months of uncertainty Marshall Aid was forthcoming. In December the terms of the issue of Transport stock (for railway nationalization) were settled, at 3 per cent for 30-40 years — which sealed the fate of Dalton's cheaper money policy.¹⁹ Only then did Treasury officials turn to consider a memorandum written to Dalton by Douglas Jay, a young Labour party economist and politician who had become a junior Treasury minister in October 1947.²⁰ Jay feared that Clearing Bank deposits, which had risen from about £ 2200m to about £ 4800m during the war, and to £ 5600m during 1946 as a result of the 1946/47 budget deficit and the cheaper money policy, were "tending to stoke up the inflationary pressure". He wanted the 1947/48 budget surplus to be used to reduce bank deposits by the amount they had risen in 1946, but without raising interest rates. Jay suggested that the authorities should buy government securities (from the market) and at the same time the Bank of England should sell government securities to the public "to such an extent as will lead to a sale over the year [1948] of about £ 600,000,000 of Government securities by the Bank and clearing banks together". This curious procedure was supposed to reduce bank deposits without raising interest rates. With "ammunition" from the Bank, the Treasury officials pointed out that they were already using the accruing budget surplus to reduce floating debt — "the most inflationary part of the National Debt"; that the Bank normally took steps to prevent bank reserves increasing as a result of debt repayment; and that the authorities could not undertake funding operations — "one of the orthodox methods of countering inflation" — while issuing

¹⁹ Mynors, "Meeting at the Treasury 2nd July 1947", 3 July 1947, G1/101, BOE; HOWSON, "origins of Cheaper Money", p. 448.

²⁰ Jay, "Interest Rates, Credit Inflation and the Budget Surplus", 5 and 24 November 1947, T233/481, PRO.

nationalization compensation stocks. At a meeting in the Treasury, although "there was general agreement with [Jay's] diagnosis of the position and with the objective of a reduction in bank deposits [it] was questioned whether a reduction of bank deposits could be sought regardless of any effect on interest rates". "With the present level of national debt it is difficult to contemplate higher interest rates, long or short term".²¹ The Treasury still felt constrained by the huge size of the postwar national debt (£ 25,770m in relation to a national income of approximately £ 10,000m) and by the need to finance the Labour government's nationalization programme.

Jay, not satisfied with this response, asked to discuss the technical points with the Bank. The Bank's position was that the high level of bank deposits was a symptom not a cause of inflation. Inflation was due to eight years of budget deficits and would fall with a budget surplus, since the Bank kept bank reserves to an 8 per cent cash to deposits ratio. Open-market operations in Treasury bills were entirely adequate for this purpose and there would be no point in raising the required cash ratio. An increase in Bank rate was useful when there was a stock exchange or commodity market boom and when there was freedom of capital movements, but at present would only serve to increase the cost of the floating debt. The "restriction of advances" by moral suasion on the clearing banks was qualitative in intent and could not be tightened.²²

The Bank at that time had no desire to change existing arrangements. Discussion between Bank and Treasury nonetheless continued, because Jay wanted to formalize the current "policy" in a memorandum for the Chancellor's approval and

²¹ "Bank deposits and inflation, Notes on Mr. Jay's memorandum", 21 January 1948, T233/481, PRO.

²² [Peppiatt], "Bank Deposits and Inflation", 28 January, and Bamford, "Note of Mr. Jay's talk at the Bank of England with Sir Kenneth Peppiatt and Mr. Mynors", 31 January 1948, T233/481, PRO. Peppiatt was then Chief Cashier, and became an Executive Director of the Bank the following year; Mynors an adviser, who became a Director in 1949.

he gained the support of the Treasury Permanent Secretary, Sir Edward Bridges, and of Robert Hall. On 25 March Cripps agreed that he would write to the Governor requesting a formal assurance that the Bank would continue with the current policy as described in a memorandum which had been drafted by Jay and revised by the Bank.²³ The letter was followed up with regular reports, prepared jointly by Treasury and Bank officials, providing monthly and quarterly analyses of the use of the budget surplus for debt reduction and of the changes in bank assets and liabilities as shown in the London Clearing Banks' monthly statements.

In the first quarter of 1948 the "Jay exercise" showed a fall in TDRs and a fall in bank deposits in spite of the repayment of maturing gilt-edged debt (see Tables 2 and 3). In the summer, when the figures showed the clearing banks' holdings of floating debt had fallen but their deposits had not, while their advances had risen by over 10 per cent since December 1947, Jay began to press for some further action, especially on advances. The Bank responded they could not reduce the banks' reserves because the banks could replenish them by running down their Treasury bills; they also rejected any ceilings on advances or deposits as unworkable; but they were agreeable to the setting up of a joint Treasury-Bank committee to monitor monetary developments.²⁴ After "a good deal of excitement in Whitehall" in October about the continuing growth of deposits and advances, the Working Party on Bank Deposits and Advances, composed of Douglas Jay, Robert Hall, Sir Wilfrid Eady (Second Secretary) and E.G. Compton from the Treasury, and Humphrey Mynors and Lucius Thompson-McCausland from the Bank, was set up. Hall was particularly active in seeking action on the monetary aggre-

²³ The discussions are recorded in T233/481, PRO. The Chancellor's letter, sent on 7 April, is in T233/482.

²⁴ Jay to Chancellor, 18 August, and Eady, "Bank Advances Policy", 24 August 1948, T233/482, PRO.

