Was there a 'Pigou-McKenna School' on Britain's Return to the Gold Standard?

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1. Introduction

In his volume of reminiscences entitled *Prejudice and Judgement* (1948), Sir P. J. Grigg carefully chronicled the discussion at Winston Churchill's dinner with Sir Reginald McKenna, John Maynard Keynes, Sir John Bradbury and Sir Otto Niemeyer on 17 March 1925. At the time, Churchill was Chancellor of the Exchequer, Grigg was his private secretary and the purpose of the dinner was to discuss the proposal for Britain to return to the gold standard. Following publication of Grigg's beautifully written account, the event has become known as Churchill's 'famous dinner party' in the literature dealing with Britain's return to the gold standard.

This dinner party is famous for three possible reasons. First, its timing suggests that it was important to the decision making process, with records of public officials noting that Churchill reached a decision on the matter by either 19 or 20 March (Moggridge, 1969, p. 56), with Churchill publically announcing that Britain would be returning to the gold standard in his budget speech of 28 April 1925. Second, the meeting is presented as something of a polemic, with Keynes and McKenna paired up as the 'antagonists' to a return to gold, and Bradbury and Niemeyer paired up as the 'proponents' of that return (Grigg 1948, 182). The polemic character was subsequently underlined by Donald Moggridge when, in drawing inspiration from Bradbury's memo of 5 February 1925 to Niemeyer that characterises the author of a Treasury memo on 'Mr. Churchill's exercise' as appearing to "have his spiritual home in the Keynes-McKenna sanctuary" (Moggridge 1969, p. 45), he coined the phrase the 'Keynes-McKenna school' (Moggridge 1969, p. 61; 1972, p. 85). Third, after agreeing with Keynes on the discrepancy between British and US price levels implied by the gold standard was 10%, and not 2.5% as implied by the actual exchange rate (Grigg 1948, 182), McKenna then says something like "There is no escape; you have to go back; but it will be hell" (Grigg 1948, p. 184). In the words of Lord Skidelsky published in the *Financial Times*, "in the end McKenna, a former Chancellor, gave way… Keynes stood firm." (1992).

Of course, the literature on this historical episode of the interwar years is extensive and much wider than just Churchill's much commented dinner.[1] Among other things,

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importance is also placed on activities of the "Committee on the Currency and Bank of England Note Issues" (henceforth referred to as simply the Committee or else, when needed to avoid confusion, the Chamberlain-Bradbury Committee, after Sir Joseph Austen Chamberlain, its first chairman, and John Bradbury, who replaced him in that post when Chamberlain assumed as Foreign Secretary on 6 November 1924). The Committee, appointed by a Treasury minute of 10 June 1924, reported to Churchill on 5 February 1925, and advised him in unequivocal terms to make a rapid and decisive return to gold.[2] Both of the protagonists in favour of an immediate resumption of the old parity at Churchill's dinner served on the Committee.

From the perspective of intellectual history, however, it is relevant also that Arthur C. Pigou was a member of the Committee as well. The final report was preceded by four draft reports, the second of which was composed by Pigou sometime between late August and early September 1924. The key feature of Pigou's text is that, instead of recommending a rapid return to the gold standard, it highlights that the matter will not become urgent for more than a year and suggests that a wait and see stance be adopted. To be noted here is that the Committee had interviewed McKenna on 10 July 1924; and although absent from the deliberations at the occasion, Pigou's personal copy of that record of interview is extant; and it includes vertical lines he drew in pencil down the margin of the paper next to transcribed sentences, and sometimes whole paragraphs.[3] Pigou was clearly interested in what McKenna had to say on Britain's return to the gold standard and it appears that he highlighted much of the testimony as a part of his preparations for making up the second draft of the Committee's report.

In light of these preliminary remarks, the general purpose of this paper is to twofold. First, to establish the character of Pigou's reading of McKenna's testimony. Second, to

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[1] Modern studies on Britain's 1925 return to gold are numerous. Donald E. Moggridge (1969) offers a minute reconstitution of the decision process leading back to gold, concluding that moral reasons had far more weight than economic ones in the final result. Donald Winch (1969) presents a comprehensive account of the reasons for Churchill's decision, such as the presumption that it would favour world trade and thus British exports; the expected gain on financial operations by the City and the fear of inflation associated with managed currencies. Brian Reddaway (1970) attacks the Committee for not taking into account the historical difficulties to reduce wages and the need to devalue the pound in view of the loss in income from property abroad. L. J. Hume (1970) and W. Adams Brown Jr. (1970) show that in spite of the general support to a stable exchange rate, there was consistent opposition to further deflationary policies in Britain. Sir Henry Clay (1957, pp. 134-217), Richard S. Sayers (1976, v. 1, pp. 110-183) and Frank Costigliola (1977) lay stress upon Lord Norman's efforts toward the reconstruction of the international gold-standard system and Britain's urgency to keep the Empire away from the dollar. Using formal models, Kent G. P. Matthews (1986) and Susan Wolcott (1993) contest the claim that a moderate devaluation could have eased unemployment in the twenties, while Derek H. Aldcroft and Harry W. Richardson (1969, pp. 127-140; 219-238), as well as Haim Barkai (1993), call attention to the long run loss in competitiveness of Britain's traditional export industries. More recently, Tamin Bayoumi and Michael D. Bordo (1998) point out the disarray in international trade, finance and exchanges rates caused by the war as the main factor behind Britain's troubles in the years following resumption.

[2] Churchill referred explicitly to the Committee's final report (Currency and Bank Notes, 1925) as crucial to the introduction of the Gold Standard Bill (1925): "It contains a reasoned marshalling of the arguments which have convinced His Majesty's Government, and it sets forth a series of recommendations, in which my right hon. Friend [Chamberlain], though he ceased to be Chairman on becoming Foreign Secretary, has formally concurred, and which His Majesty's Government are intending to follow in every respect" (Financial Statement, 1925, cc. 52-58).

