

KEYNES LECTURE

BANK RATE IN KEYNES'S CENTURY

By R. S. SAYERS

Fellow of the Academy

Read 2 May 1979

BY 'Keynes's century' I mean, in a very rough way, the century following 1883, when he was born. His first public impact in monetary affairs may be dated from, say, 1913; he lived 33 years after 1913 and has remained the most important influence through another 33 years since then—which brings us to 1979. As a half-way mark we may notice that it is close on 50 years since his classic piece on 'The Modus Operandi of Bank Rate' appeared as Chapter 13 in his *Treatise on Money*, and it is about 50 years since Keynes persuaded the Macmillan Committee to describe Bank Rate as 'a most delicate and beautiful instrument'.¹ I have labelled the period 'Keynes's century' for obvious reasons, but do not let us forget someone else: in this very year we shall be passing the centenary of the birth of R. G. Hawtrey. For posterity a bibliography of Bank Rate can be quite short, but however short, surely it must include the magisterial contributions of Hawtrey, for 40 years a Fellow of this Academy. So, although my paper might be considered an advance contribution for the centenary of Keynes, I should like it also to be noted as my tribute for the centenary, on 22 November 1979, of Hawtrey.

The Bank Rate story with which I have chosen to commemorate these two economists is one which I felt I could tell, not comprehensively or systematically as a source for future historians, but briefly to illustrate the relevance of a tool we ought to include in our equipment as economists. We are not going to be much use as economists unless we maintain a lively sense of the interaction—the mutual action and reaction—of economic events, the development of economic thought, the personalities and the opinions of men of affairs, and the shaping of their institutions. So do not fear—do not hope—that I am

¹ Report of the Committee on Finance and Industry (1931, Cmd. 3897), p. 97.

about to unroll a great chart of Bank Rate, for an inch-by-inch commentary. I am simply going to talk from the particular standpoint on which I have just insisted.

When I began to prepare this lecture, I turned first neither to Keynes nor Hawtrey, but to Clapham, for the beginning of the story.¹ I found that Bank Rate was not in Clapham's index, and this perhaps indicates how a historian of his generation could take Bank Rate rather for granted. Clapham does, however, have Bank Rate tables in each of his two volumes, and the contrast between the few entries for volume 1 and the four closely-printed pages for volume 2, brings abruptly to our notice the fact that as a weapon of policy Bank Rate did not emerge until well into the nineteenth century. The real beginning came in 1836—which enabled Hawtrey, for his Marshall Lectures at Cambridge in 1936, to take as his title 'A Century of Bank Rate'.

This arrival of the Bank's most renowned instrument more or less coincided with Parliament's attempt to give statutory force to a clear rule of conduct for the Bank. The Bank Charter Act of 1844 gave the Bank its marching orders but said nothing about Bank Rate. Bank Rate policy developed thereafter as an essentially defensive mechanism used by a company of bankers to help them to do what Parliament had told them they must do. Parliament had plumped for broadly Ricardian rules of reliance on a fixed gold value of the pound and a strict limitation of the quantity of anachronistically defined money; this was the framework within which the Bank had discretion to work. The Bank was rapidly losing the direct influence on quantities it had long enjoyed as much the biggest operator in the market and, instead, the Bank was finding a serviceable instrument in Bank Rate. Just why, in the nineteenth century, this development came to be one of the great success-stories of economic history is no simple matter. For the initial period there is illuminating discussion by Hawtrey, and in more detail by Dr Cramp in a scholarly little book.² It is not an analysis showing simple relationships between supply and price: from the beginning it is all complicated by the quicksand of expectations, especially in those decades when memories of banking crises were fresh and when the Bank of England was rapidly gaining in prestige. All I need emphasize now is that there emerged no consensus on

¹ Sir John Clapham, *The Bank of England* (Cambridge, 1944).

² R. G. Hawtrey, *A Century of Bank Rate* (London, 1938), pp. 20-46; A. B. Cramp, *Opinion on Bank Rate, 1822-60* (London, 1962), *passim*.

how it all worked, save that as time went on there was *more* emphasis on the quick and accommodating effects on the balance of international payments, and *less* on a Ricardian mechanism of the balance of trade. But the economists in this phase—Jevons for example—were remarkably quiet about it all.