Table 2
APPLICATION OF BUDGET SURPLUSES, 1947-51, £m

	1947				1948				1949				1950				1951			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Above the line surplus (deficit-)	27	218	-6	22	402	179	74	8	570	1	-18	-10	576	45	25	-16	666	13	-39	-200
Below the line expenditure ¹	-132	-41	-166	-258	-186	-146	-90	-123	-92	-172	-122	-122	-71	-111	-109	-123	-130	-118	-137	-121
Overall surplus or deficit	-105	177	-172	-236	216	33	-16	-115	478	-171	-140	-132	505	-66	-84	-139	536	-105	-176	-321
Adjustments ²	+221	-260	-38	-23	+80	-77	-9	-37	+95	-20	+30	-32	104	-23	44	11	49	-87	-65	16
Changes in TRCs	-139	-6	-6	+25	-116	4	45	44	-163	26	23	64	-152	45	69	77	-123	+81	+38	62
Net overall surplus/deficit	-23	-89	-216	-234	180	-40	20	-108	410	-165	-87	-100	454	-44	29	-51	462	-111	-203	-243
External Financing																				
EEA sterling receipts	72	-9	11	80	-29	76	36	-21	-10	69	22	-124	-108	-161	-154	-163	-135	-51	+232	+343
American aid + loans, net sterling receipts	+59	+233	+358	+92	+166	16	206	84	41	17	62	69	84	65	26	-103	-36	-6	96	+168
National insurance funds	8	12	23	17	17	15	45	37	19	37	46	41	38	41	47	43	37	44	51	18
Small savings ³	89	31	-19	1	60	-27	-25	-8	55	5	-16	-20	23	-20	-22	-20	31	-30	-23	-24
Reduction in fiduciary issue	—	—	—	—	-150	—	—	25	-25	—	—	50	-50	50	—	25	-25	50	—	50
Exchequer cash available	205	178	157	-44	244	40	282	9	490	-37	27	-84	441	-69	-74	-269	334	-84	153	312
Applied:																				
Stocks in market ⁴	-123	-26	-111	-87	-261	-34	-29	-17	-28	-40	-55	-344	36	59	21	33	-57	24	+22	+691
Market floating debt:																				
TDRs	-220	-15	-149	+110	-112	+177	-18	62	-376	108	-332	-39	-407	-115	155	20	-242	61	-55	-171
TBs	+138	-137	+103	+21	+129	-183	-235	-54	-142	-31	360	467	-70	243	-60	216	-35	-1	-120	-832
	-205	-178	-157	44	-244	-40	-282	-9	-490	37	-27	84	-441	69	74	269	-334	84	-153	-312

1. Expenditure expected to bring a cash return in subsequent years, e.g. Post Office capital expenditure, advances to local authorities for capital purposes.

2. Issue Department income + Departmental balances + sinking funds.

3. Deposits in Post Office and Trustee Savings Banks, National Savings Certificates and Defence Bonds.

4. Issues of government stocks - redemptions of government stocks (including sinking funds) - increase in holdings of Issue Department and National Debt Commissioners.

Sources: Calculated from various memoranda in T 233/482 and Exchequer financing tables in "Exchequer financing and National Debt 1945-51", *Economic Trends*, December 1961, pp. vii-xvii and in Committee on the Working of the Monetary System, *Principal Memoranda of Evidence* (1960), Vol. 1.

Table 3
 QUARTERLY CHANGES IN BANK ASSETS AND LIABILITIES
 AS REPORTED IN MONTHLY STATEMENTS OF LONDON CLEARING BANKS, 1947-51

	1947				1948				1949				1950				1951			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Deposits (net)	-56	63	11	226	-73	127	35	143	-293	167	1	175	-376	152	117	246	-292	112	15	101
Cash	-33	-2	1	37	-30	20	-2	11	-27	7	9	42	-47	-3	10	48	-51	12	2	38
Money at call and short notice	12	7	21	8	-13	6	17	-5	-3	18	18	53	-37	10	-1	49	-55	57	-12	16
Bills discounted	140	-78	86	35	11	-145	47	35	129	-84	185	138	-3	232	20	50	-95	-141	104	-304
TDRs	-243	13	-137	95	-135	208	-16	52	-441	186	-239	-110	-349	-147	138	21	-222	56	-71	-114
Investments	28	24	14	-10	3	-8	-6	6	18	6	14	-4	-9	-6	4	27	24	-2	3	412
Advances	42	97	30	57	93	41	2	36	42	28	19	56	71	54	-47	43	110	128	-5	54

Source: *Monthly Digest of Statistics*.

gates and in trying to find out exactly what the Bank were doing.²⁵

Correspondence and discussion at this time between Hall and the Bank members of the Working Party revealed the assumptions behind their different views on monetary control. As Robert Hall commented at the time, "the Bank, and the banks generally, do not think at all about credit control as economists do".²⁶ Mynors doubted the utility of any monetary target:

"The fundamental problem... is the equation of current investment with spontaneous applied saving. To suppose that anything can be achieved by pegging the volume of money in circulation is like Canute telling the waves to stand still, *unless* the indirect effects of such an instruction are to reduce investment and/or increase saving to the appropriate extent and in the appropriate quarters".

He claimed that neither restriction of bank lending nor a rise in interest rates would have much impact on investment. What was needed was "to reintroduce some measure of flexibility" in interest rates and to fund some of the floating debt. As for the monetary base the Bank had little control given the needs of the Exchequer. Hall disputed Mynors' assumption that if anticipated savings were less than planned investment the amount of money in circulation would *necessarily* rise and hence "[did] not agree at all that to peg the volume of money is like telling the waves to stand still" for by reducing liquidity it would discourage some spending. He agreed that it was difficult to predict all the effects of a ceiling on bank deposits, particularly on interest rates, since the budget surplus would work in the opposite direction, but "it [was] a risk which we certainly ought to take", in order to discourage new investment. In reply to Hall,

²⁵ Cobbold to Governor, 4 October, and Mynors, "The Exchequer and Bank Deposits", 9 November 1948, C40/685, BOE; Cripps to Jay, 13 November 1948, T233/482PRO; *Hall Diaries*, pp. 41-3; see also JAY, *Change and Fortune. A Political Record* (London, 1980), p. 185.

²⁶ *Hall Diaries*, p. 41.