[3] There is little doubt that these lines were drawn by Pigou himself because, not only are the transcripts Pigou's personal copy, but it is a practice that he adopted, although far less extensively, when reading transcripts of other interviews with the same Committee. Furthermore, the pencil lines match the one occasion when a few inconsequential words were written in pencil on a transcript in Pigou's unmistakable scrawl.

consider the content of Pigou's draft of the Committee's report, and reflect on the relationship between McKenna's testimony and Pigou's report, examining the possible existence of a 'Pigou-McKenna school' on Britain's return to the gold standard. In pursuit of this two fold purpose, this paper is structured in six sections. Section 2 provides the historical context of the study, starting with the creation of the Treasury notes, followed by Britain's abandonment of the gold standard and ending with Pigou's appointment to the Chamberlin-Bradbury Committee. Section 3 gives a detailed explanation of McKenna's ideas on currency, credit and gold, followed by a narrative account of Pigou's reading of his interview with the Committee; Section 4 discusses Pigou's second draft of the report, and considers its relationship to McKenna's testimony. Using the he evidence presented, Section 5 outlines the cases 'for' and 'against' the idea of a 'Pigou-McKenna School' on the gold question. Concluding remarks are provided in Section 6 about Pigou's approach to Britain's return to gold in 1925.

2. Treasury Notes and the Lead-up to the Chamberlain-Bradbury Committee

After Austria's ultimatum to Serbia on 24 July 1914, severe disruption hit financial markets across Europe. Heavy sales of securities followed the rise of political tension and continental stock exchanges quickly ceased their operations. Credit in general and foreign remittances came to a halt, pushing the whole system of international payments to the verge of collapse. With the formal declaration of war between Austria and Serbia on 28 July, Tuesday, panic reached the British shores and banks started to call in their loans to the discount market and the stockbrokers. On 31 July, Friday, the London Stock Exchange was shut down and the demand for rediscount at the Bank of England rising rapidly and forcing the Bank of England to raise its rate from 3 to 8 percent and to 10 percent the very next day, on 1 August, Saturday. After emergency deliberations by authorities over the weekend, a royal proclamation was issued postponing payments on bills of exchange by a month – with the moratorium later renewed until 4 November – and the bank holiday on Monday 3 August was extended to the following Thursday. During this interval, a series of meetings involving authorities, bankers, merchants, industrialists and stockbrokers were carried out at the Treasury. On 6 August, among other measures to assure an adequate provision of liquidity, and after a suggestion by the Clearing Banker's Association, the *Currency and Bank Notes Act* was rushed through Parliament in a single day to authorise the Treasury to issue currency notes of one and ten shillings in amounts the institution saw appropriate. Those notes were to be distributed through the Bank of England to interested institutions at the bank rate, which was reduced to 6 per cent on that same day and to 5 per cent two days later (Peters, 1993; Seabourne, 1986; Morgan, 1952, pp. 3-32).[4]

Several reasons were behind this rather unique initiative in British monetary history. First, the Bank of England declared itself unable to print at short notice a large volume of notes to attend the urgent needs of the market. Second, Scottish and Irish banks did not take

[4] Besides that, Scottish and Irish bank-notes and postal orders were to be accepted as legal tender, while the Bank of England and Scottish and Irish banks of issue were authorized to put into circulation additional notes beyond their legal limit under temporary assent by the Treasury (Currency and Bank Notes, 1914). The informal council dealing with the financial emergency comprised the Chancellor of the Exchequer, David Lloyd George, Sir George Paish, Lord Reading, Lord Rotschild, the Governor of the Bank of England, Lord Cunliffe, the First Secretary of the Treasury, John Bradbury, the chairman of the London City and Midland Bank, Sir Edward Holden, and the last Chancellor from the opposition side, Austen Chamberlin. In his memoirs, Lloyd George described those days as some of the 'busiest and most anxious' of his life (Seabourne, 1986; Lloyd George, 1930, p. 64).

Bank of England notes, which had the status of legal tender only in England and Wales. Third, the Treasury was already willing to expand its role in the financial market and did not hesitate to take up the incumbency, contracting a private firm to manufacture the first batches of notes in postage-stamp paper. Fourth, it was believed that an expansion in the domestic circulation of paper money would preserve international confidence in the British pound by freeing up gold to the Bank of England's operations in support of the exchanges. Lastly, the government justified the decision as a strictly temporary measure to relieve the financial market, an excuse that would soon be forgotten (Peden, 1993, pp. 80-83; Burk, 1982, pp. 82-89; Sayers, 1976, v. 1, pp. 66-78). Although only about £13 million of currency notes entered in circulation during the 1914 crisis, its amount grew exponentially over the war years, surpassing all other kinds of currencies in 1918 and hitting a ceiling of £346 million in 1920, as shown in Figure 1, until the final absorption of the totality of Treasury notes by the Bank of England in 1928.

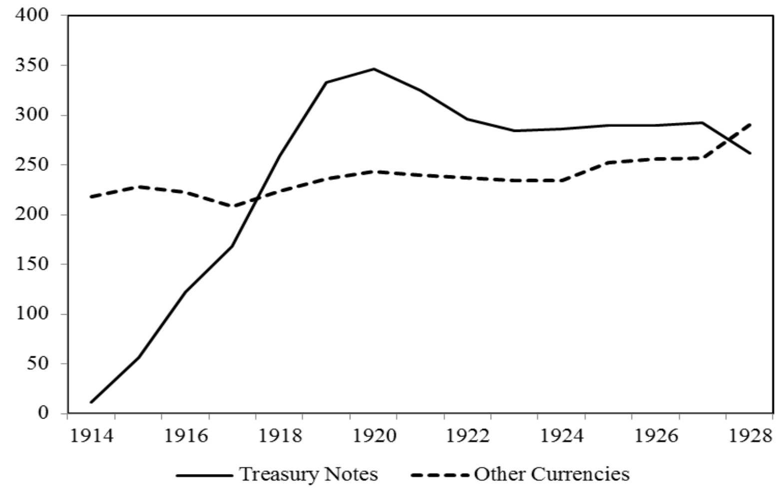

Fig. 1. United Kingdom Bank and Treasury Notes 1914-1928 (£ millions)

Source: Capie and Webber, 1985, Table III(1), p. 326. Other currencies: Coin in Circulation, Bank of England Notes, Private Bank's Notes and Joint-Stock Bank's Notes, columns I, II, V, and VI; Treasury Notes, column II.