After that there was a big change. To Bagehot Bank Rate had an importance warranting weekly attention in the columns of *The Economist* he was editing. The book he left behind him (*Lombard Street*) told a fairly simple story; and for a third of a century it held the field as 'The Intelligent Man's Guide to Bank Rate and all that'. Why it did so and why we came to grief after 1925, when Bank Rate was again enlisted as a major instrument for working a restored international system, are questions of the highest importance: questions not merely for the academic historian but also, I suggest, for the nations seeking in 1979 to create a more tolerable international monetary system.

Coming to the beginning of Keynes's century, let us notice what Marshall had to say about it all, for this was, Keynes wrote many years later, 'the doctrine on which I was brought up'; and it is worth remembering that Marshall was close to, and had appreciable influence on, a wide circle of men of affairs. Marshall gave his views to a Royal Commission—a small group of highly intelligent gentlemen, not expert technicians, evidently enjoying leisurely discussion with this great authority, then the only Cambridge Professor of Political Economy. From the outset Marshall played down Bank Rate, casting it for a very minor role in the mechanism whereby a change in price-levels followed a change in the money supply. A drop in Bank Rate 'stimulates speculation'—a tricky word this, with a big part in Bank Rate's history. Marshall implies that he is not thinking of 'new docks, new machinery and so on'; in his negative as well as in his positive statements his is a thoroughly Ricardian theory. 'The investment of capital', he says, is something which is going on, on the grand scale of Victorian construction, all the time; it is something quite different from the 'speculative investment' that can be affected by the rate of discount. 'The rate of discount', he insists, 'is merely the ripple of a wave on the surface.'¹

¹ The relevant passages are in Marshall's evidence to the Royal Commission on The Values of Gold and Silver (1887 and 1888), reproduced in his *Official Papers* (London, 1926). Keynes's brief sentences (in Chapter 13 of his *Treatise on Money*) certainly give the essence of Marshall's position, but are too brief to allow the full flavour to get through. Marshall's was no hurried

If we turn from the outside to the inside—from academic views to the practitioners, the men who made these ripples on the surface, it is a pity that there is no authoritative Bank of England statement contemporaneous with Marshall's. Indeed, there was nothing of this kind for twenty years after Marshall's evidence, and when it did come it was not for a British inquiry but for the peripatetic American inquiry that preceded President Wilson's establishment of the Federal Reserve System.¹ The Bank's answer to these Americans took a narrowly Thread-needle-Street view: 'The Bank Rate is raised with the object either of preventing gold from leaving the country, or of attracting gold to the country, and lowered when it is completely out of touch with the market rates and circumstances do not render it necessary to induce the import of gold.' This is consistent with the Bank's actual conduct almost throughout the pre-1914 generation. Notice that the Bank's answer says nothing of the balance of trade, price-levels, the money supply, unemployment—or even speculation. Fair enough—for it was *not* the Bank's purpose to discourage trade or industrial activity; the supply of money had no place in the Governor's calculations, nor was it, as a matter of fact, affected otherwise than incidentally and incalculably. When the Bank itself, a little bothered by the emergence of outside comments (to which I shall come back), tried to find out whether its actions had repercussions on industry and trade, it drew comfort from the broadly negative results. There was in fact, despite a sharp depression in 1908–09, a good deal of economic sunshine about; in the Bank's prime object of maintaining the gold standard, everything had been developing in favour of exclusive reliance on Bank Rate. A strong balance of trade was allowing massive long-term lending abroad, well under the City's control, there was continuing growth in an internationally mobile supply of bills, and the Bank of France was willing to defend stable interest rates on the Continent by showing some flexibility in its gold-hoarding policy. In these circumstances, the Bank of evidence to a Commission pressing on to get the next witness into the room. Their discussion with him on our problem was spread over two of Marshall's three days, and between the two days there elapsed four weeks (including Christmas) so that there was ample opportunity for mulling over December's discussion before returning to the problem on 16 January.