Thompson-McCausland thought there had been a "marked qualitative deflation" in 1948 despite the rise in bank deposits because (a) currency in circulation had fallen and (b) within the deposits total there had been a shift from current accounts to deposit accounts. Hence there was no need to increase the existing pressure on borrowers; the government should be reducing investment demand instead. Thompson-McCausland also claimed that a ceiling on deposits would be "quite impossible to administer", a claim Hall was "at a loss to understand": "I thought it was the first principle of central banking that there should be an effective control over the aggregate of deposits".²⁷

The official Treasury position at this time was to accept the Bank's advice. Eady's brief for the first two meetings of Jay's Working Party claimed a ceiling on deposits was "quite impracticable" and argued for action by the authorities on advances, which should be qualitative rather than quantitative — in other words another polite request to the bankers. At the meetings it was explained that the Bank were now taking some steps to reduce floating debt, namely buying long-term securities previously held by government departments and selling them to the market. After discussing the behaviour of bank deposits and advances in 1948, the Working Party recommended that in the first quarter of 1949 the authorities should use the budget surplus to reduce the floating debt in order to try to reduce bank deposits by the same amount over the same period. The control of advances was left for further discussion, but Eady's recommendation remained in an appendix.²⁸ Cripps "endorsed [the] recommendations" and discussed them with the Deputy Gov-

²⁷ Mynors to Eady and Hall, 12 November 1948, T233/482, PRO; Hall to Thompson-McCausland, 17 November 1948, C40/685, BOE; Thompson-McCausland to Hall, 26 November 1948, T233/483; and Hall to Thompson-McCausland, 1 December 1948, T233/482.

²⁸ Eady, "Deposits and Advances of the London Clearing Banks in 1948", 25 November, Working Party on Bank Deposits and Advances, 1st Report, and Jay to Bridges and Chancellor, 3 December 1948, T233/482, PRO; see also *Hall Diaries*, p. 45.

ernor C.F. Cobbold, the Governor being ill. Cobbold, on whose advice Eady had prepared his brief, then asked the Clearing Banks for their "co-operation in securing... a reduction in deposits".²⁹

At the next meeting of the Working Party, on 11 January 1949, when "the atmosphere was more sympathetic and tentative than [Mynors] expected", the Bank members explained why the Bank did not try to control the monetary base. Since the wartime increase in the floating debt, especially of TDRs, the Bank had supplied the reserves necessary to enable the banks to satisfy the government's short-term borrowing requirements, for otherwise the banks might reduce their holdings of floating debt. The Working Party also agreed there should be revised instructions to the Capital Issues Committee (which vetted new issues) and a complementary letter on advances to the bankers; these were issued in April.³⁰

The central bankers, however, were now saying to each other what they would not yet say to the Treasury: that interest rates must rise. As Thompson-McCausland put it to Cobbold:

"The real point at issue, surely is the interest rate.

"We are getting into the position of constantly telling Whitehall what *cannot* be done; which is a weak position unless we are also satisfied that nothing need be done...

"But what we mean (do we not?) is that none of the things we have been pressed to do can be done without a rise in the interest rate.

"Is it not time to put this squarely before Whitehall and the Chancellor, as the pith of the whole issue?"

Cobbold, shortly to become Governor, had also come to the

²⁹ Notes by Compton and Trend, 21 and 22 December 1948, T233/482, PRO; Note by Cobbold, 6 January 1949, C40/686, BOE. The ailing Governor also protested vigorously to the Chancellor about Hall's suggestion for quantitative monetary control: "Memorandum by Lord Catto", 15 December 1948, T233/483, PRO; CAIRNCROSS, "Prelude", pp. 5-6.

³⁰ Mynors, "Jay Working Party", 12 January 1949, C40/686, BOE; Working Party on Bank Deposits and Advances, 2nd Report, and Jay to Chancellor, 18 January 1949, T233/483, PRO.

conclusion that "we ought at least seriously to consider the question of firing up short-term money rates".³¹ He set up an internal Bank committee who suggested that this could be achieved without changing Bank rate by making the 2 per cent rate effective using open-market operations to raise money market rates (including Treasury bill rate). The committee preferred this to raising the fixed rates for Treasury bills and TDRs since the objective was not just to alter interest rates but to make them less "artificial". In other words, the Bank wanted to regain control over the money market rather in the manner that they had done after the First World War.³² From the beginning of 1949, therefore, the Bank had a scheme for tightening monetary policy ready to be hauled out at a suitable moment.

The first opportunity came during the balance of payments crisis before devaluation on 18 September 1949. Although the Treasury proposed higher interest rates both before and after the decision to devalue, the Bank lost this opportunity partly because Cobbold used it to seek reductions in government expenditure, first as a substitute for devaluation, which he strongly opposed, and then to accompany it. In June 1949, the Treasury saw "action in the monetary field" as one ingredient in a deflationary package intended to avoid devaluation; according to Bridges, it would include a review of advances control, "certainly a willingness to allow interest rates to rise" and possibly an increase in Bank rate. When Cobbold consulted his senior officials again, they pointed out that the authorities had the alternatives of making the 2 per cent Bank rate effective, as recommended in January, or of raising Bank rate (to 2½ or 3 per cent and then making the new rate effective), and inclined to favour

³¹ Thompson-McCausland to Cobbold, "Deposits", 3 December, and Cobbold to Governor, 8 December 1948, C40/685, BOE.

³² Peppiatt, "Interest Rates", 24 January, and Niemeyer to Cobbold, 3 February 1949, C42/1, BOE. On the post-World War I experience, see S. HOWSON, "The Origins of dear money, 1919-20", *Economic History Review*, 27 (February 1974), pp. 88-107.

the latter. This suggestion was incorporated in the early drafts of the Treasury's package of deflationary measures, but was rejected in the Treasury memorandum to the Cabinet Economic Policy Committee on 28 June, on Cobbold's initiative.³³ He believed a tighter monetary policy would have little effect on confidence, and hence on the exchange rate, without a large reduction in government expenditure — a view he reiterated many times in the next few weeks.