Despite the 1914 liquidity crisis, specie payments were formally maintained. For much of the war period, though, the risks associated with shipping were so great that insurance of gold being exported from Britain could not be obtained (Moggridge, 1969, p.11), so an outflow of gold would not be triggered by the exchange rate falling below the traditional gold export point. As the end of the Great War approached, the British Government started to give consideration to currency and exchange issues in the early post war period of reconstruction. In January 1918, Lord Cunliffe, the Governor of the Bank of England, was appointed to chair the "Committee on Currency and Foreign Exchanges after the War" (or the 'Cunliffe Committee', as it became known). Pigou was a member of that Committee,[5] which was instrumental in setting the future agenda for monetary matters and in shaping the financial framework that the Chamberlain- Bradbury Committee confronted in 1924 and 1925.

In regard to the agenda for currency reform, the first interim report of the Cunliffe Committee (Currency and Foreign Exchanges, 1918) noted that witnesses appearing before

[5] The views of Pigou around the time of his contribution to the Cunliffe Committee are discussed by Aslanbeigui and Oakes (2013).

the committee were at one on the restoration of the gold standard at pre-war parity; and recommended that this step should be taken as soon as permitted by fiscal (cessation of Government borrowings) and monetary conditions (suitable machinery to allow the Bank of England discount rate to check a drain of gold overseas; and limitation of fiduciary issue). In regard to reaching that end, two conditions were noted in that report. The first one, which became operative before the Chamberlain-Bradbury Committee met, was the recommendation that the issue of fiduciary notes should become law once again; with the final report of the Cunliffe Committee noting that effect should now be given to the recommendation of the interim report that the actual maximum fiduciary circulation in any one year become the legal maximum for the following year. The second condition was the termination, at the earliest possible moment, of the exchange of deposits of Bank of England notes for currency notes without affecting the reserves of the Banking Department.

A year after the Cunliffe Committee had reported, the US ceased its support for the sterling in 1919 (Eichengreen, 1992, p. 100-107) and, with the value of the pound declining, the British government introduced the following year the Gold and Silver Export Control Act (1920) to virtually prohibit the export of gold for five years. This prevented Britain's gold reserves from being drained in the event of the exchange rate falling below the gold point. In effect, this meant that the transitional arrangements established in the post Cunliffe period could continue until 31 December 1925 (Sayers, 1976, v. 3, p. 55-56). When reviewing the Treasury manuscripts of interviews conducted by the Chamberlin-Bradbury Committee, Pigou highlighted the following statement by Sir John Bradbury, which summarised the agenda that the Cunliffe Committee had set for future monetary reform.

> "It seems to me that the plan contemplated by the Cunliffe Committee's Report was, first of all, to ascertain the normal level of the gold reservoir under free import and export conditions, then fix the fiduciary issue and then transfer the note issue to the Bank of England."
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> (Bradbury in: *ACP 4 F22*, p. 11).

That is, experience of monetary conditions under the gold standard without the prohibition on the export of gold was regarded as a necessary precondition to the amalgamation of currency and bank notes. As the Cunliffe Committee had also recommended, any limit on the issue of fiduciary money would also have to be set "with reference to the actual conditions of a free gold market" (T160-197, p. 18). This explains why Britain's return to the gold standard was implemented following the recommendations of a report of the "Committee on the Currency and Bank of England Note Issues"; and not a report of a body with a title like the "Committee on the Return to the Gold Standard".

On 21 May 1924, during the period that Pigou characterised, in *Aspects of British Economic History 1918-1925* (Pigou, 1947),[6] as the 'doldrums', Niemeyer, then Comptroller of Finance at the Treasury, sent the following letter to 'Mr Pigou' informing that "The Chancellor is appointing a small Committee to advise him privately whether the time has come to amalgamate the currency and the Bank of England notes issues" and indicating that "the Chancellor would be very grateful if you would consent to serve on the Committee" (Niemeyer in G1/433). Pigou responded, on 22 May 1924, that "I am leaving England on July

[6] This book was originally written during World War II, with a view to considering any implications for the war economy. It characterised the cycle of the British post-war economy in the following terms: a period of 'breathing space', with mixed economic signals, from Armistice until the end of April 1919; followed by a monetary 'boom', and associated wage rises, which lasted until late April 1920; followed by a 'slump' that lasted until the beginning of 1923; before returning to the 'doldrums' and remaining in that state well beyond 1925.

2 and shall be away till nearly the end of August. If that is not a bar, I shall be glad to serve on the Committee" (T160/197, folio 19). That clearly did not prove to be a bar, as Pigou joined Chamberlain, Bradbury, Niemeyer, and Gaspard Farrer (Director of Bearings, Merchant Bankers) on the Committee. Mr N. E. Young, from the Treasury, was to act as Secretary.

The Committee convened seven meetings to hear testimony from twelve invited witnesses, as well as other meetings without witnesses. Pigou's absence in July and August meant that he was only present when the Committee interviewed Montagu Norman, the Governor of the Bank of England; and Charles Addis, a former Governor of the Bank of England. He had to rely on the transcripts of interview to read the testimony of the Rt. Hon. Reginald McKenna, Chairman of Midland Bank and former Chancellor of the Exchequer; as well as that other interviewees, such as those associated with the Treasury[7], the financial sector,[8] industry in general[9] and academia.[10] However, Pigou was diligent in reviewing the transcripts of interview from the meetings of the Committee that he missed and the testimony of McKenna was, judging from the number of lines he inserted to highlight text, of particular interest to him.

3. Pigou's Reading of McKenna's Testimony

3.1. McKenna on Trade, Prices and the Monetary Regime

The association of Keynes with McKenna[11], and the idea of a Keynes-McKenna school, is not based on a shared opposition to the return to the gold standard. Unlike Keynes, as shown above, McKenna did not have an in principle opposition to Britain returning to full specie payments. When asked by the Chamberlain-Bradbury if 'the fact' of a stable exchange rate with the US dollar (which was already on gold) was a reason for Britain returning to the gold standard, McKenna reply by saying 'no it is not'; he then clarified his position by suggesting three reasons why Britain may want to return to gold. The first one recognised that public confidence in a currency, be that confidence unfounded or founded, was a pertinent consideration when setting the monetary regime. The second reason suggested that the monetary regime established for Britain should be set with regard to real economic benefits for the British Empire, and not just for Britain itself. In the case of gold

[7] The two other interviewees with links to the Treasury were: Sir R. S. Horne, Chancellor of the Exchequer (1921-22); and Sir George Paish, former advisor to the Chancellor of the Exchequer.