¹ This was the National Monetary Commission (Chairman, Nelson W. Aldrich). The sentence quoted here is from page 26 of the volume *Interviews on the Banking and Currency Systems of England, Scotland, France, Germany, Switzerland and Italy*, Senate Document No. 405 (Washington, 1910).

England was getting adequate results without hurting British industry—and thus was generated, among the practical men, a doctrine of the working of the international gold standard which (to say the least) was to confuse monetary policy in the period between the wars.

Before I cross the frontier of 1914 I must put in a warning that the quiet contemplation with which Bank Rate had generally been regarded was not quite universal: there were in those last few years occasional grumbles which have, in retrospect, the merit of foreshadowing arguments destined to become lively in later decades. The vigour with which Bank Rate was used did evidently hurt some people, even if they were only the 'speculative investors'; and there was some disquiet about its occasional dependence on the good graces of the Bank of France, where things seemed to be managed better through the holding of much larger gold reserves. Eventually these grumbles made just enough political noise to require an answer. It is significant that even at that date—1913–14—it was not the Bank but Lloyd George as Chancellor who was called upon to give the answer, and it was in the Treasury, not the Bank, that the brief, the Blackett Memorandum, was prepared under the guidance of Bradbury, the first of the 'Treasury Knights' to be an authority on monetary questions.¹ (Hawtrey had a hand in it too.) Now it is notable that when Blackett refers to the Bank Rate aspect of the problem, he refers solely to 'the merchant' as the grumbler, the only operator who, apparently, has to be stopped in his tracks. The Treasury view in 1914, in the face of some disquiet, was thus still rooted in the Marshallian view. There is no trace, as yet, of any notion that a rise in Bank Rate is important as prompting a general rise of interest rates in order to depress real investment generally.

In the 1914–18 war the Bank Rate did have its history, but this is an unedifying story, and for brevity I must pass over it. We must cross the watershed completely, to the world of 1918–19. A very different world!—that sounds trite enough, but the differences were of the first importance for the subject of this lecture. Some of these changes were apparent from the outset; others—at least in their full measure—were only gradually realized, but I had better say something of them all at this juncture, rather than allow them to emerge in a lengthy unfolding of the events of the next ten years.

¹ The memorandum, *Gold Reserves*, 22 May 1914, is most readily available as Appendix 2 in R. S. Sayers, *The Bank of England 1891–1914*, vol. 3.

Particularly important among the more visible of the changes was the absence of an effective gold standard *and of the conditions that had supported it*. The freeing of the exchange market was followed by a disappointingly sharp depreciation. Even so, there was no margin of strength in the balance of trade to allow for revival of overseas lending, and this at a time when there were powerful political reasons for lending to the Empire and outside. Almost at once, there was a trade boom the nature of which was not fully recognized, but what was seen was enough to engender fears that inflation would get out of hand and the value of the monetary standard would suffer the kind of collapse then being exemplified on the Continent. Another change relevant to London's Bank Rate was in the monetary scene on the other side of the Atlantic. Before 1914 London had for several decades enjoyed unrivalled leadership as an international financial centre, but now London's weakness, while New York's international competence was rising, made any complete return to London's former primacy impossible. There was also the birth of the Federal Reserve System, in a position to make its power felt internationally and with a mind of its own which, though running on the same thoughts as those underlying British policies, could lead to strains of an unprecedented kind.

The totality of these changes would, whatever else happened, have sunk all chance of getting back to 1913, which was what all British authorities said they wanted to do. This 'back to 1913' mentality was at the heart of the notorious Cunliffe Report of 1918, which, let us not forget, was signed by Marshall's successor in the Cambridge Chair, and was largely the work of Bradbury, then at the height of his power in the Treasury.¹ The main interest of this Report, for our present purpose, was that in giving Bank Rate discussion its post-war start it gave orthodoxy a twist quite away from the Marshallian view. After rehearsing the immediate impact on the international short-capital position, the Report goes on to say that a rise in Bank Rate 'necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and