When the Treasury officials learned that after all the government would devalue the pound, they pointed out that to be successful it would have to be accompanied by an expenditure-reducing policy, including some reduction of government expenditure and a tighter monetary policy.³⁴ The Bank told the Treasury they now "inclined against specific action on bank rate or restriction of credit base". Behind the scenes they were polishing their January scheme for tightening monetary policy without a rise in Bank rate. The Chief Cashier also proposed the proportion of Treasury bills in the floating debt should be increased so as to reduce that of TDRs. This would reduce the cost to the Exchequer of raising short-term rates (since Treasury bills, with a shorter maturity, carried a slightly lower interest rate). The Governor agreed and notified the Treasury of the Bank's intentions on 15 July.³⁵ In the Treasury senior officials were pressing for both budgetary and monetary deflationary measures, and Hall and Eady worked out what monetary action would involve if the government tried to rely on it alone: mak-

³³ Bridges to Chancellor, 18 June 1949, T269/1, PRO; Peppiatt to Governor, 21 June, and Mynors to Eady, 24 June 1949, C42/1, BOE; Bridges to Chancellor, "Dollar Situation, Part I", paras. 3-8, and EPC(49)72, "The Dollar Situation, Memorandum by the Chancellor of the Exchequer", 28 June 1949, paras. 33-4, T269/2, PRO; Note by Mynors, 28 June 1949, G1/70, BOE.

³⁴ "Note of Meeting Held in Sir Edward Bridges' Room at 3:30 p.m. on Friday, 22nd July 1949", T269/1, PRO; on the decision to devalue see CAIRNCROSS, *Years of Recovery*, Chapter 7.

³⁵ Beale, "Money Market Technique", 28 June, Governor's Note, 4 July 1949, C42/1; Extract from Governor's Diary, 15 July 1949, G1/70, BOE.

ing Bank rate effective and then raising it to 3 per cent, which would raise the cost of the floating debt by about £ 65m a year and government bond yields to 4 per cent and a request to the banks for a *general* reduction in advances.³⁶

The issue of domestic policy measures was not resolved until after devaluation, although the Jay Working Party decided on another request to the Clearing Banks for "caution in their policy on advances".³⁷ Meanwhile money market rates of interest began to rise as the supply of Treasury bills increased and on 14 September Cobbold asked to continue this process by allowing the Treasury bill rate to rise, in order to make Bank rate effective, from the day after the devaluation.³⁸ Hall was "definitely in favour" but Eady and other Treasury officials prevaricated, knowing that Labour ministers, including the Chancellor, disliked a measure which would increase the profits of the Clearing Banks. The limited nature of the Governor's request also militated against its acceptance. Before refusing Cobbold his request on 22 September, Cripps consulted Douglas Jay, Hugh Gaitskell (then Minister of Fuel and Power) and Harold Wilson (President of the Board of Trade), who were "influenced partly by the obvious political considerations... and partly by their inability to agree that the very moderate increase in short-term rates... would have any real disinflationary effect" on the money supply.³⁹ Treasury and Bank officials decided on another request to the bankers. Sent on 24 October, and announced as

³⁶ "Economic Situation, Note by the Permanent Secretary, H.M. Treasury", 26 July 1949, T269/1; Eady, "Credit Policy", 22 July 1949, T233/1400, PRO.

³⁷ Note of meeting of Jay, Trend, Hall, Peppiatt and Thompson-McCausland, [22 July 1949], T233/483. The Governor spoke to the clearing bankers on 4 August: Cobbold to Eady, 4 August 1949, T269/1, PRO.

³⁸ *Bank of England Statistical Abstract*, No. 1, 1970, Table 29; Cobbold to Bridges, 14 September, Bank of England, "Short-term Interest Rates", 19 September 1949, T233/1400, PRO.

³⁹ Trend, "Short-term Interest Rates", 20 September, Note by Radice, 16 September, Trend to Wass, 21 September 1949, T233/1400, PRO; Mynors, "Meeting at the Treasury on 22nd September 1949", G1/70, BOE.

part of the government's package of deflationary measures, this was, at Cobbold's suggestion, published in the financial press.⁴⁰

During 1949 the issues of monetary control had thus been clarified but not resolved between the Bank and the government. The strongest advocates of controlling the money supply were the economists in Whitehall. Their position was undermined by the government's reluctance to raise the cost of the floating debt and the official Treasury's inclination to accept the Bank's arguments against quantitative controls. When Cobbold enlisted the help of the Clearing Banks (in the persons of the Chairman and Deputy Chairman of the Committee of London Clearing Banker) in his discussions with Cripps in October 1949, Hall persuaded and Treasury officials then dissuaded the Chancellor from sending a sharp reply to the Governor on the subject of the bankers' "banking school" views. As Hall put it, "I do not think that the Chancellor of the Exchequer could possibly admit that the volume of deposits is a matter for the judgment of the banking system".⁴¹ Cobbold, however, wanted to restore the Bank's prewar position in the British financial system (above, p. 8), and his predicament at the beginning of 1950 was, as one of his colleagues put it:

"The Governor rightly dislikes finding himself in a position where, however much a rise in short-term interest rates may be called for on general grounds, he is (almost) precluded from acting in the orthodox manner because of the adverse impact such a move would have on the budgetary problem in view of the present size and nature of the Floating Debt...

"The ideal situation would be a large funding operation, but the prospects for this are at present remote".⁴²

⁴⁰ Note by Mynors and Trend, 14 October 1949, C42/1; Cobbold, "Credit Policy", 21 October 1949, G1/70, BOE; Note by Bridges, 21 October, Cripps to Cobbold, 24 October 1949, T233/1400, PRO.

⁴¹ "The Growth of Bank Advances Since the War", 4 November 1949, Hall, "Bank Advances", 16 November 1949, T233/1400; *Hall Diaries*, p. 97; "Draft Letter from the Chancellor of the Exchequer to the Governor of the Bank of England", 23 November 1949, G1/70, BOE.

⁴² Peppiatt, "Short-term Interest Rates/Bank Rate", 5 January 1950, C42/1, BOE.

Cobbold hoped that the February 1950 general election might produce a more sympathetic administration, but the Labour Party, and Cripps, remained in office. Hugh Gaitskell joined the Treasury as Minister of State for Economic Affairs, and succeeded to the Chancellorship when Cripps resigned in October 1950.