[8] The interviewees from the financial sector were: Mr L. Currie, partner of Glyn, Mills Currie & Co; Sir Felix Schuster, director of the National Provincial Bank; Sir W.H.N Goschen, partner of Goshens and Cunliffe; Dr Walter Leaf, chairman of Westminster Bank; Mr F. C. Goodenough, chairman of Barclay's Bank.

[9] ; The interviewees representing the Federation of British Industries were Messrs Chisholm and Glenday.

[10] The two academic economists interviewed were: John M. Keynes, fellow of King's College Cambridge; and Edwin Cannan, professor of political economy at the University of London.

[11] McKenna was born on 6 July 1863, in Kensington, London, and studied in France and Germany in his early years. On his return to England, in the late 1870s, he attended King's College, London and, after that, Trinity Hall, Cambridge. In 1895 he was returned by the Liberal Party for North Monmouthshire, seat that he held until 1918. In 1915, in the first Coalition government, he succeeded Lloyd George as Chancellor of the Exchequer, staying in office until late 1916. McKenna became director of the Midland Bank in 1917 and its chairman from 1919 onwards. His annual addresses to the bank stockholders from 1920 to 1928 were compiled in the volume *Post-War Banking Policy*, out in print in 1928. Keynes observed that the former Chancellor, through those meetings, helped make the entrenched orthodoxy of the twenties disappear like 'the old London fogs' (Keynes, 1972, p. 58). McKenna died in London, on 6 September 1943 (Gregier, 2004; The Times, 1943, p. 6).

producing empire countries, the benefit to the Empire had less to do with an increase demand for gold, as the US was already on the that regime and active in maintaining a high and stable gold price, than with an increase in the likelihood of the gold standard, and the associated contribution of monetary authorities to the demand for gold, being maintained over time. The third reason returned to the question of public confidence in a currency, which is enhanced if simple arrangements apply. In that regard, members of the community "understand that [gold] better than the arbitrary control of credit by the Bank of England which exits today" (McKenna in: *ACP 4 F25*, p. 21).

But these three points hardly constitute a compelling case for Britain to abandon a managed currency: the first and the third are due to perceptions or ease of understanding, which are transitory notions, and the second, while potentially significant, will have next to no immediate impact on Empire countries while, as discussed below, the US stands ready to actively preserve the gold price. Rather, to McKenna, the first order point appears to not concern the exchange rate regime *per se*, but the gains from international trade associated with the exchange rate regime that is stable relative to both commodities and gold. In that regard, he first emphasised that Britain's trade was not advantaged by any particular level of the exchange rate. "There is no question in my mind of there being any advantage of trade of the Exchange being at one level more than another level" (McKenna in: *ACP 4 F25*, p. 21). He recognised the short term impact on trade that changes in the exchange rate have on the relative prices of exports and imports; but for long term – to fully exploit the gains from trade –advantage is obtained through stability.

> "There may be advantage in getting down to a level, there may be disadvantage in getting down to a level; there may have been advantage in getting up to another level, there may have been a disadvantage in getting up to another level. But when you are there, stay there so far as trade is concerned."
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> (McKenna in: *ACP 4 F25*, p. 21).

When viewed in the context of a return to the gold standard, McKenna's reference to 'when you are there' means when the sterling has successfully returned to the pre-war exchange rate of where one pound equals $4.86. But a fixed exchange rate is only one of two necessary conditions that in McKenna has in mind when considering stability. The second concerns the stability of the gold price because of the interdependence between the exchange rate and the gold price, especially in a world where some nation's exchange rates are pegged to the gold standard and some are not: "I would not be at 4.86 without that [stability]. I do not want to fluctuate. If gold is going to fluctuate I do not want to fluctuate with gold: I want stability" (McKenna in: *ACP 4 F25*, p. 22).

The forces that determine the exchange rate in McKenna's expressed view are simple and unequivocal. He rejected any suggestion that the present exchange rate was a result of sentiment, as exchange rates would be entirely determined by the price level in Britain relative to the price level of other nations: "Chamberlain: You think it is entirely dependent upon the price level? McKenna [in reply]: Price level entirely." (*ACP 4 F25*, p. 19). Consequently, McKenna held that relative purchasing power parity is the sole explanation for the rate of exchange whether or not the currency is pegged to gold. When there are divergences between movements in relative sterling-US dollar exchange rates and relative British-US price levels, McKenna suggested that that would be probably due to error in deriving price estimates and not the result of sentiment.

In 1924, the pound could buy less than 4.86 US dollars, but price levels in Britain were growing slower than in the US. In view of this, McKenna's expected the pound to appreciate and he believed that that process would progressively return the sterling exchange rates to parity before the prohibition on the export of gold terminated at the end on 1925. "In the language of a great statesman, 'wait and see'. American prices will probably be up to that level before the 1st January 1926. We shall automatically be on the gold basis when we open our mints." (McKenna in: *ACP 4 F25,* p. 18). Sir John Bradbury correctly characterised McKenna's position in the following terms:

> "Now am I correct in saying that the advice you would be disposed to give would be to do nothing at all until such time as the pressure of events brings Sterling to par, and then to have an international monetary conference with a view to settling the general terms, as between nations, for the ultimate resumption of the gold standard? Is that a correct summary?"
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> (Bradbury in: *ACP 4 F25,* p. 24).[12]

3.2. McKenna on How to Manage a Gold-Backed Currency

Once par has been attained, the exchange rate could be maintained by Bank of England's policy on the Bank Rate, with a rise in the Bank rate acting to check both inflation and an outflow of gold reserves. But that is not the full story. As the gold price too is, like all commodities, subject to market forces, McKenna emphasised that stability for countries on the gold standard would also depend on the price of gold being stable. To maintain a fixed gold price, he argued that countries on the gold standard were, in effect, obliged to enter gold markets to purchase gold when there is downward pressure on gold prices even when those purchases are not required as reserves for strictly monetary purposes. At the time of the Committee's enquiry, the US, which was already on the gold standard, was actively buying gold as a means of maintaining the price of gold.