¹ The 'First Interim Report' of the *Committee on Currency and Foreign Exchanges after the war* (reprinted in T. E. Gregory, *British Banking Statutes and Reports, 1832-1928*, vol. 2) was signed on 15 August 1918 by Lord Cunliffe, Sir John Bradbury, Professor A. C. Pigou, and ten bankers and other businessmen.

other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money tended to press their goods on a weak market. The result was a decline in general prices' which corrected the adverse balance of trade. Here, you see, was already that 'delicate and beautiful instrument' the Macmillan Committee was to notice twelve years later. It was not what people had said or written before 1914: the impact on those marginal speculative transactions had now grown to 'new enterprises' and 'the demand for constructional materials and other capital goods', and there was the Multiplier as well. Where had Bradbury got this from, this new doctrine that was to command the assent of all his colleagues on the Committee and the tacit or explicit agreement of authoritative commentators for years afterwards? I cannot think it was from any close analysis of the economic history of this country in the pre-war decades. My belief is that the new stress on fundamental adjustments, instead of 'ripples on the surface', stems from the attention given by economists, since about 1860 but especially since 1890, to the problem of *the trade cycle*.

The trade cycle was not a novel subject; but late in the nineteenth century economists' interest in it moved somewhat from the moment of crisis to the cyclical fluctuations in industry and employment. I use the word 'employment' deliberately, for a mainspring of this surge of interest was the analysis of the problem of poverty; when Beveridge produced in 1908 his analysis of the unemployment problem, the trade cycle was one of the more intractable villains of the piece. One economist after another produced important published work on it: Tougan-Baranovsky, Spiethoff, Pigou, Hawtrey, Lavington, Robertson, Mitchell, Fisher—all over the place, books or large chunks of books were being devoted to the trade cycle. Factual material was assembled, focusing discussion on the relative instability of the capital goods industries and on the cyclical movement of interest rates. In a generation that retained a touching faith in the price mechanism it was, I suppose, inevitable that Bank Rate, itself fluctuating cyclically, should be supposed an important piece of the mechanism of the fluctuations in industrial employment.

It was this development in economic thought—reaching back well before 1914—that gave the Cunliffe Committee's brief analysis its un-Marshallian slant; and—of fundamental

importance for Bank Rate in the 1920s—this new slant, just when persistent mass unemployment was about to emerge, forced Bank Rate on to the political stage—an innovation singularly disagreeable to those who, at the Bank and elsewhere, had believed that the Cunliffe–Bradbury policy of ‘Back to 1913’ would restore the Bank Rate question to the Governor’s room in Threadneedle Street. But I must not go too fast on this, for this novel turn of the Bank Rate problem, which might have come almost imperceptibly over the years, was precipitated by the extraordinarily difficult situation in which the authorities immediately found themselves.

By the time the authorities in London got round to considering Bank Rate, in the late summer of 1919, there was a wide measure of agreement about what was happening and about what should be done. A vigorous restocking boom—a demand for refilling the industrial pipelines both at home and abroad—was easily absorbing the labour released from the armed forces, and the lengthening order-books and spiralling prices seemed to be getting out of hand; and at the same time there was the pound depreciating against the dollar, under strain of international capital movements because money could be borrowed in London 2 or 3 per cent more cheaply than in New York. The remedy—to raise Bank Rate sharply—looked obvious enough. Keynes, now outside the Treasury but privately consulted by the Chancellor, had no hesitations.¹ His detailed arguments are worth noticing. Though he was prepared to force a financial crisis, it was not now a matter merely of discriminating against speculation; it was necessary, he argued, to take drastic action ‘to stop proposals for expansion—by prosperous well-conducted businesses whose order books are full and who therefore feel disposed to increase their works’. He would be prepared to go to 10 per cent, and to hold that rate long enough to get results. There was, however, some political opposition, using the argument that high interest rates would raise the cost of urgent housing programmes, forcing the dilemma of less housing or bigger government deficits, at a time when both ‘more housing’ and ‘less government expenditure’ were formidable political cries.