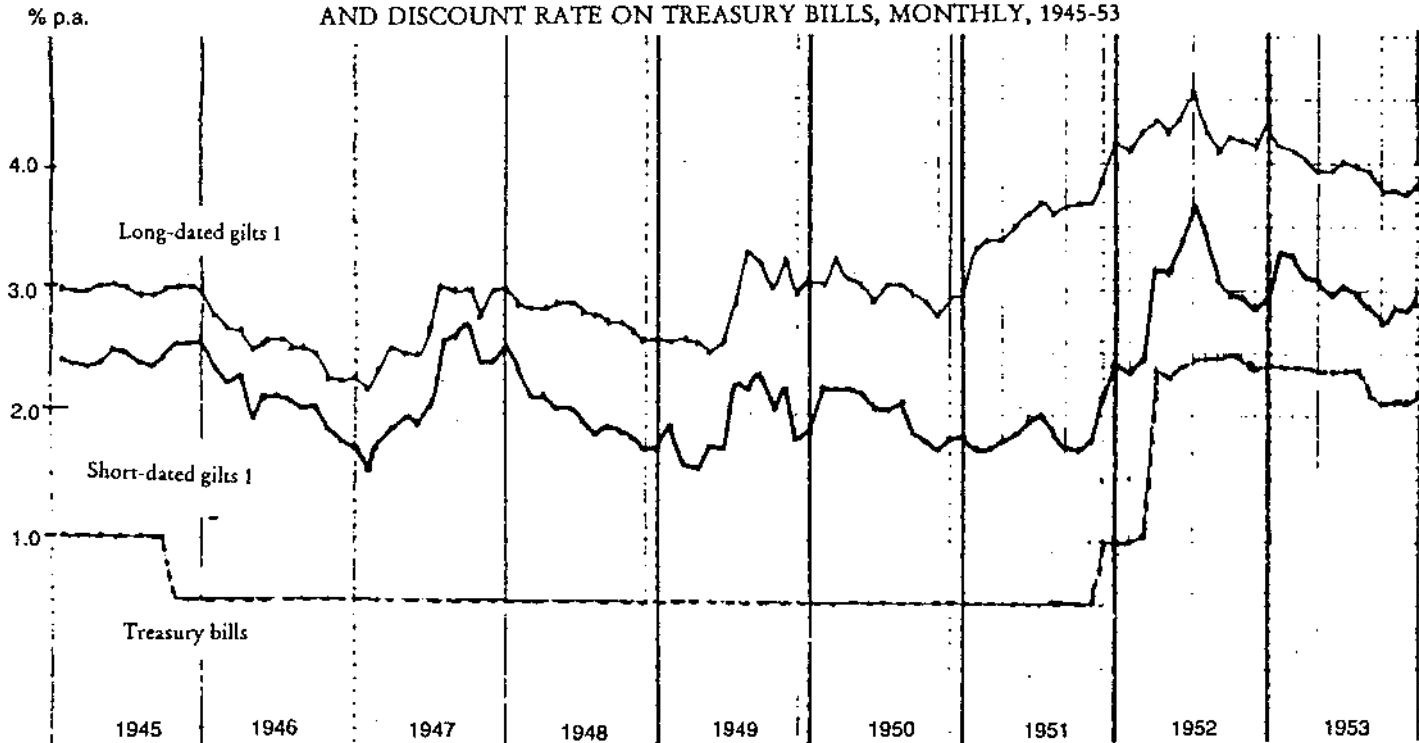
The second half of 1949 had seen long-term interest rates rise from 3 per cent to above 3½ per cent while short-term rates remained around 2 per cent (see Chart 2). There was then a lull in the authorities' monetary policy discussions, until the outbreak of the Korean war and British rearmament renewed fears of inflation. Jay's Working Party ceased to meet after the election. Meanwhile the authorities managed to make two funding issues of long-term debt both to replace maturing short-term bonds and to reduce the floating debt.⁴³ TDRs were steadily reduced, from £ 1136m (20 per cent of total floating debt) in March 1949, to £ 465m (10 per cent) in March 1950, and £ 283m (5 per cent) in March 1951.

Gaitskell was less averse than Cripps to raising interest rates, even though he continued to worry about the costs of increasing interest payments to the banks on the floating debt. He was happy to let long-term interest rates go up — and readily agreed to the funding operations in 1950 — but hoped to be able to keep short rates down. In the summer of 1950, while Gaitskell was still Minister of State, Treasury officials reported to the Bank that “we are likely to suffer a return to the sort of discussions we had about controls which we had last year (but fortified by the Minister of State)... [However] entire stability of rates is likely [not] to be so firmly held as one of the data in the problem”. The Bank produced memoranda on ‘selective credit policy’ and on methods of credit control in other countries, be-

⁴³ On the issues, on 7 June and 31 October 1950, see Treasury files T233/550 and 551, PRO.

Chart 2

NOMINAL YIELDS ON BRITISH GOVERNMENT SECURITIES
AND DISCOUNT RATE ON TREASURY BILLS, MONTHLY, 1945-53



The Problem of Monetary Control in Britain, 1948-51

1. The yields for short-dated and long-dated government securities are gross redemption yields of selected stocks with 5-7 years and 25-27 years, respectively, to final maturity.

Sources: Short- and long-dated government securities yields: *Bank of England Statistical Abstract*, No. 1, 1970, Table 30. — Treasury bill discount rate: F. CAPIE and A. WEBBER, *A Monetary History of the United Kingdom 1870-1982, Volume 1, Data, Sources, Methods*, Table 113(10).

cause the Treasury officials thought Gaitskell would like "an airing given to 'gadgets' e.g. compulsory reserve ratios etc."⁴⁴

Cobbold did not fail to seize his chance to ask the new Chancellor for a rise in short-term interest rates. His colleagues "found no difficulty in reaching the conclusion that general inflationary pressures and risks" had been increased in 1950 by higher world commodity prices, devaluation, rising wages, and rearmament. They suggested "some mildly spectacular move... the raising of Bank rate from 2% to 2½%", mainly for the psychological effects but also for the possible impact on bank lending. It would raise the cost of the floating debt but have less impact on long-term interest rates which had already risen, and there was no risk of unemployment in present conditions. Cobbold put their proposal to the Treasury on 3 November, and, after lengthy discussion with the officials, to Gaitskell.⁴⁵

Senior Treasury officials, but not Robert Hall, were initially unenthusiastic about the Bank's proposals — largely because the Bank were vague about the effects of their proposal — but were subsequently persuaded. In early December they agreed a date for action (11 January 1951) if the Chancellor concurred.⁴⁶ When Gaitskell read the papers, however, he told Cobbold that:

"In present conditions long-term borrowing rates were much more important than short-term. He certainly did not want to see a long-term rate of interest lower than 3½%... and he would not be perturbed if it went a little higher... He was less convinced of the necessity of doing anything about short-term rates."