> "Now if gold were depressed in value the United States being on the gold standard, that is today, having their Mints open and obliged to coin gold on demand into dollars, if the gold were allowed to fall in value the dollar would also fall in value and immediately prices would rise in the United States and the United States would get into a state of real bad inflation."
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> (McKenna in: *ACP 4 F25,* pp. 9-10).

He illustrates his concern in that regard when discussion of the British-US exchange rate relationship was extended to include the British-US-German exchange rate relationships in the face of changes contemplated for Germany as part of the plan presented in the 'Dawes Committee Report' (1924).[13] In that regard, the Chamberlain-Bradbury Committee was interested in McKenna's views on the risks to Britain from Germany stabilising its mark by fixing it to the US dollar. As the US was already on the gold standard, the Committee saw as Germany adopting a *de facto* gold standard and was interested to know whether it would have an adverse effect on Britain if it was not on the gold standard as gold prices vary.

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[12] McKenna's reply confirmed that Bradbury's characterisation had correctly summarised his view.

[13] Following Germany's default on war reparation payments, troops from France and Belgium occupied the Ruhr Valley, leading to major disruption to production in this coal and steel producing area of Germany. In response, the *Allied Reparations Commission* established an international committee, with representatives from Belgium, Britain, France, Italy and United States, chaired by the American senator and future vice-President, Charles Dawes, to work out the terms under which troops would be withdrawn from the Ruhr Valley (Maier, 1988, pp. 355-420). The resulting Dawes plan, which was published in April 1924, called for 800 million gold marks to be given in credit to Germany by major powers assist in reconstruction, reschedule reparation payments and facilitate the reorganisation of the *Reichsbank* under allied supervision to maintain currency stability. This plan was ratified by the governments concerned at the end of the London Conference, on 16 August 1924 (Mowat, 1927, pp. 260-278).

> J. Bradbury: "Assuming that it [Germany stabilising its currency against the US dollar] is successful, then you will have a condition in which the dollar-mark exchange rate is stable. If the value of commodities in gold is variable, you will have concurrently a condition in which the sterling gold, sterling-mark exchange, is unstable, because sterling will follow commodities, and the mark will follow gold. Do you see the danger?"
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> R. McKenna [in reply]: "I see great danger to dollars and marks, but not to sterling. Sterling would be the stable, and the others would be fluctuating."
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> (*ACP 4 F25*, p. 27)

To McKenna then, Britain had little to fear from staying off the gold standard if Germany adopted a *de facto* gold standard because a variation in the price of gold would only impact directly on the purchasing power of money in countries that are on the gold standard. The critical point to McKenna appears to be that variability in the gold price, or what Bradbury calls variability in 'the value of commodities in gold', only directly alters the domestic price of commodities (price levels) in Germany and the US. All this serves to underline the fundamental importance that stability has for the gold price from nations on the gold standard, such as for Britain if it returns to the gold standard, and its lack of direct relevance to countries not on the gold standard, such as in 1924 Britain.[14]

As a gold standard country, McKenna observes that the US has undertaken two actions to prevent the emergence of high rates of inflation following a fall in the price of gold. First, it has become a major buyer in international gold markets. In that regard, he estimated the value of world consumption of gold to about 70 million pounds sterling, 60 million of which was purchased by, or deposited in, the US to support the price of gold; with the remaining 10 million pounds of gold purchased by 'genuine buyers' who demand gold (McKenna in: *ACP 4 F25*, p. 9). Secondly, McKenna points out that the US sterilises the impact of excess gold purchases, undertaken for the purpose of maintaining the gold price, on overall credit creating capacity. It did so through the Federal Reserve, which purchased securities back from bond holders.

> "In order to prevent ... ['real bad inflation'] happening the United States buy all this gold and do not allow it to become the basis of new credit. They achieve that object in this way. As fast as gold is poured into the Federal Reserve Bank creating thereby an additional account of Bank cash in the hands of the Banks who have brought the gold and sent it into the Federal Reserve Bank, the Federal Reserve immediately reduces the amount of Bank cash by selling securities or Bills. I call a Bill a security of course. Just as I said the Bank of England could reduce credit by selling securities, so the Federal Reserve Bank reduces cash by as fast as cash would have been increased by the sale of gold."
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> (McKenna in: *ACP 4 F25*, pp. 9-10).

However, the moment that Britain returns to the gold standard, it would have to join with the US in meeting a share of the cost of gold price maintenance activities. It would have no alternative but to 'buy gold'. The cost of this exercise was one legitimate reason in McKenna's eyes for Britain not returning to the gold standard, in which case he advocated an immediate amalgamation of the Bank Note and Currency note issues.

> "If we are not going back to the gold standard; if we are able to find a better standard for ourselves or if we feel that the gold standard, while it is a pretty good standard, is nevertheless too costly under existing conditions for any nation but the United States to support, then I would amalgamate the two [note] issues now."
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> (McKenna in: *ACP 4 F25*, p. 8).

[14] McKenna here implicitly set aside real trade effects on countries that are not on the gold standard, which may arise as an indirect consequence of monetary instability, sparked by gold price instability, in countries that are on the gold standard.

But if Britain decided it could afford to contribute to the cost of gold price maintenance and returns to the gold stand is the intention, then McKenna regarded the question of whether Britain should, or should not, sterilise all or some of its gold surplus as very important. As McKenna saw it, Britain's capacity to sell securities to sterilise associated credit growth following the purchase of gold was diminished by its weak fiscal position and large national debts. In view of this, his preferred solution would be to not sterilise all of the gold inflow from gold price maintenance activities, leaving some of it as a basis for providing new credit opportunities because a modest degree of inflation is conducive to trade and economic growth.