Bank Rate was thus right in the political arena: a portent indeed. The dear-money side won in the end—but ‘in the end’ only. Although the authorities did put one toe in the water late

¹ Pages 179–86 of vol. xvii of the *Collected Writings of John Maynard Keynes* (London, 1977). The Chancellor was Austen Chamberlain.

that autumn, it was not until the spring of 1920, after further exchange depreciation and much wilder prices, that Bank Rate went to 7 (not Keynes's 10). Most unfortunately, the boom was already cracking, though, in the absence of any worthwhile economic forecasting, this was unsuspected for several months. During those months and for many more the rate was held at 7 per cent. And, disastrously for British policy, the Americans were trying (also too late) to beat the trade cycle; they had moved their rates up simultaneously with London, and were similarly slow to realize that on trade cycle grounds they ought to come sharply down again. It was in fact a year before the two central banks began to move their rates down, and they took more than another year to get down to a really 'cheap money' level. London was tied to New York by the exchange weakness and the European spectacle of what currency collapse could be like, and by London's underlying policy of getting back to gold at the old parity as soon as possible. The Bank of England had hoped that the sharp rise in 1919-20 might so strengthen the pound *vis-à-vis* the dollar that an early return to gold might yet be possible; but as the American central bankers had also been getting new ideas about monetary policy and were terrified of continuance of an inflationary boom, the international effect of London's dear money had been neutralized by the simultaneous rise in New York. What was worse, Benjamin Strong at the New York Bank remained fearful of the boom long after it had broken, and, because London still wanted to go back to gold, New York's reluctance to cut Bank Rate imposed on London a parallel slowness.

The personal closeness which was now developing between Strong at the New York bank and Norman in London, allowing a close concerting of Bank Rate moves in the two centres, became of great importance at this stage, and remained so through the decade, even after Strong's death in 1928. Without their collaboration the long drawn-out process of falling Bank Rate in 1921-2 would probably have been even longer, though it was political pressure in their respective countries that eventually forced the final cuts in 1922. Because of Norman's idiosyncrasies—his ostentatious secretiveness, for example—this collaboration between the top central bankers became politically suspect, and therefore gave Bank Rate a further push into the political arena; but there can be no doubt that for a few years it did make for a lessening of strains in *international* monetary relationships. Fortunately the two men were

o

agreed in one of their primary objectives—the restoration of exchange stability and monetary order in Europe; they had similar views, too, on how Bank Rate should be used; both regarded themselves, and not the politicians, as the proper people to wield the Bank Rate weapon, but unfortunately the closeness of their views did not alter the fact that economic conditions in their two countries were, after 1921–2, setting contrasting tasks for the monetary doctors. (I mention this feature because it has a moral for those who *in this present time* are seeking vigorous progress towards monetary union in Europe.)

Once the New York rate had reached its extreme low point at the bottom of the slump, it did not seem difficult to work London's Bank Rate on a course designed to drive borrowers to New York and get the sterling-dollar exchange back to par; and to do this without having to go to a level of Bank Rate that would arouse the unemployment argument. And this—with encouraging moderation at the New York end—is broadly what was done until the pound went back to gold in April 1925. Norman took very gingerly steps—he would not, if he could avoid it, lay himself publicly open to a charge of provoking unemployment; but in this approach to the gold standard he was able to keep Bank Rate on a very moderate level consistently with such progress towards international monetary stability that the Bank's policy could be represented as in total an encouragement to trade. Actually Norman managed to get through from mid-1922 to the spring of 1925 with only one change in Bank Rate. This, a rise from 3 to 4 in July 1923, was not enough to disturb the overdraft rates of the joint-stock banks, or indeed any other of their actions in this extraordinarily wooden decade in their history. Even Keynes was quiet—or rather he was concentrating on other questions. This unwontedly quiet spell deceived Norman: he was lulled into the belief not only that the gold standard could be restored but, further, that with a restored gold standard the Bank would be free to manipulate Bank Rate to maintain the gold standard in the old way.