⁴⁴ Notes by Mynors, 26 July 1950, C40/686, and 9 August 1950, C42/1, BOE. The Bank's memoranda are on T233/1400, PRO. This concern for methods of "direct" control over monetary growth goes back to prewar discussions among the Labour Party's "young economists", who included Gaitskell: Howson, "Socialist monetary policy", pp. 550-1.

⁴⁵ Niemeyer, Peppiatt, Mynors and Beale, "Interest Rates", 30 October 1950, C42/1, BOE; Cobbold to Bridges, 3 November 1950, and subsequent memoranda on both C42/1 and T233/1401 (PRO).

⁴⁶ See especially Trend to Eady, "Bank Rate", 8 November, Eady to Bridges, "Interest rates", 14 November, Bridges to Eady, 2 December 1950, T233/1401, PRO; Mynors, "Meeting in Sir Edward Bridges' Room on the 1st December 1950", G1/70, BOE.

A rise in short-term rates would certainly increase interest payments on the floating debt, whereas its benefits, especially the psychological effects, claimed by the Bank were uncertain. At a second meeting with the Governor, attended also by senior Treasury and Bank officials, and in a letter to Cobbold, Gaitskell reemphasized the budgetary problem of raising short-term interest rates, and, supported by Jay, asked for consideration of alternative methods of raising bank lending rates. Hall, Eady and Bridges supported the Governor. Gaitskell turned down Cobbold's request and asked for another set of instructions to the Capital Issues Committee and another letter to the banks.⁴⁷

Cobbold tried again in the early summer of 1951. He asked this time only to raise treasury bill rate. Gaitskell countered the Bank's new argument that the present rate structure would soon break down because the yield gap was so wide, with the suggestion that if the demand for Treasury bills did fall off the banks could be required to hold specified amounts of Treasury bills or TDRs in order to prevent an undesirable increase in the monetary base. If the object was to reduce bank lending the monetary base should be reduced. Cobbold responded that "instructions to the banking system to hold a specified amount of Government short-term debt would... be a fundamental blow to British Government credit" and would make government borrowing difficult, especially for the nationalized industries. They "agreed therefore to differ and let the matter stand as it is until the autumn". Cobbold did, however, volunteer to speak to the clearing bankers again and Gaitskell agreed to make a policy statement about "inflation etc.", which he did to Parliament on 26 July. The previous "requests" to the banks were now at last beginning to bite, with a general rise in bank overdraft rates (the first for twenty years).⁴⁸

⁴⁷ "Governor's Note", 2 January 1951, Mynors, "Meeting at the Treasury: 5th January 1951", and Gaitskell to Cobbold, 17 January 1951, C42/1, BOE; Trend, "Note of a Meeting on the 5th January", 23 January 1951, T233/1401, PRO.

⁴⁸ Cobbold to Gaitskell, 31 May and 5 July, Gaitskell, "Credit Policy", 2 June,

In the autumn a Conservative government was elected in the midst of another balance of payments crisis. Cobbold had no difficulty in persuading the new Chancellor to include a rise in Bank rate in his immediate crisis measures, to be accompanied with a new rate of discount for Treasury bills ($1\frac{1}{2}$ per cent below Bank rate) and a special funding operation to reduce the floating debt. The authorities (and the market) had expected some move in monetary policy as soon as there was a new administration, and the Governor had marshalled his forces in preparation for the final attack in his long drawn out campaign for a "flexible" monetary policy.⁴⁹

Why had that campaign been so prolonged? As in the United States there were "technical" difficulties to be overcome. These stemmed from the large postwar debt especially short-term debt, whose budgetary burden had been one reason for a postwar low interest rate policy in the first place. There was also fear of unemployment — of the postwar slump that never materialized. The Treasury, and the Chancellor, did not share this fear after 1947, when they recognized inflation as the danger, although it lingered with other ministers.⁵⁰ Labour ministers were also reluctant to make higher interest payments to bankers, especially when the government was trying to persuade trade unions not to seek higher wages. This was important not so much in itself as because it meant Cripps and Gaitskell had, if only to persuade their Cabinet colleagues, to be provided with incontrovertible arguments of (anti-inflationary) benefits of a tighter monetary policy that would outweigh this and the direct budgetary burden of higher short-term interest rates.

and Note by Gaitskell, 3 July 1951, T233/1401; SAYERS, *Modern Banking* (3rd edition, 1951, reprinted 1952), pp. 326-8.

⁴⁹ The Bank's preparations are summarized in W.M. Allen, "Discussions preceding the change in monetary policy in 1951", G15/13, BOE; the Treasury's reactions to the proposals are on T233/1684, PRO. For the market's expectations see *The Economist* and the *Financial Times* from the summer onwards.

⁵⁰ For examples see *Hall Diaries*, pp. 28-30 and *The Political Diary of Hugh Dalton 1918-40, 1945-60* (ed. B. Pimlott, 1986), pp. 451-2.

The Bank of England's attitude affected the outcome in at least two ways. First, their inability or unwillingness to explain their position to the government meant that they produced obscure arguments which did not readily convince Treasury officials or their ministers. To quote Gaitskell, "whether they are right or not in matters of judgement they are singularly bad at putting their case".⁵¹ Second, as Robert Hall frequently complained, they did not want to control the monetary base or bank deposits. From the time that Cobbold took charge, they wanted to restore an independent role for the Bank and return to a variable Bank rate policy as in gold-standard days, even though they did not really know how it would work under post-1945 conditions with partially controlled capital movements. Thus the Bank harped on the need to reduce government expenditure and short-term debt, and Cobbold did not ask to *increase* Bank rate except when it would affect 'confidence' in sterling.