> "…the effect would be to introduce a long slow period of rising or inflated prices due to varying value [stocks] of gold and, in view of the immense national debts, I think the easiest way to get rid of an excessive burden which the taxpayer cannot bear is by a slow process of inflation. You have to distinguish this from what is ordinarily termed inflation because I do not mean the inflation of 1919 nor the ordinary credit inflation which is done voluntarily. I do not mean that. I mean precisely the same inflation as this country had from the year 1901 to the year 1914. Prices were during that period steadily tending upward owing to the oversupply of gold. … I think it would be good for our trade because it would mean a period of rising prices, rising prices restricted by the quantity of gold and, therefore, not due to an unrestricted issue of currency by a defaulting Government."
>
> (McKenna in: *ACP 4 F25*, p. 12).

Consequently, once Britain returns to the gold standard and adds to its gold surplus to maintain the price of gold, the extent to which that increase in the gold surplus needs to be sterilised is consistent with maintaining relatively modest inflation rate in Britain, provided it does not exceed the inflation rate in the US (and other countries returning to the gold standard). As McKenna perceived American prices rising faster than British prices, he thought a 'wait and see' approach to the return to gold as leading to the possibility of modestly expansionary monetary policy. That is: wait and see if the exchange rate returns to parity, which delays the need for Britain to join the US in shouldering the cost of gold price maintenance; and wait and see what the movement in relative price levels in the US and Britain are to determine whether there is a need for Britain to also bury the gold it has brought as part of its gold price maintenance activities by buying bonds (or an increase in the Bank Rate could bring down the rate of inflation low enough to maintain the British exchange at a level above the gold point).

A rapid return to the gold standard before the change in price levels in the US relative to Britain had brought the exchange rate back to its pre-war level, in McKenna's view, be folly. When quizzed by Austen Chamberlain on what would happen if the Chancellor of the Exchequer were to make an announcement on the matter, McKenna replied: "I should liken him to King Canute who told the tide to recede" (McKenna in: *ACP 4 F25*, p. 18-19).

> "You cannot get us on to the gold standard by any action of the Chancellor of the Exchequer in any way. You cannot do it. Nothing that he could do in the way of restricting credit here and forcing down prices in this country would get him to the gold standard. He would cause infinite trouble, cause unlimited unemployment, immense losses and ruin, but he could not balance his Budget while he was doing it, and he would have to begin to borrow. Before he got our price level down 10% he would be borrowing again because his revenue would not be coming in. He would be having to inflate before he got there. The Budgetary difficulty will always beat them in forcing down prices."
>
> (McKenna in: *ACP 4 F25,* p. 18-19).

Finally, irrespective of whether the gold standard is, or is not, adopted, the prevailing long term monetary regime must not, in McKenna's assessment, be subject to any restriction on the quantity of currency being issued because limits on the issuing of credit cannot possibly operate advantageously (McKenna in: *ACP 4 F25*, p. 19). Rather, monetary policy should be implemented by the Bank of England through the Bank Rate to control credit in response to movement in relative price levels and the limit on the issue of currency recommended by the Cunliffe Committee should be abolished and not re-introduced.

> J. Bradbury: "You would rely entirely as a safeguard against inflation ... upon the discretion of the Bank of England in controlling credit?"
>
> McKenna [in reply]: "Entirely."
>
> J. Bradbury: "You suggest that discretion should be exercised by the Bank, not with reference to the size for the time being of the reserve of the banking department – because the size of the reserve of the bank is with the Treasury notes an illusory thing – but the examination of statistics of price levels?"
>
> McKenna [in reply]: "It should be founded on price levels."
>
> (*ACP 4 F25*, p. 29).[15]

4. Pigou's Draft of the Committee's Report in Relation to the McKenna Interview

The second draft report of Chamberlain-Bradbury Committee, prepared by Pigou, is written in three sections: I, which is untitled but deals with introductory and contextual matters; II, which is titled "The Gold Standard", and III, which is titled "The Amalgamation of the Note Issues". Given the objectives of this study, section II of Pigou's draft, on the gold standard, is of greatest relevance. Within that section, his opening paragraph mentions, and then immediately dismisses, the options of: (i) returning to the gold standard with a lesser gold content per one pound sovereign than applied under the pre-war standard (so exchange rate at parity would be achieved at a lower exchange rate than that which prevailed pre-war) and (ii) the abandonment of the gold standard altogether. Without reflection on either of these options, the following assertion is made: "as a practical present day policy for this country there is, in our opinion, no alternative comparable with the return to the former gold parity of the sovereign" (Pigou in: T160 197).

After the introductory paragraph, Pigou's section II, "The Gold Standard", is discussed under two revealing sub-headings: *Is the restoration of the gold standard a matter of immediate urgency*; and *The three routes to the restoration of gold standard at pre-war parity*. Given the purpose of the present study, it is necessary to underline the coincidence between much of what Pigou wrote under these two headings and a considerable part of the evidence presented by Sir Reginald McKenna to the Chamberlain-Bradbury Committee.

Is the restoration of the gold standard a matter of immediate urgency?

McKenna spent considerable time during his interview arguing in favour a 'wait and see' approach to the return to gold. Pigou too devoted a whole section of his draft to reflection on whether there is any urgency associated with the return to gold. His answer is that the matter won't become urgent for more than a year, to 31 December 1925, when the embargo on the export of gold would expire. That conclusion is, in Pigou's assessment, unaffected by

[15] However, McKenna does recognise that conducting monetary policy solely with respect to price levels alone could only be permanent and sustainable in 'an intelligent world'; in the 'world in which we are', however, he concedes that a permanent currency system could not be contemplated on the basis of price levels alone (McKenna, *ACP 4 F25*, p. 29). Some level of reserve would be needed to manage imperfections associated with a less than intelligent world.

Germany's return to the gold standard under the provisions of the Dawes Report and the desire of countries of the British Empire for Britain to return to gold. Like McKenna, Pigou is dismissive of the idea that Germany's return to the gold standard could have an adverse impact on Britain.