(You will notice, incidentally, that I am now speaking of 'Norman', rather than 'the authorities', for in these few years Norman was at the height of his power, both within the Bank and outside it. My design is also to emphasize that, fearful though he was of the penalty of neglecting the politics of monetary action, it was Norman's misjudgement at crucial

steps in this phase that really undermined the Bank's independence).

So early in 1925 Norman came back from an American tour full of newly-gained confidence, and was successful in persuading the Government (who were the acknowledged arbiters in this decision) to take the plunge into gold at 4.86. There was no concomitant decision that the Bank should henceforth run the show, but Norman took this for granted. He was to be rudely awakened. Within weeks he was fearing that a mistake had been made in returning to the gold standard, but he gathered up his courage in August and, acting as he believed in the best tradition, he was able quietly to drop Bank Rate (in two steps) from 5 to 4. But when he presumed on this to hoist Bank Rate back to 5 in December, there was a sharp brush with the Conservative Chancellor—and this settled, in some ways finally, that the Bank and its Governor must remember the political corns.¹

For Norman and the Bank, there was no gainsaying this latest lesson of 1925, and their acceptance for a time almost destroyed Bank Rate as an instrument of policy. The Bank knew there would be trouble if Bank Rate went up, and it was almost as fearful of putting it down lest it should soon want to reverse engines and so again incur political wrath. So Bank Rate was almost frozen: no change at all through 1926; one only—a wee step down—in 1927; and no change in 1928. With his right hand tied behind his back Norman resorted to all the new devices he had been learning: he used all his blandishments with Benjamin Strong and other friends in New York; he exercised an iron control in the discount market; he kept a tight grip on overseas issues; he built up and ran down a secret reserve of dollars; he even stumbled into an old Bank trick of widening the gold points, on which Keynes had in 1922 at Genoa preached in vain.² Then in 1929 the Wall Street boom got completely out of hand and forced a break from the rigidity of Bank Rate. This story is too well known for me to repeat here. I would simply emphasize that the Bank Rate changes of 1929–31 were

¹ Since this December 1925 occasion (when Churchill was Chancellor) only an exceptionally weak Chancellor (Simon) has ever, confessing that he didn't understand what it was all about, been able to turn his back on the subject, and that was in 1939 when everybody had too much else to think about.

² For Keynes at Genoa see the *Collected Writings* vol. xvii; the suggestion on the gold points is on p. 365.

moderate, for even in such a situation the Bank was feeling the political restraint and turning all the auxiliary screws as sharply as it could. Yet in the end the Bank found itself forced to submit to the appointment of the Macmillan Committee. There is little wonder that Norman shied at the Macmillan Committee's request for light on Bank Rate, and preferred to fill in time by talking about international co-operation and about his ventures in financial reconstruction of depressed industries.

All this was very confusing for students brought up on the old doctrines, and I must turn back for a moment from the train of events to the train of thought during the twenties. We have seen how in economic thought at the beginning of the decade Bank Rate, ceasing to be a 'ripple on the surface', had become a central part of the mechanism. Exactly how the mechanism worked was for some time a little hazy. At first one of the old-fashioned notions hung on: a rise in Bank Rate checked trade chiefly by causing a shrinkage of bank credit. This was always a wobbly argument, and was particularly weak in a decade when the joint-stock banks were extraordinarily wooden. The resulting theoretical confusion did not last long, however, for Keynes soon got round to reading Wicksell, and by the end of the decade most of us had learned that Bank Rate no longer depended on some magical scaring of lending banks but that its major operation was through its influence on the whole structure of interest rates. This was Keynes's story, in the *Treatise* of 1930; the Macmillan Report gave it wider publicity a year later, though how that committee reconciled this with the bewildering evidence they had heard, I can only guess. Fortunately, the collapse of the Wall Street boom had removed all the pressure for high rates, and through 1930 and the first half of 1931 the central bankers on both sides of the Atlantic were able to subscribe to any doctrine that was preached at them, as they brought rates down much faster than they had done ten years earlier. The sterling crisis in the autumn of 1931 brought a brief and half-hearted reversion to old ways, but the extreme views held in some quarters were disregarded and, thanks partly to infiltration of new doctrines into the Bank of England, there was little hesitation in moving to extremely cheap money in the first half of 1932. At that point (if we want to be candid) the fascinations of technical possibilities of reducing the burden of National Debt took over, but the practical effect accorded with the latest doctrines and everyone was happy.