The outcome

The outcome for nominal monetary aggregates of the authorities' monetary actions — and inaction — in 1948-51 can be seen in Chart 1. This plots monthly figures for the money stock (M3), the monetary base (conventionally defined as the sum of currency in circulation and commercial bank reserves) and the ratios of commercial bank deposits to bank reserves and to currency in circulation for the twenty years 1932-58.⁵² It shows the

⁵¹ *The Diary of Hugh Gaitskell 1945-1956* (ed. Philip M. Williams, 1983), p. 227, see also *Hall diaries*, p. 143.

⁵² The *Monetary History's* series on the other hand include notes and coin in the Banking Department of the Bank of England in commercial bank reserves and "other deposits" at the Bank of England in commercial bank deposits — making the monetary base less variable, and the deposit/currency and deposit/reserve ratios more variable, than in the more usual definitions used here: "The monetary base — a statistical note", *Bank of England Quarterly Bulletin*, 21 (March 1981), pp. 59-65, *Monetary History*, pp. 12-13.

very slow growth in the money stock in 1947-51, compared with the very rapid growth which preceded it and the moderate growth which followed. The monetary base shared the rapid wartime expansion but slowed down in 1946 and fell in 1947-8; it then grew steadily, and faster than the money stock, for the rest of the period. This behaviour differs from the US postwar experience in that in the USA rapid wartime monetary growth ceased in 1945; then after three years of slow growth, growth in the nominal money stock picked up following the 1949 US recession and was "unusually steady" until 1960.⁵³ In the USA in 1949-51 there was also more variation in the monetary base and in the deposit-reserve ratio (mainly the result of changes in reserve requirements) than in the UK, where both were very stable in those years.

The sharp rise in the deposit-reserve ratio in the UK at the end of 1946 was due to the abolition of the London Clearing Banks' practice of "window dressing" their published reserves by bunching the maturities of their Treasury bills at half-year ends. In 1947-51 the deposit-reserve ratio (for all banks) remained around its new average level of 14.0, and then fell with the introduction of the "new" monetary policy. The deposit-currency ratio shows its wartime and postwar adjustments, falling from its prewar level of about 6.5 during 1941-4 to a low of 4.8, and rising again in 1946-8 to around 5.5. It remained at that level until 1951 and then declined through the 1950s whereas in the USA the ratio continued to rise for at least 15 more years.

During their prolonged debate over monetary control in 1948-51 the authorities took two tentative monetary steps: to try to reduce the floating debt with the budget surplus and to reduce bank lending by moral suasion. Their impact on the nominal money stock, and that of other forces affecting UK monetary conditions, can be analysed with Tables 2 and 3. First,

⁵³ FRIEDMAN and SCHWARTZ, *Monetary History of the United States*, pp. 574-6, 592-601, and charts 46 and 53.

however, it is useful to consider the determination of the UK monetary base in the later 1940s.

There is little correlation between the UK monetary base and official international reserves, which began the postwar period around £ 600m, improved somewhat in the second half of 1946, and declined, with occasional improvement, to £ 350m by the time of devaluation. After the exchange-rate adjustment, within eighteen months the reserves more than doubled, but they fell quickly back to £ 600m by early 1952. Comparison of monthly changes in reserves and in the base shows consistent movements in the same direction only in the summer and autumn of 1947 and the autumn of 1948.⁵⁴ In 1947 the balances of payments of both Britain and the rest of the sterling area (which together determined Britain's reserves) were deteriorating, and restrictions on sterling convertibility were being (temporarily) relaxed. In other periods the authorities were able to sterilize the effects of reserve changes on the monetary base through the Exchange Equalization Account (EEA). The mechanism of the EEA meant, however, that a decline in reserves or overseas financial assistance would reduce sales of Treasury bills to the money market, and thus the amount of the floating debt held by the private sector (see below).

The Bank of England did not attempt to control the monetary base in the 1940s. The pegging of interest rates on the floating debt meant that the Bank supplied the banks with the cash reserves needed to keep their cash to deposits ratios stable (at 8 per cent for the London Clearing Banks after 1946) and to permit them to take up the desired (by the authorities) quantity of Treasury bills each week. Hence in 1947-51, when the deposit-reserve ratio was very stable, the behaviour of the monetary base usually followed that of the money stock.

In the second half of 1947 and first half of 1948, however, the monetary base fell (see chart 1). This was mainly a fall in

⁵⁴ Reserves from *Bank of England Statistical Abstract*, No. 1, 1970, Table 27.

currency in circulation, which declined by 5 per cent July-December 1947 before the authorities reduced the fiduciary note issue in the first quarter of 1948, the first significant reduction since March 1939.⁵⁵ The authorities were responding to the postwar decline in the demand for currency, which is also seen in the concurrent rise in the deposit-currency ratio from its war-time trough.

Turning to the authorities' efforts to reduce the floating debt, Table 2 presents the details of Exchequer financing in the form they were prepared for the Jay Working Party. It shows that after making the necessary adjustments to the published budget surplus to arrive at a net overall surplus or deficit, a deficit usually remained in 1947-51. However, as Dow pointed out, that deficit was more than covered by external financing, both reserve losses and North American aid.⁵⁶ The using up of the American and Canadian loans and the reserve losses sustained by the Exchange Equalization Account in 1947 contributed a total of £ 896m external financing towards turning the domestic borrowing requirement from £ 861m in 1946 to -£ 497m in 1947. External financing continued to contribute much of the "Exchequer cash available" (for debt redemption) in 1948 and (to a lesser extent) in 1949, and again in the second half of 1951. In 1950, on the other hand, external financing was negative, as official reserves were rising after devaluation, but then "Exchequer cash available" became negative. Nonetheless, there were considerable sums available for debt redemption in the first (tax gathering) quarters of each year.

Table 2 also shows that the cash available was concentrated on the reduction of the floating debt. Exceptions were 1948 I, when the authorities repaid a bond maturity as well as reducing the fiduciary issue and 1949 IV when there was large-scale official support of the government bond market after devaluation.

⁵⁵ Peppiatt to Rickatson-Hatt, "The Fiduciary Issue", 7 January 1948, C40/573, BOE.

⁵⁶ Dow, *Management*, pp. 228-9.