> "There is no little apprehension in this country as to the effects of the re-establishment in Germany of a gold standard or a gold exchange standard in accordance with the Report of the First Committee of Experts (the Dawes Report). ... In our view, however, the provisions of the Dawes Report by no means necessarily imply that the mark will be continuously maintained at full gold parity. We do not think it inconsistent with the successful application of the recommendations of that Report that the mark would, at any rate for some considerable time, stand at a discount in relation to gold as great as that at which sterling now stands.
>
> (Pigou in: T160-197, p. 4)

The difference between McKenna and Pigou on this issue is simply one of emphasis, with the former underlining the problems that the US and Germany would have if their exchange rates remained fixed to the gold standard rate while their price levels fluctuated; and the latter suggesting that this would probably cause Germany's full parity to break down. Pigou also indicates, in his draft of the report, that even if the Dawes plan leads to German's successful return to parity, other countries considering associating with Germany in forming a gold standard block would refrain from doing so until experience under the new monetary regime had convinced them that Germany could permanently maintain the gold value of its currency. In view of such caution toward the new monetary arrangements in Germany, Pigou's draft concludes that "we are not therefore convinced that this consideration need be treated as of immediate urgency" (Pigou in: T160-197, p. 5).[16]

As noted earlier, McKenna, in his testimony, listed three possible reasons why Britain might wish to return to the gold standard, two of which concern flawed perceptions by people at large (the gold standard as safer than other standards; and the gold standard is easier to understand than credit controls) and one of which is based on a real benefit (the gain to gold producer nations in the British Empire). On this third point, Pigou's report notes the 'strong desire of the self-governing dominions' for Britain to return to the gold standard. However, he does not accept that this adds to the urgency of reaching that position. In relation to self-governing dominions, Pigou regarded Britain's decision to get back to gold as priority over the timing of that return.[17]

The three routes to the restoration of gold standard at pre-war parity.

The first of Pigou's three routes to the restoration of the gold standard is basically McKenna's preferred path, with the Bank of England adopting a banking and credit policy that maintains general price levels in Britain while waiting for the American expansion in credit to varying the dollar-pound exchanges rates to par before the embargo on the export of gold is removed. The second route is for the Bank of England to adopt a banking and credit policy that depresses prices in Britain to a point that the dollar-pound exchanges rates rise to

[16] Pigou's discussion on Germany and the Dawes Plan was not retained in the final version of the Committee's report. However, it is unlikely that that it is due to dissent among the Committee members. Rather, it is probably due to the lack of urgency, noted by Pigou, together with the fact that the Dawes plan only become operational on 1 September 1924, around the time that Pigou was writing the Committee's second draft of the report, and because experience under that new arrangement, from then until submission of the final report in February 1925, had done nothing to suggest that Germany's exchange rate regime should influence the timing of Britain's return to gold.

[17] In Pigou's words: "We assume, however, that a definite decision as to the policy to be pursued in the near future would be communicated confidentially to the self-governing Dominions, and this might well precede by some time the adoption of an active policy on our part." (Pigou in: T160-197, p. 5)

par before removing the embargo on the export of gold. The third route is for the Government to announce that Britain will remove the embargo on the export of gold on a particular date in the near future, which would force the Bank of England use banking and credit policy to return to the pre-war parity before the gold embargo is lifted. This third route is basically a variation on the scenario that led McKenna to suggest that the Chancellor, or Government in this case, is acting like King Canute if he things a simple announcement will return Britain to the god standard.

If these routes are considered with respect to the relationship between the return to parity exchange rate and British and US price levels and, which is the most basic analytical framework espoused by McKenna, these three routes may be reduce to two general paths: the non-activist non-deflationary path whereby a neutral monetary policy is employed in Britain under the expectation that rises in US prices will bring about a return to pre-war parity (route 1); and an activist deflationary path whereby contractionary monetary policy is employed in Britain to force the return to pre-war parity (routes 2 and 3). Pigou suggested that it is evident that the second and the third routes come to much the same thing as they involve a restriction in credit to ensure that sterling prices fall (Pigou in: T160-197, p. ?). In regard to these second path, Pigou, like McKenna, emphasises that a restriction in credit to cause sterling prices to fall must, to some degree, discourage industry and threaten employment.

> "Plainly it [the mechanism of the process for reducing prices] is one which is undesirable if there is reasonable hope that, within a short time, American action will permit our goal being attained by the first of these three routes."
>
> (Pigou in: T160-197, p. ?)

As there is no urgency to act for more than a year, the above statement suggests that Pigou advocates a wait and see approach, along the lines advanced by McKenna. This conclusion is supported by Pigou's discussion of events in the USA to determine whether there is pressure for price rises in that country that may remove the need for Britain to act on reducing price levels. That discussion is almost entirely informed by McKenna's comments on the Federal Reserve Board's policy of accumulating gold and sterilising the monetary effects of that accumulation. Pigou calls this a 'skilful policy'. He adds also that the Federal Reserve Board is seeking to stimulate trade by not be sterilising all of its holds of gold and allowing 'part of their gold holdings to have its natural effect'.

> "In these circumstances, on the assumption that the Bank of England is willing and able to prevent sterling prices from rising in any marked degree, we conclude that the British Government should not at present take any active steps towards restoring the gold standard. ...we recommend[18] that, for another year, the Government should wait upon events. If at the end of 1925 the dollar has not approximated to parity, deliberate action to secure that result may become necessary."
>
> (Pigou in: T160-197, p. ?)

5. Cases 'for' and 'against' the 'Pigou-McKenna School'

Having gone through McKenna and Pigou's views on Britain's return to gold in 1925, can we legitimately speak of the 'Pigou-McKenna School' on this specific issue? This question is tentatively considered below by reflecting on the cases for and against the proposition.

The Case for

[18] It should be noted that this recommendation is conditional on the Federal Reserve Board not reversing its policy of accommodating American price rises and prices in Britain not booming, however, Pigou also writes that: "we do not anticipate either of these contingencies." (Pigou T160-197, p. ?).

The case for the idea that there was a 'Pigou-McKenna School' rests on their shared views in four main areas. First, their recognition of the primary role of relative price levels in determining exchange rates: in that context, the gold standard is a viable monetary standard when price levels, in general, and the gold price, in particular, are stable. Second, notwithstanding the merits of the convertibility regime, their views on the transition to the full restauration of the old parity were cautious in equal measure. A 'wait and see' approach to the timing of Britain's return to gold was seen as desirable by both men because they thought that US policies may lead to a rise in price levels in America relative to Britain and facilitate a transition back to the gold standard without having to impose contractionary monetary policy to reduce prices that would impact adversely on industry and create unemployment. Third, they had a shared appreciation for the 'skilled policy' of the Federal Reserve Board in buying gold, for gold price maintenance, and the sterilisation of the monetary impact of those surplus gold reserves. Fourth, they both recognised that Germany's return to gold, undertaken as part of the Dawes report, should have no short term influence on the timing of Britain's return to gold.