This is really all that need be said about how Britain stumbled

into the long period of cheap money when Bank Rate was a dead letter for almost twenty years (I pass over the unedifying interruption in 1939). Bank Rate ceased to have any importance in its own right. Although Hawtrey was reiterating something like the traditional views, the prevailing view now was that Bank Rate was an instrument for pushing long-term rates around, a matter in which longer-range policies were more appropriate than weekly announcements. Consequently when, in the latter part of the Second War, reconstruction policies were under discussion, the problem was seen as the question of *the rate of interest*, meaning long rates, rather than a question of how an old-fashioned Bank of England should seek to startle the world from week to week. Reflecting this change of approach the emphasis in the early post-war years, in both Britain and the United States, was on maintaining the stable bond market at very low rates of interest, Bank Rate being completely subordinated to this. And when, after two or three years of post-war full employment, people began to worry about the long-range implications of trade union pressures, Robertson addressed the world not on the question 'What has happened to Bank Rate?' but 'What has happened to the Rate of Interest?'.¹

The unease expressed in Robertson's question marked, as we see in retrospect, the first hint of a coming break in monetary policy. The low level of London's reserves in relation to its liabilities as centre of the sterling area left London exposed to continual difficulty, despite a sharp devaluation in 1949. Then the uprush of world prices in the Korean war jeopardized the attempt to hold internal costs close to their post-war levels, and for the first time fears of a continuing fall in the standard of value became widespread. The new-fangled trust in fiscal measures seemed to be breaking down, and late in 1951 there was a tentative turn towards monetary weapons. Bank Rate, however, was not brought effectively into action in Butler's first group of monetary measures: the main weight was on unorthodox measures for reducing banking liquidity and a stiffening of administrative control of bank lending. Four months after these preparatory steps Bank Rate was raised, the operative lender-of-last-resort rate becoming $3\frac{1}{2}$ against $\frac{1}{2}$ per cent in the early post-war years. But through most of the 1950s

¹ Professor D. H. (later Sir Dennis) Robertson took this question as the title of a lecture he gave in Paris in December 1948, published in both French and English early in 1949. It is available in his *Essays in Money and Interest*, a posthumous selection made by Sir John Hicks (London, 1966).

Bank Rate remained only a minor instrument, the authorities continuing to rely on a wide range of measures (the notorious 'package deals'). Neither the authorities themselves nor their critics seem to have had any clear idea about what Bank Rate itself might achieve. The most that anybody expected was that Bank Rate would impress financial circles outside Britain, and thus afford some immediate relief in a balance-of-payments crisis; and perhaps a high rate might encourage the slimming of commodity stocks, which had been getting rather out of hand through peculiarly post-war circumstances. The authorities had little faith in action on long rates otherwise than by changing short rates; anyway they were, for narrowly Treasury reasons, reluctant to see any sharp rise in long rates; at first they regarded any such rise as a nuisance, not as itself a deflationary influence.

In the late fifties there was some change in the official attitude: the authorities became more willing to see long rates rise as a deterrent to extravagances in capital construction. In pursuit of this they broadened their view of the technical possibilities: though very tentatively, they began by their operations in the gilt-edged market to give a more positive lead to the behaviour of long rates; and with timid steps they continued in this direction throughout the 1960s. Though this was not at all obvious, the change in the flavour of official policy can be seen as matching an important swing in pure economic theory, where any notion of *the* rate of interest, or of any simple *structure* of interest rates, was quietly breaking down. Bank Rate had ceased all pretence of being king of the interest rates, while the whole apparatus of monetary controls—interest rates, exhortations to the banks, liquidity controls, and all the rest—remained no more than a partner of fiscal measures and wage exhortations, in the efforts of successive governments to meet the rising threat of long-term inflation and exchange depreciation.