The reductions in floating debt were usually in TDRs, and often counteracted by increases in market Treasury bills. "Market" Treasury bills included those held by overseas official holders (and the Banking Department of the Bank of England) which fell considerably in 1948 and the first half of 1949.⁵⁷ Treasury bills held by the private sector (mainly British banks and discount houses) did not fall as much as Table II suggests. The reduction in the floating debt was a slow and unsteady process, and although the floating debt held by the banks fell in the first quarter of each year, it rose in many other quarters (Table 3).

Table 3 gives the quarterly changes in the assets and liabilities of the London Clearing Banks. The most consistent feature is the steady rise in advances, which only fell in 1950 III and 1951 III. Advances had fallen considerably during the war, absolutely and as a proportion of deposits; their rise in the immediate postwar years took them from 16.4 per cent of deposits in 1945 to 29.6 per cent in 1951, compared with over 40 per cent in the late 1930s.⁵⁸ When the growth of deposits slowed after 1946, advances continued to increase as other assets, especially government debt, declined. With cash reserves available as needed from the Bank and large holdings of liquid assets (whose liquidity was enhanced by the replacement of TDRs by Treasury bills), the banks were always able to meet the demand for loans. They did not see any need to raise rates on advances before the summer of 1951 (above p. 12).

There were falls in advances in 1950 III and 1951 III. In 1950 III, a large part of the £ 47m fall in advances came from the repayment of bank loans to nationalized industries out of the proceeds of bond issues.⁵⁹ At the same time there were large capital

⁵⁷ "Exchequer Financing and National Debt 1945-51", *Economic Trends*, December 1961, Table 2(b).

⁵⁸ H.G. JOHNSON, "Some implications of secular changes in bank assets and liabilities in Great Britain", *Economic Journal*, 61 (September 1951), pp. 544-561.

⁵⁹ "London Clearing Banks January 1948 to October 1950", 2 November 1950, C40/757, BOE.

inflows, reducing the Treasury bills held by the EEA and increasing the government's domestic borrowing requirement (Table 2). TDRs rose by £ 155m, an increase not offset by a reduction of Treasury bills in banks' portfolios, and deposits rose by £ 117m. In 1951 III, however, the EEA was contributing sterling to the "Exchequer cash available", which was used to reduce both Treasury bills and TDRs. The rise in deposits was less than in any other quarter except 1949 III. The argument that this is the first time that the authorities' advances "control" had some effect is strengthened by a rise in money market interest rates as well as in bank overdraft rates.⁶⁰

In general, with pegged short-term interest rates and hence no control over the monetary base, the money supply was determined by the demand for money. The war and Dalton's cheaper money policy had left the private sector with exceptionally large money balances in relation to income (above p. 4). Once the Dalton experiment ceased, one would expect the private sector to reduce its money holdings and spend its accumulated wartime savings (much of which were held as money). There are ample signs of this in the very low personal saving ratio in 1947-51, in the decline in "small savings", and in the pattern of consumption expenditure which shows large shifts toward durables.⁶¹ From the peak of 79 per cent of GNP that M3 had reached in 1946, the money-to-income ratio declined rapidly back to its 1939 level of 55 per cent by 1952; and continued to decline, though more slowly, in the rest of the 1950s (Table 1). As in the USA in earlier postwar years, the government's

⁶⁰ On the effectiveness of later attempts at "direct" controls of bank lending or deposits see the Radcliffe Report, paras. 455-460, and J.H.B. TEW, "Monetary Policy, Part I", in F.T. BLACKABY (ed.), *British Economic Policy 1960-74* (Cambridge, 1978), pp. 222-226, and M.J. ARTIS, "Monetary Policy, Part II", in the same volume, pp. 260-70.

⁶¹ Aggregate personal sector saving was only 1 per cent of personal disposable income in 1947-51, compared with over 4 per cent for the 1930s and the later 1950s: C.H. FEINSTEIN, *National Income*, Table 10, and Tables 24 and 25 for consumers' expenditures. The decline in "small savings" can be seen in Table 2.

budget surplus, by offsetting private dissaving, helped to prevent the running down of money balances from leading to a steep rise in prices. The annual increase in the GDP deflator fell from 9 per cent in 1947 to less than 1 per cent in 1950 before rearmament and rising world prices pushed it up again.⁶² Cripps' "disinflationary" budgetary policy was even successful enough to prevent an increase in the rate of inflation after devaluation — although it was reinforced by a wage freeze agreed with the trade unions, from March 1948 to June 1950. With a slow rise in prices and an endogenously determined nominal money supply, the private sector's *real* balances (M3 divided by the GDP deflator or the consumption price index),⁶³ which had increased under Dalton's experiment by 12 per cent in one year, declined by the same amount over the following four years.

The conclusions of this paper can be briefly summarized. First, the description of monetary policy in 1948-51 as a "neutral" policy does not accurately reflect the authorities' objectives or intentions in these years. They were in fact anxious to curb monetary growth, specifically to reduce or at least to prevent further increases in bank deposits as part of an anti-inflationary policy. However, the government did not want short-term interest rates to rise, because that would increase the cost of the national debt and the profits of the banks. The obvious "solution" was to try to resort to quantitative control of bank assets or liabilities. This much exercised the Treasury, but in the Bank the issue was simpler. From the time he became Governor (March 1949), Cobbold campaigned for higher short-term interest rates, for a reduction in the floating debt, and for the restoration of control of the money market to the Bank. The authorities' inaction reflected this dilemma and the dispute was not resolved until the Labour government had been defeated in the

⁶² FEINSTEIN, *National Income*, Table 61. On the American experience in 1946-8 see FRIEDMAN and SCHWARTZ, *Monetary History of the United States*, pp. 580-3.

⁶³ Price indices from FEINSTEIN, *National Income*, Table 61.

1951 general election. Second, the outcome of the authorities' deliberations and disagreements, and of the Bank's actions with respect to the monetary base, was an endogenously determined money supply. The Treasury hoped to reduce monetary growth by using budget surpluses to reduce bank assets, but the slow-down in monetary growth that was observed after 1947 owed more to the external financing of the government's borrowing needs and to the private sector's adjustment to peacetime conditions. Although direct "controls" on bank advances continued in the 1950s and 1960s, they probably had little impact in 1948-51, except in the summer of 1951.