Finally, McKenna's 27 January 1925 address to the Midland Bank meeting – some six months after her had been interviewed by the Chamberlain-Bradbury Committee McKenna and nearly two months before the famed dinner with Churchill, Keynes, Bradbury and Niemeyer – is broadly consistent with the idea of a Pigou-McKenna school. In that address, McKenna remarked that restoring the gold standard was finally within grasp as the actual sterling-US dollar exchange rate had come close to its pre-war parity. As per his evidence to the Chamberlain-Bradbury Committee, he noted that that movement owed more to the recent inflation in the United States than to the previous deflationary policy at home. He also noted that the experience of managed currency in Britain had actually kept domestic prices more stable than on the other side of the Atlantic. Nevertheless, McKenna recognised that a full return to gold would be more advantageous to Britain for a series of reasons, namely: the provision of a universally accepted measure of value; the automatism of the system, which minimized the risk of unwise discretion by central banks; the nation would feel better about herself for being honest to her past; the fear of driving the economy off the gold standard would act as a check to the extravagance of future governments; confidence would be restored, facilitating international trade, and conditions had improved in Europe and many nations were already back to gold. As he summed up his opinion:

> "So long as nine people out of ten in every country think the gold standard is the best, it is the best. If in the future there were an immense increase or decrease in the output of gold and consequently a startling rise or fall in prices, re-consideration of the subject might be forced upon public attention, but at the present there is no single nation, so far as I know, which is now off the gold standard, that does not regard the return to it as the most desirable of all financial measures."
>
> (McKenna, 1928, p. 103).

The Case Against

The case for the idea that there was a 'Pigou-McKenna School' needs to be broken down into two parts. One part concerning the idea's Pigou outlined when writing the second draft of the Committee's report and a second part concerning all other considerations subsequent to that draft.

There are two notable contrasts between what Pigou highlighted on McKenna's interview with the Committee and what Pigou wrote in his second draft. First, although McKenna recognised that the gold standard was a viable standard, he was more ready than

Pigou to accept circumstances when the return to the gold standard should not be pursued. For example, if the cost of British contributions to the cost of gold price maintenance were too high, McKenna considered that a return to the gold standard may not be appropriate. Pigou's draft report was silent on this question. Also, McKenna's ideal path to a resumption of the gold standard was for events to bring the sterling to par and, once that stage had been reached, to convene an international conference to settle on the general terms for resuming the gold standard. Pigou did not advocate the use of an international forum to that end. This could be because his committee was reporting to the Chancellor of the Exchequer, so a national focus was more appropriate. Secondly, McKenna was very much opposed to setting limits on the issuing of money. On this point his testimony is closer to Keynes than Pigou; as Pigou's report, in the section on the amalgamation of note issues, associates the Committee's 'decided preference' with a permanent fixed fiduciary issue, although it was recognised that this limit cannot be fixed until the actual conditions of a free market for gold are known.

The main aspect of the case for opposing the idea of a Pigou-McKenna school, though, concerns events subsequent to Pigou's draft. The comments of Chamberlain and especially Bradbury on Pigou's draft of the report demonstrate that they were not happy with his wait and see position:

> I should rather like to say definitely that (i) we are strong enough to restore the old gold parity at once and that there would be no exchange danger in announcing the very early removal of the embargo; (ii) but this would involve a sudden fall in prices which industry in its present distressed condition cannot stand; and (iii) would be improvident if, as seems likely, American prices rise, so that the sharp reduction would in large measure at least be only temporary ... To me this is the only reason for not acting now and I should like it put strongly.
>
> (Chamberlain, 11 September 1924, in: T160 197)

> "For the moment we propose to wait and see which way the cat jumps. If she jumps one way, we can avoid jumping after her – and whether we can or not remains to be seen – everything will probably be all right. If it isn't, we shall be prepared to be a good deal braver than we can be at the moment. I think we ought to make it perfectly clear that we regard a return to a free gold market at the pre-war parity without long delay as of vital importance"
>
> (Bradbury, 11 September 1924, in: T160 197; and Moggridge 1972, p. 49)

But Pigou was not willing to defend his draft or persuade his fellow members of the Committee to change their minds in line with what he had written. From a draft note that Pigou prepared, and which Mr Young quotes on a letter to Bradbury on 12 September 1929:

> "On the main issue, which is one of practical politics rather than economics, whether the Government should take the plunge now and announce no renewal of the embargo, I am only just on balance in favour of a 'wait and see' policy. It would be inappropriate of me as an academic person to press for heroism; but if the rest of the Committee had been in favour of it, I doubt if I should have opposed."
>
> (Pigou in: Moggridge 1972, p. 49).

In view of this, the final report of the Chamberlain-Bradbury Committee was unequivocal and uncompromising in its support for a quick return to the gold standard. To a large extent, Pigou is judged by that report, which he did not dissent from, and which has very little in common with McKenna's opinions on the subject. When the policy issue of Britain's return to gold was still on the balance on 17 February 1925, Pigou's views did not figure significant because he had given up his largely pro-McKenna position on 12 September 1924. In a historical sense, timing is everything!

6. Concluding remarks

When limited to the strict realm of the history of thought about monetary policy, it is legitimate to talk of a 'Pigou-McKenna school' on the return to gold, particularly if taking into consideration the ideas expressed in McKenna's interview with the Chamberlain-Bradbury Committee and in Pigou's draft of the Committee's report. In that realm, McKenna's preference for a late return to the gold standard once the exchange rate had reached the old parity and Pigou's cautious draft make the notion of a 'Pigou-McKenna school' rather more appealing than the more common idea of a 'Keynes-McKenna school'.

However, once Pigou had surrendered that policy position to his fellow members of the Chamberlain-Bradbury Committee, the idea of a 'Pigou-McKenna school' loses all historical traction. By February 1925 when the critical policy issue had shifted to a question of the timing of a return to gold, the heightened anxiety about the timing of a potential return to gold makes the idea of the 'Keynes-McKenna school' compelling.

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