Early in the 1970s the Bank changed its practice in fixing Bank Rate, incidentally to the wider changes foreshadowed in the 'Competition and Credit Control' document (1971). The essence of the wider change was that the Bank set itself the task of establishing a basic reserve position for the entire banking system, leaving to competitive forces among the banks the establishment day by day of a structure of interest rates. Though there was a tinge of monetarism about this, the Bank's explicit purpose was simply to maintain its ultimate power over the market consistently with freeing the commercial banks from autocratic restraints on competition among themselves. The

Bank emphasized the change by certain procedural innovations: among them the official lender-of-last-resort rate ceased to be, at least in public, a matter of Thursday's decision by the Court and became an automatic derivative of Friday's outcome of the weekly tender for Treasury Bills. The Bank also rechristened Bank Rate as 'the Minimum Lending Rate', though for the remainder of this lecture I shall find it convenient to stick to the historic term 'Bank Rate'.

The new system first operated in October 1972, and thereafter Bank Rate moved, as was intended, more frequently and with a little less noise. In the previous four years there had been only six changes in the Rate, its range being 8 to 5 per cent. Now, in the first four years of the new system there were forty-five changes, swinging between $12\frac{3}{4}$ at the top and $7\frac{1}{4}$ at the bottom. Towards the end of these four years the Bank was in fact cossetting the changes rather more actively, and in November 1973 it reverted once to the old procedure of a Thursday announcement, jumping the rate from $11\frac{1}{4}$ to 13. Since then changes have continued to average about one a month, but the range of movement has increased further: between 15 at the top and 5 at the bottom. On many occasions the Bank has used the old procedure, and through these last two years this has again become normal.

Let me reflect briefly on this latest phase in the light of the earlier history I have rehearsed in the main part of this lecture. The procedural changes of 1972, although lately revised, appear to have released inhibitions: the authorities have swung Bank Rate back and forth more frequently and over a much wider range than ever before, and, I think I can add, with much less fuss than for a very long while. There have been several reasons for this behaviour: principally, the collapse of the dollar's easy primacy, as the key currency, was followed by a period of exceptional instability of exchange rates, a period in which there has been revolutionary technical advance in the international short-loan market and gigantic growth of the internationally mobile short funds. These mobile funds have been subject, it is true, to gusts of international opinion, sometimes for and sometimes against sterling (and other currencies), but their total volume has been so huge that even a marginal impact of Bank Rate changes has been worth getting. Hence the frequent and extreme movements of Bank Rate have been worthwhile as a stabilizing influence in the foreign exchange markets; and the procedural changes of the early seventies have

helped to give Bank Rate flexibility without arousing any great trouble at home. Indeed, in the present conjuncture of inflation and depression, it has generally been possible to claim (without much confidence) that a move in Bank Rate has had useful effects at home, whether the move has been up or down. And, by much exercise of skill in the management of the National Debt, it has generally been possible to turn the movements of Bank Rate to good account, especially in getting the long-term market adjusted in some degree to the persistent fall in money's value, with which we are having to learn to live.

So Bank Rate policy has not faded out, as at one time looked distinctly possible. Indeed, the hoary old weapon has been quite useful at times, for getting round some tight international corners without causing great offence. But let us not be too comfortable. Jumps in Bank Rate in these last few years have been more readily tolerated because the authorities have been operating in capital markets only partially adjusted to the continuous inflation. Also it would be well to remember that, in a context where intellectual fashions come and go, other countries may go much further in their own use of interest-rate weapons, so undermining the competitive power of London's moves. Do not let us forget that during the most successful phase in the history of London's Bank Rate (that is, its pre-1914 phase) the power of London's Bank Rate depended on its *not* being a fashionable weapon elsewhere. If many countries share the fashion, stable exchange rates—within or outside Europe—will be under greater strain. Which all goes to show that if we are to maintain a stable system, we must have not merely agreement about intervention in exchange markets but also a deep and sympathetic understanding of each other's internal monetary problems and Bank Rate policies. Whether the best way to promote that understanding is from inside or from outside a European Monetary System is a question on which the British government (of whatever complexion) will soon have to make up its mind.